

**Panera Bread Company**

**Ray's Recommendation** Buy by  
Ray Xiao | [ruixiao@tufts.edu](mailto:ruixiao@tufts.edu)

**Price**  
\$175

**12-Month Target**  
\$207

**Sector** Consumer

**Sub-sector** Restaurant

**Summary** This company owns, operates, and franchises retail bakery-cafes in the US and Canada. We recommend PNRA shares with a Buy rating and 12-Month target price of \$207, which implies 18% upside to the current price

Market Data	
Ticker	PNRA
Current Price	175
Shares Outstanding (M)	29.18
Mkt Cap (M)	5106.5
Cash (M)	193.96
Debt (M)	0
Enterprise Value	4912.54
52 Week High	194.77
52 Week Low	150.33
FCF LTM	100.93M
PEG	1.56
Inst. Ownership	80%
Beta	1.08
Dividend	0
EPS 2013 LTM	6.65
EPS 2013 E	6.53
EPS 2014 E	7.58

Metrics and Multiples (1Yr Forward)			
	12/31/2011	12/31/2012	1/14/2014
EV/EBITDA	10.36 x	10.55 x	10.99 x
EV/EBIT	13.69 x	14.04 x	14.98 x
EV/Sales	1.82 x	1.84 x	1.94 x
P/E	23.66 x	23.59 x	23.04 x
Text			

Important Growth Data			
	2012	2013E	2014E
Bakery-café Rev	1,879.27	2,061.00	2,336.09
		9.7%	13.3%
Franchise Rev	102.08	111.39	122.57
		9.1%	10.0%
Food Cost	552.58	615.89	700.83
		11.5%	13.8%

**Investment Highlights**

• **Long-term growth in sales**

The firm is expanding its brand and shows a strong growth in past few years. It has been proved to be a firm with solid earning ability and financials, with adequate working capitals and no long-term debt.

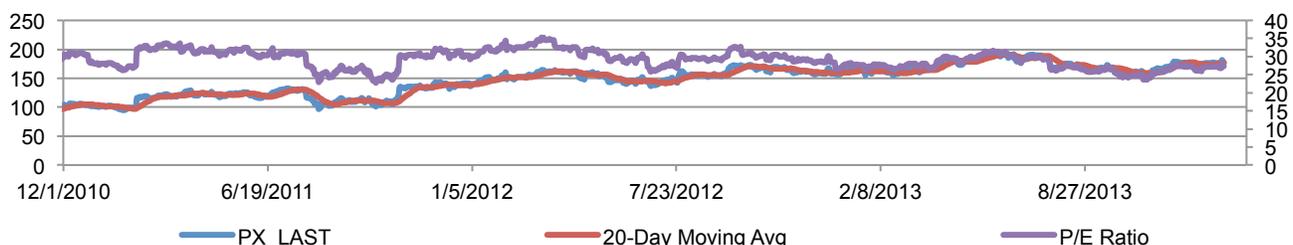
• **Missing consensus estimation and lower its EPS expectation**

The market has consistently set high expectations for Panera's earnings. Panera has lowered its target earnings ranges on multiple occasions and it did not meet analysts' expectation on certain occasions as well. We believe this creates investment opportunities because the company has made steady earnings for years and will eventually achieve the revenue growth that the market has envisioned for them.

• **Change in operating strategy to boost transaction growth**

In the company's recent quarter report and discussion, the firm realized its decreasing transaction growth and decided to initiate a few strategies to improve its traffic. By conducting self-examination research, the firm figured that the negative transaction growth is not because of demand, but because of its own operating strategy to focus on cost and efficiency in the past year, which harmed the customer experience. The firm will be increasing 35 working hours for the same store per week to improve the customer experience. This movement will result in 15M extra labor cost annually. However, We believe that the strategies implemented will sound and foster a better growth in transactions. The risk will be the execution of the plan and whether the transaction grows as expected.

