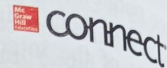


CASE 13

Panera Bread Company in 2016— Is the Company's Strategy to Rejuvenate Its Growth Working?



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In spring 2016, Panera Bread was widely regarded as the clear leader of the “fast-casual” segment of the restaurant industry—fast-casual restaurants were viewed as being a cut above traditional quick-service restaurants like McDonald’s because of better food quality, limited table service, and, in many instances, often wider and more upscale menu selections. On average, 7.8 million customers patronized Panera Bread’s 1,972 company-owned and franchised bakery-café each week, and Panera baked more specialty breads daily than any other bakery-café enterprise in North America. In 2015, Panera had corporate revenues of \$2.7 billion, systemwide store revenues of \$4.5 billion, and average sales of \$2.5 million per store location.

In 2006, Panera Bread executives announced their strategic intent to grow the company from 1,027 locations to 2,000 locations by the end of 2010. But the advent of the Great Recession of 2008–2009 forced the company to drastically downscale the number of planned store openings; Panera ended 2009 with only 1,380 bakery-café locations. Then, in 2010 with a modest economic recovery seemingly underway, Panera’s top executives decided that market conditions were favorable enough to permit the company, given customer enthusiasm for eating at Panera’s bakery-café, to accelerate the number of new store openings and reinstitute their strategy to grow the company, albeit at a pace slower than what was envisioned back in 2006. The company proceeded to open a net of 76 new company-operated

and franchised units in 2010, 88 new units in 2011, 111 new units in 2012, 125 units in 2013, 114 units in 2014, and 112 units in 2015. Going into 2016, Panera had 1,972 company-owned and franchised bakery-café in operation in 46 states, the District of Columbia, and Ontario, Canada. Plans called for opening 90 to 100 new company-operated and franchised units in 2016.

But despite the ongoing series of store openings, the company was struggling to grow revenues and earnings nearly as fast as top executives wanted. Revenue growth of 6.0 percent in 2014 and 6.1 percent in 2015 was well short of the robust 19.9 percent compound average growth achieved during 2009–2013. Moreover, sales at bakery-café open at least one year rose only 1.1 percent in 2014 and 1.9 percent in 2015, compared to 2.3 percent in 2013 and 6.5 percent in 2012. The slower-than-desired revenue growth, coupled with higher operating expenses, squeezed Panera’s profitability, resulting in declines in net income from \$196.2 million in 2013 to \$179.3 million in 2014 and to \$149.3 million in 2015 and drops in earnings per share from \$6.85 in 2013 to \$6.67 in 2014 to \$5.81 in 2015.

Nonetheless, in February 2016, top management confidently expressed the belief that Panera had turned the corner and forecast that recently undertaken strategy initiatives would deliver positive

earnings growth in 2016, accelerating further in 2017. In announcing the company's financial results for Q4 and full-year 2015 on February 9, 2016, Ron Shaich, Panera's chair and CEO, said:

Our strategic plan is working. Our comps [company-owned store sales growth] of 3.6% in Q4 2015 and 6.4% in the first 41 days of Q1 2016 are leading indicators of the impact our initiatives are having. Further, we are confident that our results will continue to strengthen as the startup and transition costs associated with our initiatives begin to crest and our sales continue to grow. We now expect the EPS growth we saw in Q4 2015 will improve in 2016 and further accelerate in 2017. Today, we are confident we are on a path to return to sustained double-digit earnings growth.¹

Panera indicated it was expecting EPS growth of 2-5 percent in 2016.

