Street Perception
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Facing maturation in the fast casual industry

- Starbucks 1971
- Panera 1981
- Chipotle 1993
- Zoes 1995
- Shake Shack 2000

Maturity in FC
Panera 2.0 Costs
Slowing Growth

Investors are worried about new sources of growth
Growth is slowing, due to maturity, has ~1900 locations.
Labor costs increased in the short run due to training costs and longer hours. The street also views 2.0 as a failed cost-saving initiative.

Higher wage rates from minimum wage increases
The franchising of a substantial number of cafes will aid growth from royalties and additional revenue than from company-owned stores.

- Franchises pay substantial opening fees
- 5% royalty
- Must also exclusively buy dough and other products from Panera
Panera Bread

Bakery-Café Concept with about 2000 cafes, about 975 are franchised (10Q)

**Franchised Cafes**
- Owe Panera royalty fees of about 5%
- Panera trusts franchisees with brand name and distribution
- Panera sells food and paper products to franchised cafés
- Franchise owners must demonstrate brand commitment and strong credit
- Profit per dollar cost is about 44% (44% ROI for each dollar spent on franchised cafés)

**Company Owned Cafes**
- All revenue goes to company
- Create majority of costs
- Management desires company owned cafés to be 35-50% of total cafés
- Profit per dollar cost is about 23% (23% ROI for each dollar spent on company owned cafés)
- Plan to sell 50-150 cafes in 2015, with 70 LOIs by end of Q2

Goal: Same Customer Experience
Less risk of altering brand image
Changing Composition of Ownership

<table>
<thead>
<tr>
<th>Year</th>
<th>Company</th>
<th>Franchise</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>48.02%</td>
<td>51.98%</td>
</tr>
<tr>
<td>2013</td>
<td>48.97%</td>
<td>51.03%</td>
</tr>
<tr>
<td>2014</td>
<td>48.79%</td>
<td>51.21%</td>
</tr>
<tr>
<td>2015</td>
<td>49.20%</td>
<td>50.80%</td>
</tr>
<tr>
<td>2016*</td>
<td>45.73%</td>
<td>54.27%</td>
</tr>
<tr>
<td>2017*</td>
<td>42.49%</td>
<td>57.51%</td>
</tr>
<tr>
<td>2018*</td>
<td>42.92%</td>
<td>57.08%</td>
</tr>
</tbody>
</table>
Variant Perception

Franchising

Panera 2.0

Store Growth

Fundamentals
**Fundamentals of Panera 2.0**

**Goal:** improve guest experience by reducing friction

**Digital access initiative**
- Catering and delivery service using mobile, web and kiosk access to shorten wait times and improve to-go / eat-in experiences

**Operational integrity**
- Using upgraded equipment and management tools to keep up with its growing orders

Better way to order and receive orders & differentiated approach to production
Early Adopters of “2.0” Changes

Applebee’s (DIN):

• Three quarters of consecutive sales decline

• Brand reset into a modern Grill & Bar ➔ installed thousands of E La Carte tablets in stores

• Rose sales by 3%, turned into five consecutive positive quarters

• Plans to transition this change into IHOP in the future

Restaurants with more tech have enhanced their image and seen profitable results from this change.
Early Adopters of “2.0” Changes

The Habit Burger Grill (HABT):

• Focused on dine-in customers during peak lunch and dinner hours → takeout business consisted of less than 1% of sales

• Partnered with Restaurant Revolution Technologies (RRT) to manage call center, mobile and online ordering platforms for takeout orders

• Takeout business increased to over 4% of its overall revenue mix

HABT and PNRA have seen potential in the takeout business and are setting themselves appropriately to capture this market
Variant Perception

Franchising  Panera 2.0  Store Growth

Fundamentals

History of Digital Optimization in the Restaurant Industry

Revenue growth from implementation of Panera 2.0
Panera 2.0 as a Revenue Driver (cont.)

2.0 Café Revenue Growth

- Q3 comps increased at 3.8% (1% transaction, 2.8% check)
- Two year Q3 comps at 5.9%, highest in 7 quarters
- “Here is what we feel confident in Panera 2.0. Each week, we compare 2.0 and 1.0 comps and I can tell you affirmatively, each week that 2.0 comps materially exceed 1.0 comps, each week we see it, and each week we acknowledge it.”