**History Price**



# Panera Bread Company

## Business Summary

Panera Bread Company operates as three business segments: Company bakery-cafe operations, franchise operations, and fresh dough and other product operations. As of December 25, 2012, its Company bakery-cafe operations segment consisted of 809 Company-owned bakery-cafes, located throughout the United States and in Ontario, Canada, and its franchise operations segment consisted of 843 franchise-operated bakery-cafes, located throughout the United States and in Ontario, Canada. As of December 25, 2012, its fresh dough and other product operations segment, which supplies fresh dough and other products daily to most Company-owned and franchise-operated bakery-cafes, consisted of 24 fresh dough facilities (22 Company-owned and two franchise-operated), located throughout the United States and one in Ontario, Canada. In the fiscal year ended December 25, 2012, or fiscal 2012, the revenues were \$2,130.1 million, consisting of \$1,879.3 million of Company-owned net bakery-cafe sales, \$102.1 million of franchise royalties and fees, and \$148.7 million of fresh dough and other product sales to franchisees. Franchise-operated net bakery-cafe sales, as reported by franchisees, were \$1,981.7 million in fiscal 2012.

Its bakery-cafes are located in urban, suburban, strip mall, and regional mall locations. Panera Bread company features high quality, value priced food in a warm, inviting, and comfortable environment. With Panera's identity rooted in handcrafted artisan bread, it bakes fresh bread every day. Panera Bread company is committed to providing great tasting, quality food that people can trust. All of its bakery-cafes have a menu highlighted by antibiotic-free chicken and roasted turkey, whole grain bread, and select organic and all-natural ingredients, with zero grams of artificial trans fat per serving, which provide flavorful, wholesome offerings. Its menu includes a wide variety of year-round favorites complemented by new items introduced seasonally with the goal of creating new standards in everyday food choices. In neighborhoods across the United States and in Ontario, Canada, Panera's customers enjoy its warm and welcoming environment featuring comfortable gathering areas, relaxing decor, and free internet access. Bakery-cafes routinely donate bread and baked goods to community organizations in need.