COMPANY BACKGROUND

In 1981, Louis Kane and Ron Shaich founded a bakery-café enterprise named Au Bon Pain Co., Inc. Units were opened in malls, shopping centers, and airports along the east coast of the United States and internationally throughout the 1980s and 1990s; the company prospered and became the dominant operator within the bakery-café category. In 1993, Au Bon Pain Co. purchased Saint Louis Bread Company, a chain of 20 bakery-cafés located in the St. Louis area. Ron Shaich and a team of Au Bon Pain managers then spent considerable time in 1994 and 1995 traveling the country and studying the market for fast food and quick-service meals. They concluded that many patrons of fast-food chains like McDonald's, Wendy's, Burger King, Subway, Taco Bell, Pizza Hut, and KFC could be attracted to a higher-quality quick dining experience. Top management at Au Bon Pain then instituted a comprehensive overhaul of the newly acquired Saint Louis Bread locations, altering the menu and the dining atmosphere. The vision was to create a specialty café anchored by an authentic, fresh dough, artisan bakery and upscale, quick-service menu selections. Between 1993 and 1997, average unit volumes at the revamped Saint Louis Bread units increased by 75 percent, and over 100 additional Saint Louis Bread units were opened. In 1997, the Saint Louis Bread bakery-cafés were renamed Panera Bread in all markets outside St. Louis.

By 1998, it was clear the re-concepted Panera Bread units had connected with consumers. Au Bon Pain management concluded the Panera Bread format had broad market appeal and could be rolled out nationwide. Ron Shaich believed Panera Bread had the potential to become one of the leading "fast-casual" restaurant chains in the nation. Shaich also believed that growing Panera Bread into a national chain required significantly more management attention and financial resources than the company could marshal if it continued to pursue expansion of both the Au Bon Pain and Panera Bread chains. He convinced the Au Bon Pain board of directors that the best course of action was for the company to go exclusively with the Panera Bread concept and divest the Au Bon Pain cafés. In August 1998, the company announced the sale of its Au Bon Pain bakery-café division for \$73 million in cash to ABP Corp.; the transaction was completed in May 1999. With the sale of the Au Bon Pain division, the company changed its name to Panera Bread Company. The restructured company had 180 Saint Louis and Panera Bread bakery-cafés and a debt-free balance sheet.

Between January 1999 and December 2006, close to 850 additional Panera Bread bakery-cafés were opened, some company-owned and some franchised. In February 2007, Panera purchased a 51 percent interest in Arizona-based Paradise Bakery & Café, which operated 70 company-owned and franchised units in 10 states (primarily in the west and southwest) and had sales close to \$100 million. At the time, Paradise Bakery units had average weekly sales of about \$40,000 and an average check size of \$8 to \$9. Panera purchased the remaining 49 percent ownership of Paradise Bakery in June 2009. In 2008, Panera expanded into Canada, opening 2 locations in Ontario; since then, 10 additional units in Canada had been opened.

In May 2010, William W. Moreton, Panera's executive vice president and co-chief operating officer, was appointed president and chief executive officer and a member of the company's board. Ron Shaich, who had served as Panera's president and CEO since 1994 and as board chair or co-chair since 1988, transitioned to the role of executive board chair. In addition to the normal duties of board chair, Shaich maintained an active strategic role, with a particular focus on how Panera Bread could continue to be the best competitive alternative in the

market segments the company served. However, on March 15, 2012, the company announced that Ron Shaich and Bill Moreton would become co-CEOs, effective immediately; Shaich's formal title was changed to board chair and co-CEO and Moreton's title became president and co-CEO. In August 2013, Shaich and Moreton took on new titles because of family-related issues that required more of Moreton's time—Shaich became board chair and CEO and Moreton was named executive vice chair, with a role of helping oversee Panera's business operations. In February 2015, Moreton also held the title of interim chief financial officer.

Over the years, Panera Bread had received a number of honors and awards. In 2015, *Fast Company* named Panera Bread as the Most Innovative Company in Food. In 2011, 2012, and 2013, Harris Poll EquiTrend® Rankings named Panera Bread as Casual Dining Restaurant Brand of the Year.² Zagat's 2012 Fast Food Survey of 10,500 diners ranked Panera as fourth for Top Food, second for Top Décor, and fifth for Top Service among national chains with fewer than 5,000 locations.³ For nine of the past 12 years (2002–2013), customers had rated Panera Bread tops on overall satisfaction among large chain restaurants in Sandelman & Associates's Quick-Track study "Awards of Excellence" surveys; in Sandelman's 2012 Quick-Track study of more than 110,000 customers of quick-service restaurants, Panera ranked number one in the Attractive/Inviting restaurant category.⁴

A summary of Panera Bread's recent financial performance is shown in Exhibit 1. Exhibit 2 provides selected operating statistics for Panera's company-owned and franchised bakery-cafés.

