PANERA BREAD

Panera winning on numerous fronts

Boosted by rapid growth in digital sales, a burgeoning catering business, early successes in its delivery program and growth in its consumer packaged foods business, Panera Bread Co. achieved strong earnings growth in 2016 and expects growth to accelerate in 2017.

Ambitious initiatives requiring major investments are paying generous dividends, the St. Louis-based company's top executives said in a Feb. 8 conference call with investment analysts.

For the year ended Dec. 27, 2016, non-GAAP earnings per share at Panera rose 9% from the year before. For fiscal 2017, the company is projecting non-GAAP earnings-per-share growth of 11% to 14%.

Investors responded to the results and 2017 guidance with enthusiasm. In trading Feb. 8 on the New York Stock Exchange, Panera shares surged to a record high, closing at $232.90, up nearly 9% from the close a day earlier. It was Panera's largest one-day move in almost two years.

Results in 2016 were strong by numerous measures. Comparable-store sales growth was 4.2%.

"What's more, we again took market share in 2016 as our company comps outperformed the Black Box all-industry composite by 530 basis points," Ron Shaich, chairman and chief executive officer, said in a Feb. 8 conference call with investment analysts.

For 2017, the company foresees same-store comparable sales growth of 3.5% to 4.5%.

New cafes performed well, with average weekly sales hitting a record $49,745 in 2016.

Net income at Panera in the year ended Dec. 27, 2016, totaled $44,010,000, equal to $1.93 per share on the common stock, up 2% from $43,160,000, or $1.75 per share, in the same period a year ago. Net revenues increased 5% to $727,106,000 from $691,765,000.

In the conference call, Mr. Shaich said success in 2016 should be viewed as an outcome of "themes" the company has been developing for the last several years. These themes include:

- "Using digital to create a frictionless" guest experience to drive frequency;
- Recipe reformulations with an eye to build customer trust;
- Developing a successful loyalty program; and
- Building out an omnichannel strategy around pick-up, catering, delivery and Panera at Home.

Mr. Shaich addressed a number of these themes in his remarks, noting that 24% of all Panera sales occur digitally, a percentage that leads the bakery cafe industry. The company's mobile order and pay program accounts for 9% of all sales.

He also described the MyPanera loyalty program as "industry leading," with 25 million members, accounting for 51% of all company transaction.

Catering sales rose 12% in 2016, and the company's new delivery sales have climbed to $5,000 per week where implemented (see related story on Page 40). Panera at Home grew by double digits in 2016 and is generating $175 million in sales at retail, Mr. Shaich said.

He described the strong financial performance in 2016 as a "byproduct of our effort" around the various themes, noting that the 4.2% gain in comparable sales growth was the largest increase in four years.

The success Panera has achieved in digital, catering and delivery all are built on the company's Panera 2.0 initiative that has been gradually rolled out systemwide. Currently, 70% of company stores have been converted to Panera 2.0. About 10% of franchise-operated stores have been converted.

Blaine Hurst, who was named president of Panera in December, said comparable sales growth in Panera 2.0 stores has outpaced growth in 1.0 stores. He said years of technology investment have left Panera with a decided advantage versus competitors.

Progress in and success from the Panera 2.0 initiative is rooted in the "strength of our app," Mr. Hurst said.

"We are particularly pleased to note that our iOS app is among the two most highly rated restaurant apps, with a five-star rating, and our Android app is among the most highly rated in the Google Play store," he continued. "The truth is, we are years down the road investing in our digital capabilities."

Product innovation also has been a

Panera looks to change delivery paradigm, plans to double down on efforts

Panera Bread Co. has some ambitious plans for its delivery business, hoping to expand from 15% of the system currently to 35% to 40% of the system by the end of 2017, company executives said.

In a Feb. 8 conference call with analysts, Blaine Hurst, president of Panera, said the St. Louis-based company is "highly confident" it can meet its target of 35% to 40%.

"We see the potential to change the delivery paradigm by offering a fast-casual, higher self-esteem experience through our menu offerings and our service," Mr. Hurst said. "That makes us very different from the typical commoditized pizza players and Asian offerings that are widely available for delivery in most of America.