## Corporate information

**Investor contact**  
J.W Kip

**Office**  
3630 South Geyer Road, Suite  
100, St. Louis, MO 63127

**Telephone**  
314-984-1000

**Fax**  
314-9093300

**Email**  
investor@panera.com

**Website**  
www.panera.com

## Officers

**CEO**  
R.M. Shaich

**CFO**  
R.C Matthews, Jr.

**Vice Chairman**  
W.W Moreton

**COO**  
C.J. Chapman, III

**Domicile**  
Delaware

**Founded**  
1981

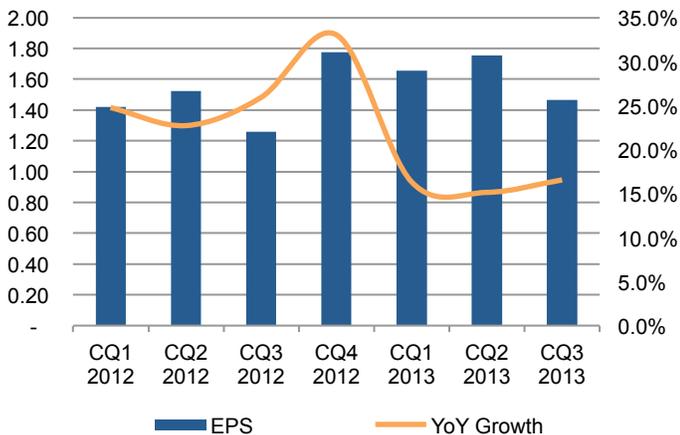
**Employees**  
36,300

**Stockholders**  
1,252

## Panera Bread Company

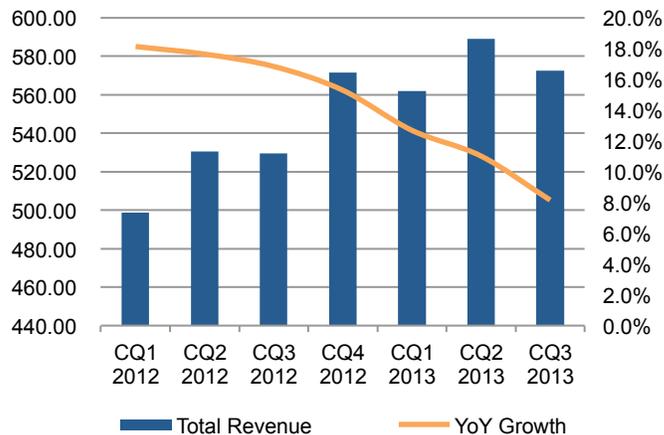
### Data Exhibition

**Exhibit 1: EPS since 2012**



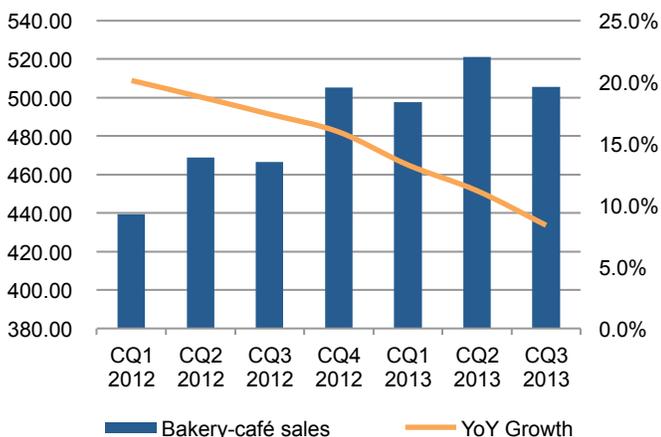
Source: Bloomberg, Ray's Analysis

**Exhibit 2: Total revenue**



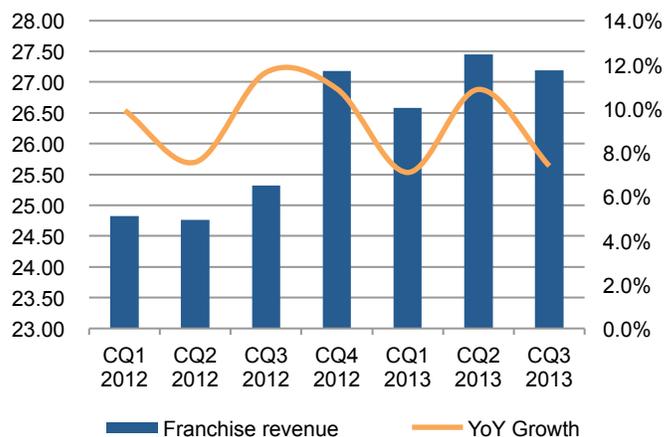
Source: Bloomberg, Ray's Analysis

**Exhibit 3: Bakery-café sales**



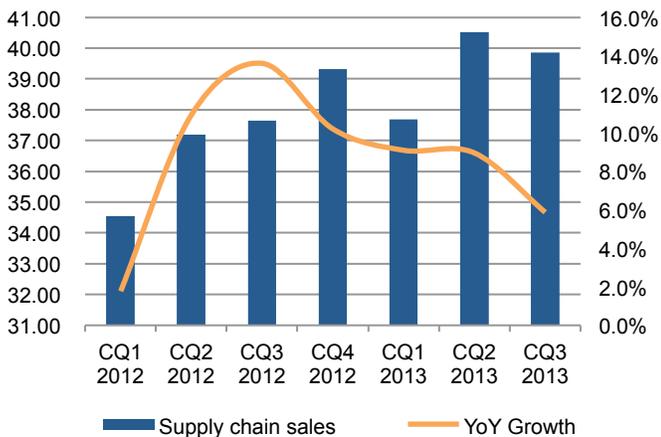
Source: Bloomberg, Ray's Analysis

**Exhibit 4: Franchise revenue**



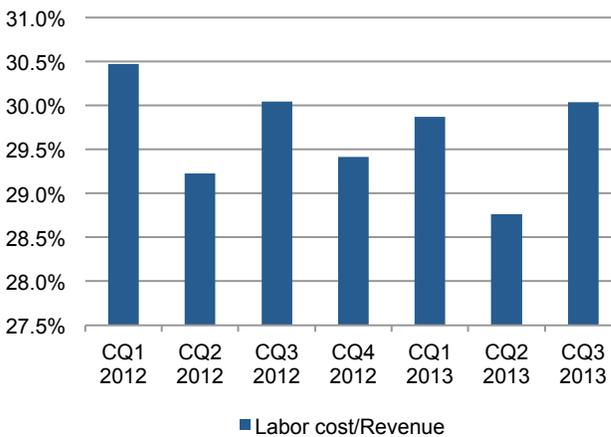
Source: Bloomberg, Ray's Analysis

**Exhibit 5: Supply chain sales**



Source: Bloomberg, Ray's Analysis

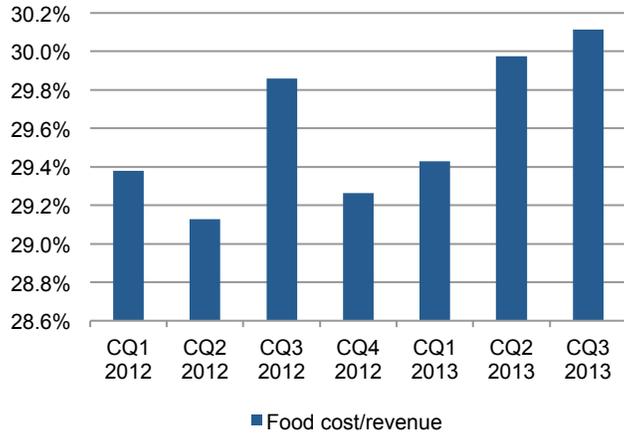
**Exhibit 6: Labor cost**



Source: Bloomberg, Ray's Analysis

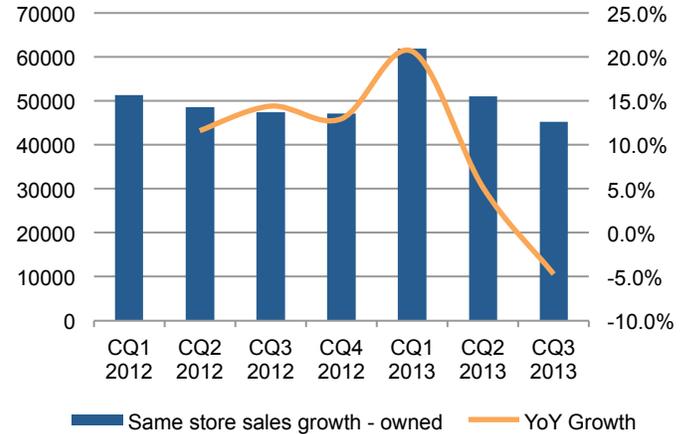
## Panera Bread Company

**Exhibit 7: Food cost**



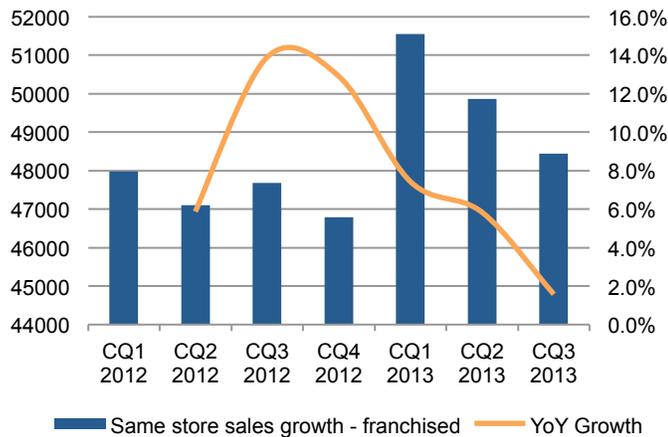
Source: Bloomberg, Ray's Analysis

**Exhibit 8: Same store sales - owned**



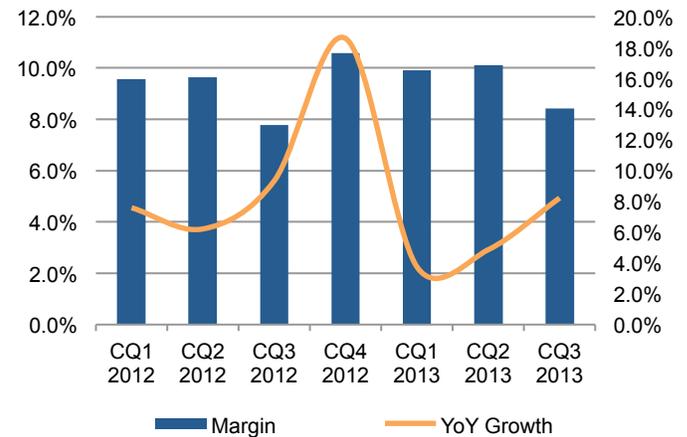
Source: Bloomberg, Ray's Analysis