PANERA BREAD'S CONCEPT AND STRATEGY

Panera Bread's identity was rooted in its fresh-baked artisan breads handcrafted with attention to quality and detail. The company's breads and baked products were a major basis for differentiating Panera from its competitors. According to Panera management, "bread is our passion, soul, and expertise, and serves as the platform that makes all of our other food special." The featured menu offerings at Panera locations included breads and pastries baked in-house, breakfast items and smoothies, made-to-order sandwiches,

signature soups and salads, and café beverages. Recognizing that diners chose a dining establishment based on individual food preferences and mood, Panera strived to be the first choice for diners craving fresh-baked goods, a sandwich, soup, a salad, or a beverage served in a warm, friendly, comfortable dining environment. Its target market was urban workers and suburban dwellers looking for a quick-service meal or light snack and an aesthetically pleasing dining experience. Management's long-term objective and strategic intent was to make Panera Bread a nationally recognized brand name and to be the dominant restaurant operator in upscale, quick-service dining. Top management believed that success depended on "being better than the guys across the street" and making the experience of dining at Panera so attractive that customers would be willing to pass by the outlets of other fast-casual restaurant competitors to dine at a nearby Panera Bread bakery-café.⁵

Panera management's blueprint for attracting and retaining customers was called Concept Essence. Concept Essence underpinned Panera's strategy and embraced several themes that, taken together, acted to differentiate Panera from its competitors:

- Offering an appealing selection of artisan breads, bagels, and pastry products that are handcrafted and baked daily at each café location.
- Serving high-quality food at prices that represent a good value.
- Developing a menu with sufficiently diverse offerings to enable Panera to draw customers from breakfast through the dinner hours each day.
- Providing courteous, capable, and efficient customer service.
- Designing bakery cafés that are aesthetically pleasing and inviting.
- Offering patrons such a sufficiently satisfying dining experience that they are induced to return again and again.

Panera Bread's menu, store design and ambience, and unit location strategies enabled it to compete successfully in multiple segments of the restaurant business: breakfast, AM "chill" (when customers visited to take a break from morning-hour activities), lunch, PM "chill" (when customers visited to take a break from afternoon activities), dinner, and take-home, through both on-premise sales and off-premise catering. It competed with a wide

EXHIBIT 1

Selected Consolidated Financial Data for Panera Bread, 2011-2015
(in thousands, except for per-share amounts)

Income Statement Data	2015	2014	2013	2012	2011
Revenues:					
Bakery-café sales	\$2,358,794	\$2,230,370	\$2,108,908	\$1,879,280	\$1,592,951
Franchise royalties and fees	138,563	123,686	112,641	102,076	92,793
Fresh dough and other product sales to franchisees	184,223	175,139	163,453	148,701	136,288
Total revenues	2,681,580	2,529,195	2,385,002	2,130,057	1,822,032
Bakery-café expenses:					
Food and paper products	715,502	669,860	625,622	552,580	470,398
Labor	754,646	685,576	625,457	559,446	484,014
Occupancy	169,998	159,794	148,816	130,793	115,290
Other operating expenses	334,635	314,879	295,539	256,029	216,237
Total bakery-café expenses	1,974,781	1,830,109	1,695,434	1,498,848	1,285,939
Fresh dough and other product cost of sales to franchisees	160,706	152,267	142,160	131,006	116,267
Depreciation and amortization	135,398	124,109	106,523	90,939	79,899
General and administrative expenses	142,904	138,060	123,335	117,932	113,083
Pre-opening expenses	9,089	8,707	7,794	8,462	6,585
Total costs and expenses	2,439,986	2,253,252	2,075,246	1,847,187	1,601,773
Operating profit	241,594	275,943	309,756	282,870	220,259
Interest expense	3,830	1,824	1,053	1,082	822
Other (income) expense, net	1,192	(3,175)	(4,017)	(1,208)	(466)
Income taxes	87,247	98,001	116,551	109,548	83,951
Less net income (loss) attributable to non-controlling interest	(17)	—	—	—	—
Net income to shareholders	\$ 149,325	\$ 179,293	\$ 196,169	\$ 173,448	\$ 135,952
Earnings per share					
Basic	\$5.81	\$6.67	\$6.85	\$5.94	\$4.59
Diluted	5.79	6.64	6.81	5.89	4.55
Weighted average shares outstanding					
Basic	25,685	26,881	28,629	29,217	29,601
Diluted	25,788	26,999	28,794	29,455	29,903