Shifting Product Mix

- Digital utilization accounts for 12% of sales, higher than any other public restaurant company other than pizza chains
- 2.0 technology will directly help grow their delivery business
  - currently testing internal drivers and external delivery organizations
Panera 2.0 as a Revenue Driver

It’s Not About Cutting Costs

- Doesn’t necessarily cut down costs
- Cuts down on cashier workers, but more are hired to make customized orders & to cater food
- However, market fails to see the revenue boost from 2.0 will eventually lead to better operating leverage
Variant Perception

Franchising

Panera 2.0

Store Growth

Fundamentals

History of Digital Optimization in the Restaurant Industry

Revenue growth from implementation of Panera 2.0

2.0 Expansion
2.0 Expansion

250+ converted cafes as of today

Planned total of 300-400 cafes by the end of 2015

2.0 implementation in all cafes expected in the next 3 years
Variant Perception

Franchising  Panera 2.0  Store Growth

Opening new company-owned cafes

• Expecting less store growth than previously, but still ≈50 new company-owned stores yearly and ≈50 franchised (base case) → Conservative estimates

• Optionality for expansion into Canada
Fast Casual has been growing at over 5.5X that of the Fast Food Industry.

The American fast casual food craze (sales growth since 1999)

Growth forecasted in the double digits through 2022, while the rest of restaurant industry is expected to post 0.5% growth.

Reason for Appeal:
The price point no longer holds as much weight
Millenials are increasingly seeking out fast casual restaurants.

Fast casual growth coming primarily from Millenials.
Total restaurant industry in 2015: ≈$710 billion
Size of fast casual industry in 2015: ≈$32 billion
→ Fast casual is still a very small part of the restaurant industry, but as the overall restaurant industry is growing, it is also gaining a higher market share from **fast food** and **casual dining** in that rapidly growing industry.
Valuation & Recommendation
## Comparable Multiples

<table>
<thead>
<tr>
<th>Company</th>
<th>EV</th>
<th>EV/EBITDA</th>
<th>P/E</th>
<th>5yr Rev Growth</th>
<th>5 yr EBITDA growth</th>
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</thead>
<tbody>
<tr>
<td>Panera Bread</td>
<td>4.37B</td>
<td>11.54</td>
<td>28.55</td>
<td>64.29%</td>
<td>61.20%</td>
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<tr>
<td>Chipotle</td>
<td>21.82B</td>
<td>18.00</td>
<td>35.37</td>
<td>123.37%</td>
<td>129.33%</td>
</tr>
<tr>
<td>Starbucks</td>
<td>84.66B</td>
<td>18.92</td>
<td>33.64</td>
<td>53.62%</td>
<td>104.97%</td>
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<tr>
<td>DineEquity*</td>
<td>2.83B</td>
<td>15.08</td>
<td>27.22</td>
<td>-50.86%</td>
<td>-17.19%</td>
</tr>
<tr>
<td>Habit</td>
<td>604.4M</td>
<td>27.72</td>
<td>114.82*</td>
<td>196.61%</td>
<td>240%</td>
</tr>
<tr>
<td>Darden*</td>
<td>8.59B</td>
<td>11.46</td>
<td>23.84</td>
<td>-9.81%</td>
<td>-35.03%</td>
</tr>
<tr>
<td>Mean</td>
<td>20.48B</td>
<td>17.12</td>
<td>43.91*</td>
<td>62.87%*</td>
<td>80.55%*</td>
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<tr>
<td>Median</td>
<td>6.48B</td>
<td>24.08</td>
<td>27.89</td>
<td>58.96%</td>
<td>83.1%</td>
</tr>
</tbody>
</table>

*conglomerates
Valuation Case Assumptions – P/E

Target Price: $206.79 (23%)

**Bear Case: $158.03 (-6%)**
- Panera 2.0 fails as a growth driver, averaging 0.8% yoy AWNS growth
- Panera sells 60/90 cafes to franchisees
- Opens 35-40 company owned and 40-45 franchised cafes per year
- Higher rate of closing franchise and company owned cafes
- Refranchising loss in 2015 and 2016
- 2018 P/E of 25

**Base Case: $206.79 (23%)**
- Average weekly net sales grow at about 2.4% for company owned and lag for franchised stores
- Panera sells 75/75 cafes to franchisees
- Opens 45-50 company owned and 48-52 franchised cafes per year
- G&A decrease
- Moderate rate of closing cafes
- 2018 P/E of 28.6