**Exhibit 9: Same store sales - franchise**



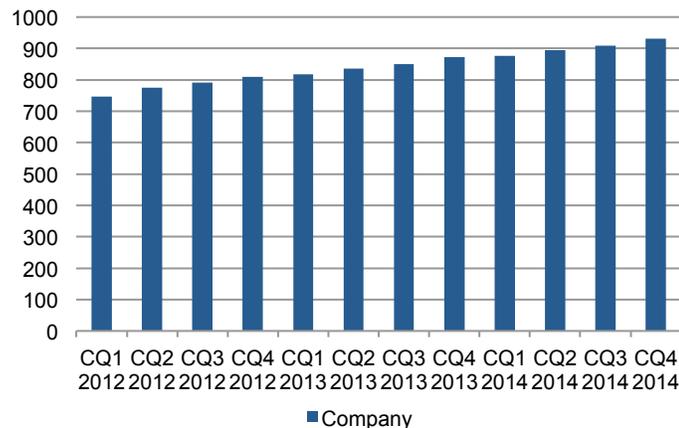
Source: Bloomberg, Ray's Analysis

**Exhibit 10: Margin**



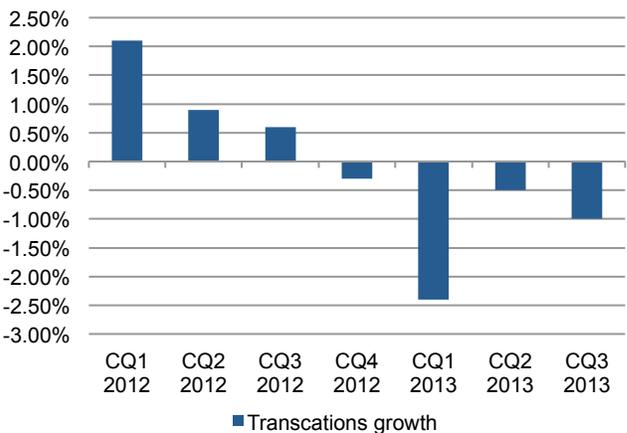
Source: Bloomberg, Ray's Analysis

**Exhibit 11: Number of stores**



Source: Bloomberg, Ray's Analysis

**Exhibit 12: Transactions**



Source: Bloomberg, Ray's Analysis

**Panera Bread Company**

---

**Catalyst: Increasing labor cost leads to improvement in customer experience**

---

**Miss consensus estimates due to negative transaction growths**

In the 2013 Q3 conference call, the firm realized that its performance relative to the same industry was getting worse, with 190 basis points better than the industry comparing to 300 basis points better last year. Panera Bread realized that this was mainly due to an unfavorable transaction decrease in its business. The transaction was 200 basis points better than industry last year, whereas it was 81 basis points better this year.

The firm rated its performance of comparable stores in past few years to be 8 or 9 out of 10, whereas the management team believes that the performance in recent quarters was at the level of 6 out of 10. It makes sense because over the same 5 years, unit volumes are growing in excess of 20%. Store-level margin are growing nearly 400 basis points from 16.3% to 20.2%. The average comparable sales growth has been 5.8% over the past 16 quarters with only 2.5% from price on average. New café units set records every year. The success in the past may be part of the problem the management team faces now.

**Decrease in traffic due to unfavorable customer experience**

By doing detailed self-examination and firm-wide research, the management realized that the demand for products is not the issue. **The problem is keeping up with in meeting that demand with an in-café experience that delivers something truly differentiated.** They realized that many customers walk out of cafes every day when they are not able to wait in line. According to the survey, the top reason for less customers is the diminished in-café experience. More than a quarter of the polls identified problems in slower service, less comfort and the accuracy of orders. On a higher level, the firm realized that they were overly focused on efficiency and cost balancing at the expense of an effective customer experience.

**Refocus on customer experience by increasing labor cost**

So they decided to **refocus on providing best customer experience** first by delivering the changes to the operational leadership team, and increase 35 additional hours per week into each of its cafes. This will lead to \$15 million increase in the labor cost. The firm believes that the investment in labor is necessary because it will raise the constraints of each café in terms of productions and line processing, which will potentially lift the transactions.

We believe that the effect of the strategy change will take place in the second half of the year 2014. Some positive growth and the execution of the strategy should be revealed soon in the 2014 Q1.