Balance Sheet Data

Cash and cash equivalents	\$ 241,886	\$ 196,493	\$ 125,245	\$ 297,141	\$ 222,640
Current assets	502,789	406,166	302,716	478,842	353,119
Total assets	1,475,318	1,390,686	1,180,862	1,268,163	1,027,322
Current liabilities	399,443	352,712	303,325	277,540	238,334
Total liabilities	654,718	654,718	177,645	168,704	372,246
Stockholders' equity	497,300	736,184	699,892	821,919	655,076

Cash Flow Data

Net cash provided by operating activities	\$ 318,045	\$ 335,079	\$ 348,417	\$ 289,456	\$ 236,889
Net cash used in investing activities	(165,415)	(211,317)	(188,307)	(195,741)	(152,194)
Net cash (used in) provided by financing activities	(107,237)	(52,514)	(332,006)	(19,214)	(91,354)
Net (decrease) increase in cash and cash equivalents	45,393	71,248	(171,896)	74,501	(6,659)

Sources: 2015 10-K report, pp. 43-46; 2014 10-K report, pp. 41-43; 2013 10-K report, pp. 41-43; 2011 10-K report, pp. 41-43.

EXHIBIT 2 Selected Operating Statistics, Panera Bread Company, 2010-2015

	2015	2014	2013	2012	2011	2010
Revenues at company-operated stores (in millions)	\$2,358.8	\$2,230.4	\$2,108.9	\$1,879.3	\$1,593.0	\$1,321.2
Revenues at franchised stores (in millions)	\$2,478.0	\$2,282.0	\$2,175.2	\$1,981.7	\$1,828.2	\$1,802.1
Systemwide store revenues (in millions)	\$4,836.8	\$4,512.4	\$4,284.1	\$3,861.0	\$3,421.2	\$3,123.3
Average annualized revenues per company-operated bakery-café (in millions)	\$ 2.552	\$ 12.502	\$ 2.483	\$ 2.435	\$ 2.292	\$ 2.179
Average annualized revenues per franchised bakery-café (in millions)	\$ 2.479	\$ 2.455	\$ 2.448	\$ 2.419	\$ 2.315	\$ 2.266
Average weekly sales, company-owned cafés	\$49,090	\$48,114	\$47,741	\$46,836	\$44,071	\$41,899
Average weekly sales, franchised cafés	\$47,680	\$47,215	\$47,079	\$46,526	\$44,527	\$43,578
Comparable bakery-café sales percentage increases*	3.0%	1.4%	2.6%	6.5%	4.9%	7.5%
Company-owned outlets	1.0%	0.9%	2.0%	5.0%	3.4%	8.2%
Franchised outlets	1.9%	1.1%	2.3%	5.7%	4.0%	7.9%
System-wide						
Company-owned bakery-café open at year-end	901	925	867	809	740	662
Franchised bakery-café open at year-end	1,071	955	910	843	801	791
Total bakery-café open	1,972	1,880	1,777	1,652	1,541	1,453

*The percentages for comparable store sales are based on annual changes at stores with an open date prior to the first day of the prior fiscal year (meaning that a store had to be open for all 12 months of the year to be included in this statistic).

Sources: Company 10-K reports for 2015, 2014, 2013, 2011, and 2010.

assortment of specialty food, casual dining, and quick-service establishments operating nationally, regionally, and locally. Its close competitors varied according to the menu item, meal, and time of day. For example, breakfast and AM “chill” competitors included Starbucks and McDonald’s; close lunch and dinner competitors included such chains as Chili’s, Applebee’s, California Pizza Kitchen, Jason’s Deli, Cracker Barrel, Ruby Tuesday, T.G.I. Friday’s, Chipotle Mexican Grill, and Five Guys Burgers and Fries. In the bread and pastry segment, Panera competed with Corner Bakery Café, Atlanta Bread Company, Au Bon Pain, local bakeries, and supermarket bakeries.