**Bull Case: $255.54 (52%)**
- Average weekly net sales grow 2.5-4% growth for company owned and lag for franchised stores
- Panera sells 90/60 cafes to franchisees
- Opens 65 company owned franchised cafes per year
- G&A expenses decrease as % of revenue by 250bp
- Low rate of closing cafes
- 2018 P/E of 31
Valuation Case Assumptions – EV/EBITDA

**Target Price: $201.74 (20%)**

**Bear Case: $154.67 (-8%)**
- Panera 2.0 fails as a growth driver, averaging 0.8% yoy AWNS growth
- Panera sells 60/90 cafes to franchisees
- Opens 35-40 company owned and 40-45 franchised cafes per year
- Higher rate of closing cafes
- Refranchising loss in 2015 and 2016
- 2018 EV/EBITDA of 10

**Base Case: $201.74 (20%)**
- Average weekly net sales grow at about 2.4% for company owned and lag for franchised stores
- Panera sells 75/75 cafes to franchisees
- Opens 45-50 company owned and 48-52 franchised cafes per year
- G&A decrease
- Moderate rate of closing cafes
- 2018 EV/EBITDA of 11.54

**Bull Case: $245.54 (46%)**
- Average weekly net sales grow 2.5-4% growth for company owned and lag for franchised stores
- Panera sells 90/60 cafes to franchisees
- Opens 65 company owned franchised cafes per year
- G&A expenses decrease as % of revenue by 250bp
- Low rate of closing cafes
- 2018 EV/EBITDA of 12.5
## Multiples and Possible Returns on Investments

<table>
<thead>
<tr>
<th>P/E</th>
<th>24</th>
<th>25</th>
<th>26</th>
<th>27</th>
<th>28</th>
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<th>30</th>
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<tbody>
<tr>
<td>Bear</td>
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<td>-6%</td>
<td>-2%</td>
<td>2%</td>
<td>5%</td>
<td>9%</td>
<td>13%</td>
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<tr>
<td>Base</td>
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<td>17%</td>
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<td>25%</td>
<td>29%</td>
<td>34%</td>
<td>38%</td>
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<tr>
<td>Bull</td>
<td>17%</td>
<td>22%</td>
<td>27%</td>
<td>32%</td>
<td>37%</td>
<td>42%</td>
<td>47%</td>
<td>52%</td>
<td>56%</td>
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</table>

<table>
<thead>
<tr>
<th>EV/EBITDA</th>
<th>9</th>
<th>10</th>
<th>11</th>
<th>12</th>
<th>13</th>
<th>14</th>
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</thead>
<tbody>
<tr>
<td>Bear</td>
<td>-17%</td>
<td>-8%</td>
<td>2%</td>
<td>11%</td>
<td>21%</td>
<td>30%</td>
</tr>
<tr>
<td>Base</td>
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<tr>
<td>Bull</td>
<td>5%</td>
<td>17%</td>
<td>29%</td>
<td>40%</td>
<td>52%</td>
<td>64%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Current P/E</th>
<th>Current EV/EBITDA</th>
</tr>
</thead>
<tbody>
<tr>
<td>28.58</td>
<td>11.54</td>
</tr>
</tbody>
</table>
Recommendation and Q&A

We recommend a long position using 5-7% of the portfolio to purchase Panera Bread for an expected 20% return.

Questions?
Appendix
CEO Robert N. Schaich

- Founder, Chairman and CEO of Panera Bread (61 years old).
- Has been with Panera for over 30 years; lives, breathes and exhibits Panera’s vision and commitment to sustainable and healthy eating.
- Still at the forefront of all major initiatives at Panera; unlikely to step down within our investment horizon (Panera is his lifetime-project).
- Known for his entrepreneurial skills and has demonstrated this over time.
- Has created shareholder value through two separate share buyback programs in recent history.
### Who Can Franchise

<table>
<thead>
<tr>
<th>Experience</th>
<th>Financial Strength</th>
<th>Good Fit</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Experience as a multi-unit restaurant operator</td>
<td>• Net worth of $7.5 million</td>
<td>• Total commitment to the development of the Panera Bread brand</td>
</tr>
<tr>
<td>• Recognition as a top restaurant operator</td>
<td>• Liquid assets of $3 million</td>
<td>• Cultural fit and a passion for fresh bread</td>
</tr>
<tr>
<td>• Real estate experience in the market to be developed</td>
<td>• Infrastructure and resources to meet our development schedule</td>
<td>• Average Franchise group (35 total) owns about 27 bakery cafes per group</td>
</tr>
</tbody>
</table>

Less Risk of incurring costs over poor franchisee management and maintaining positive brand image