---

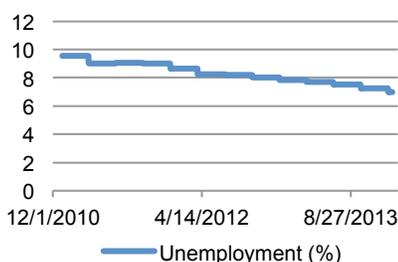
**Panera Bread Company**

**Industry Analysis: Better economy in the United States; Food cost is stable**

**Revenue outlook in macroeconomics**

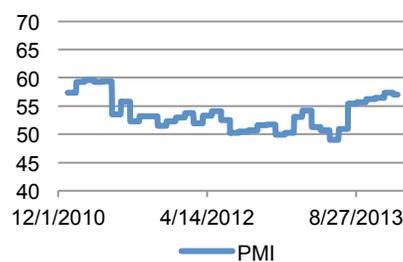
We believe the consumer confidence and purchasing power will pick up within next twelve months because of positive economic indicators domestically. Unemployment rate is declining because of a better economy, which is due to the effective execution of Fed policy. The PMI data shows an expansion in manufacturing, meaning a better economy nationally. Better economy will indicate a strong momentum in the consumer purchasing power which would drive the revenue and food demand, which is favorable for the industry.

**Exhibit 13: Domestic unemployment**



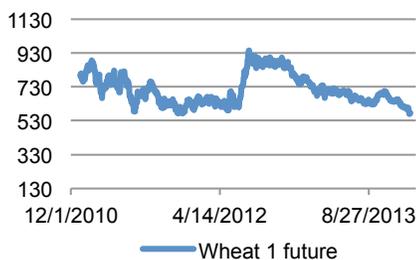
Source: Bloomberg, Ray's Analysis

**Exhibit 14: PMI**



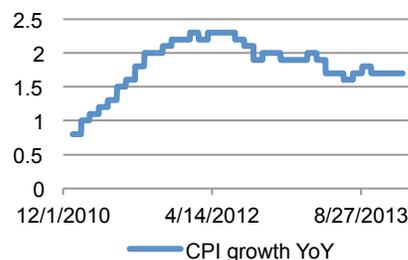
Source: Bloomberg, Ray's Analysis

**Exhibit 15: Wheat 1 future price**



Source: Bloomberg, Ray's Analysis

**Exhibit 16: CPI-Urban YoY growth**



Source: Bloomberg, Ray's Analysis

**Cost outlook in macroeconomics**

In terms of cost, the wheat price, which is the main cost of the Panera Bread's product, is being relatively positive. According to the Exhibit 15, we see a declining trend in wheat 1 future price. We believe that the main food cost will stay in a low position within the next twelve months. CPI has been steady since 2012 and continues to show a low growth, which is beneficial to the cost control of Panera Bread.

## Panera Bread Company

---

### Consensus Views: Buy/Hold; Target price is close to the current price

---

The consensus has been giving a high expectation on the growth to Panera Bread Company in the past years. However, the Panera Bread Company misses consensus estimations in 2013Q3, leading to a major price drop on the end of October. Since then, the expectation became a little too pessimistic. Here are a few comments that consensus has given recently:

#### Positive Comments

- **Increasing multiples.** We're looking for healthy multiple expansion in 2014 (Jeff Farmer from Wells Fargo)

#### Neutral Comments

- **Lower SSS while remain confidence.** We now forecast 3% SSS in 2013 (down from 4-5%) with a return to 4%+ SSS and positive traffic delayed until 2014. While a return to positive traffic is likely delayed, we still have confidence in this eventually, and see this as a primary lever on the stock in the future. (Michael Kelter from Goldman Sachs)

#### Negative Comments

- **Over-earning.** Rising spend on ops investments, with an unclear payoff. The firm has been over-earned in the past few years however they need to reinvestment some of those margin gains in the coming quarters, which will drive the margin down. (Jason West from Deutsche Bank)
  - **Ineffective advertising strategy.** We questioned the use of national advertising because the sales during these periods do not appear to reflect any material benefit (Christopher O'Cull from KeyBanc)
  - **Long recover period.** Traffic growth is incrementally impacted by throughput bottlenecks during peak hours, while incremental labor being added at the store level to alleviate bottlenecks will weigh on margins. We think this problem is fixable while it might need a few quarters to remedy (Andy Barish from Jefferies)
-