"We believe Panera has moved extremely quickly to capitalize on that white space for healthful, high-quality salads, soups and sandwiches in the $40 billion delivery market, and that our opportunity is to be a premium, but mass market restaurateur delivering our great food to our customers."

PANERA BREAD

During the fourth quarter of fiscal 2016, Panera launched delivery in 22 additional company bakery-cafes and an additional 17 franchise bakery cafes. For the year, the company ended 2016 with cafe-based delivery in 306 cafes system-wide, Mr. Hurst said.

Touching on some of the lessons learned within its delivery business during 2016, Mr. Hurst said Panera found the fully integrated digital investments that the company bet on a few years ago are foundational to its ability to be successful with delivery and are key to the rapid deployment of delivery across the Panera system.

"Because we've already made this investment in our digital capabilities, delivery requires de minimis capital expenditures and a modest start-up investment of about $25,000 per cafe, primarily related to hiring, training and the grassroots marketing efforts to build customer awareness," he said.

Panera also learned that hiring and training drivers is the largest hurdle in the market roll-outs. Mr. Hurst said Panera believes it has a competitive advantage in hiring drivers, though, because the restaurant chain has better working hours and because deliveries primarily go to office workers, which tends to lead to bigger tips.

Building on Mr. Hurst's comments, Ron Shaich, founder, chairman and chief executive officer of Panera, said he believes delivery can be a game changer for the company.

"I think it was ambitious getting to 15% in one year," Mr. Shaich said. "That was tough, because we had to start the machine up. ... This is probably as powerful initiative as we've seen in Panera in a long, long time — maybe the initiative of the decade in Panera. It's really the big deal. So there's tremendous capability, tremendous traction, and tremendous enthusiasm behind getting this done. And most importantly, getting it done right." **FBN** source of success, Mr. Hurst said. He said the company's chipotle chicken avocado melt introduced in the fall remains the best-selling Panera sandwich. The success, he said, is "proof positive that we are hitting on all the attributes our customer is asking for. We have more bold sandwich flavors to add to the menu later this year, and we'll fill you in on those at that later time."

Efforts at upgrading the Panera menu were much broader than one-off new product introductions. Mr. Hurst noted the company in 2016 completed its program to make its menu "100% clean," meaning no artificial flavors, artificial sweeteners or colors from artificial sources.

"We are the first and only restaurant brand to commit to such a comprehensive pledge and achieve it," Mr. Hurst said. "In fact, we reformulated 122 menu items. We are today the reference brand for clean food, and we are very proud of this accomplishment."

Additional menu changes are planned for the company's salads, bakery items and beverages, Mr. Hurst said, adding that offering details at this point would be "premature."

Asked by an analyst whether Panera still has the potential to become a $1 billion brand at retail and whether Panera At Home has significant profit margin upside ahead, Mr. Shaich said, "I'll tell you, the goal remains $1 billion. Where you're not going to pin me down is the date we get there. Straight up. I think if you talk about margins, we're just getting into this. But probably the gold standard here is our friends at Starbucks. You guys know it better than I. But they're producing material percentages of their entire corporate operating income from their C.P.G. business."

With the major initiatives Panera has in place, growth in 2017 also is expected to come from new bakery cafe openings, expected to total 70 to 80.

At the end of 2016, a total of 2,036

bakery cafes were operating systemwide, including 902 that were company owned and 1,134 that were franchise-operated.

Adding color on the company's earnings outlook was Michael J. Bufano, chief financial officer.

He said operating margins in 2017 will be unchanged to up 50 basis points versus 2016. Mr. Bufano painted a varied picture of the 2017 cost outlook.

"First, we are expecting food cost to decline about 1% year over year," he said. "This reflects modest commodity cost inflation, offset by the intensive margin improvement efforts we've been executing. Second, we anticipate 2017 will be another year of labor deleverage for several reasons. We believe wage inflation for our retail hourly associates will be approximately 5% for the year. The roll-out of delivery will increase labor expense during the conversion and start-up phase." **FBN**

L. Joshua Sosland
josh@sosland.com