Except for bread and pastry products, Panera’s strongest competitors were dining establishments in the so-called fast-casual restaurant category. Fast-casual restaurants fill the gap between fast-food outlets and casual, full table service restaurants. A fast-casual restaurant provides quick-service dining

(much like fast-food enterprises) but is distinguished by enticing menus, higher food quality, and more inviting dining environments; typical meal costs per guest are in the \$7–\$12 range. Some fast-casual restaurants have full table service, some have partial table service (with orders being delivered to the table after ordering and paying at the counter), and some are self-service (like fast-food establishments, with orders being taken and delivered at the counter). Exhibit 3 provides information on prominent national and regional dining chains that competed against Panera Bread in some or many geographic locations.

Panera Bread’s growth strategy was to capitalize on Panera’s market potential by opening both company-owned and franchised Panera Bread locations as fast as was prudent. So far, working closely with franchisees to open new locations had been a key component of the company’s efforts to broaden its market penetration. Panera Bread had organized its

Representative Fast-Casual Restaurant Chains and Selected Full-Service Restaurant Chains in the United States, 2014-2015

Company	Number of Locations, 2013	Select 2014-2015 Financial Data	Key Menu Categories
Atlanta Bread Company	~100 company-owned and franchised bakery-café in 21 states	Not available (privately held company)	Fresh-baked breads, salads, sandwiches, soups, wood-fired pizza and pasta (select locations only), baked goods, desserts
Applebee's Neighborhood Grill and Bar* (a subsidiary of DineEquity)	2,000+ franchised locations in 49 states, two U.S. territories, and 16 countries outside the U.S.	2015 average annual sales of about \$2.5 million per U.S. location	Beef, chicken, pork, seafood, and pasta entrees, plus appetizers, salads, sandwiches, a selection of under-500-calorie Weight Watchers-branded menu alternatives, desserts, and alcoholic beverages (about 12 percent of total sales)
Au Bon Pain	300+ company-owned and franchised bakery-café in 26 states and 5+ foreign countries	Not available (privately held company)	A focus on healthful, nutritious selections with superfood ingredients, including hot cereals, bagels, soups, salads, sandwiches and wraps, and coffee drinks
Buffalo Wild Wings*	1,170 locations in the U.S., Mexico, Canada, and Philippines	2015 revenues of \$1.8 billion; average sales of \$3.25 million per location	Chicken wings, chicken tenders, specialty hamburgers, sandwiches, flatbreads, salads, full bar
California Pizza Kitchen* (a subsidiary of Golden Gate Capital)	~300 locations in ~32 states, 16 countries, and 218 cities	Average annual sales of about \$3.2 million per location	Signature California-style hearth-baked pizzas, plus salads, pastas, soups, sandwiches, appetizers, desserts, beer, wine, coffees, teas, and assorted beverages
Chili's Grill and Bar* (a subsidiary of Brinker International)	1,580 locations in 50 states and 307 locations in 30 foreign countries and territories	2015 average revenues of ~\$2.9 million per location; 2015 average check size per customer of \$14.52	Chicken, beef, and seafood entrees, steaks, appetizers, salads, sandwiches, desserts, and alcoholic beverages (14.1 percent of sales)
Chipotle Mexican Grill	2,000+ units	2015 revenues of \$4.5 billion; average unit sales of ~\$2.5 million; average check size \$10.17	Gourmet burritos and tacos, salads, beverages (including margaritas and beers)
Corner Bakery Café	202 locations in 22 states and District of Columbia	2014 sales per location of \$2.33 million; menu price range: \$0.99 to \$8.99	Specialty breads, hot breakfasts, signature sandwiches, grilled panini, pastas, seasonal soups and chili, made-to-order salads, sweets, coffees, and teas
Cracker Barrel*	637 combination retail stores and restaurants in 42 states	Restaurant-only sales of \$2.27 billion in 2015; average sales per restaurant of \$3.6 million; average guest check of \$10.23; serves an average of ~1,000 customers per day per location	Two menus (all-day breakfast and lunch/dinner); named by <i>Technomics</i> in both 2013 and 2015 as the full restaurant category winner of its "Chain Restaurant Consumers' Choice Award"

(Continued)