## Panera Bread Company

## Valuations and Projections

## Target price and benchmark group

We have set a target price of \$207 in the next twelve months with EPS 2014E of \$7.60. We come up with this valuation by considering two cases. We take an estimated P/E of 28.6x, which is 1x industry median P/E, which yields a price of \$232. The stock is currently trading at 0.8x industry median P/E while in 2012 it was trading at 1.1x. We look forward to a better market expectation, because strategies that the firm is implementing now should lead to a high growth and better growth expectation in the future. However, using EV/EBITDA multiple yields a lower valuation, as Panera has no debt and will have a lower EBITDA. It makes the EBITDA multiple higher and leads to a misunderstanding of how the stock is currently trading at. So I combined the two scenario and set a target price of \$207.

In picking benchmark group, we think placing PNRA on a growth-FSR restaurant group is fairer than placing it in the whole industry, as Panera Bread is still having a huge growth with 8% number of stores growth. If placing PNRA on a traditional FSR group, it is trading a 1x industry median P/E.

Company	Ticker	Forward P/E on 12/31				Forward EBITDA multiple on 12/31				EPS Growth LTM	PEG
		2010	2011	2012	1/14/2014	2010	2011	2012	1/14/2014		
Panera Bread Co.	PNRA	21.5	23.7	24.3	23.1	8.9	10.4	10.8	10.5	16.6%	1.80
Buffalo Wild Wings, Inc.	BWLD	17.8	20.9	20.1	31.3	6.0	7.4	7.1	11.7	63.8%	0.49
BJ's Restaurants, Inc.	BJRI	36.2	33.9	24.4	31.5	13.3	13.6	9.1	9.2	-45.8%	-0.69
Cheesecake Factory	CAKE	18.4	15.9	15.2	20.0	8.1	7.5	7.2	9.8	2.0%	10.20
Chipotle Mexican Grill	CMG	32.3	39.1	28.5	40.9	15.4	19.3	14.3	20.8	14.8%	2.77
Red Robin Gourmet Burgers	RRGB	26.5	15.2	17.5	25.8	6.1	5.6	6.1	9.3	33.7%	0.77
Chuy's Holdings Inc	CHUY	NM	NM	NM	49.0	NM	NM	NM	20.6	15.0%	3.27
Del Frisco's Restaurant	DFRG	NM	NM	NM	23.0	NM	NM	NM	10.2	11.0%	2.09
Median		24.0	22.3	21.8	28.6	8.5	8.9	8.2	10.3		1.9
Mean		25.4	24.8	21.5	30.6	9.6	10.6	9.1	12.8		2.6
PNRA/Median		0.9 x	1.06 x	1.08 x	0.81 x	1.05 x	1.16 x	1.29 x	1.02 x		0.92 x

## Projections

We expect Panera Bread Company will achieve revenue growths of bakery-café segment of 13% in the next year. The performance in 2013Q4 might be down because the company should need time to recover from the customer satisfaction. **We believe that the transaction growth will pick up soon, because we see a high correlation between labor expense and revenue, with a coefficient of 0.97/1.** Even cost of food has only 0.91/1. Among all costs, labor cost is the only figure that is positively correlated with profits, with a coefficient of 0.15/1, according to our sensitivity analysis.

Another fact is, we see on the financial statement that:

	CQ4 2011	CQ1 2012	CQ2 2012	CQ3 2012	CQ4 2012	CQ1 2013	CQ2 2013	CQ3 2013
Labor	15.5%	17.3%	15.2%	15.4%	14.6%	11.0%	9.4%	8.3%
Bakery-cafe sales	17.4%	20.1%	18.8%	17.4%	15.9%	13.3%	11.2%	8.4%

Labor cost growth decreased in the 2012Q4, from 17% level to 13%, and worse in the following quarters, which yields directly to the bottleneck in the peak hour, leading to a bad customer experience and less transactions.

**Panera Bread Company**

Our sensitivity analysis and financial statement analysis coincide with company's judgment, and we believe the SSS will highly likely to recover to the same growth level as before.

We project the labor cost, D&A, and occupancy expense to be positively correlated with the number of stores owned. Restaurant revenue is projected by the linear regression of revenue on labor cost, as we think that given the demand of food unchanged, the transaction should be positively correlated with the labor cost.

**Price target range**

