case 5

Panera Bread Company in 2015—What to Do to Rejuvenate the Company's Growth?

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In spring 2015, 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 such as 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 restaurants each week, and Panera baked more specialty breads daily than any other bakery-café enterprise in North America. There were 1,880 company-owned and franchised bakery-cafés in operation in 45 states, the District of Columbia, and Ontario, Canada, under the Panera Bread, Saint Louis Bread Co., and Paradise Bakery & Café names. In 2014, the company had corporate revenues of $2.5 billion, systemwide store revenues of $4.5 billion, and average sales of almost $2.5 million per store location.

The number of Panera Bread locations was up from 1,027 units in 36 states at the end of 2006 but well short of the ambitious target the company set in 2006 to have 2,000 outlets in operation by the end of 2010. While the Great Recession of 2008–2009 had forced management to scale back Panera's expansion plans, the company decided to reinstitute its rapid growth strategy by opening 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, and 114 units in 2014. Plans called for opening 105 to 115 new company-operated and franchised units in 2015.

But despite the recent acceleration of store openings, the company's 6.0 percent revenue growth in 2014 fell far short of the robust 19.9 percent compound average growth achieved during 2009—2013. Moreover, sales at bakery-cafés open at least one year rose only 1.1 percent in 2014, compared to 2.3 percent in 2013 and 6.5 percent in 2012. The growth slow-down, coupled with higher operating expenses, squeezed Panera's profitability, resulting in a decline in net income from $196.2 million in 2013 to $179.3 million in 2014 and a drop in earnings per share from $6.85 in 2013 to $6.67 in 2014—the first such earnings decline since 2007.

Top management in February 2015 indicated that it was expecting 2015 sales gains of between 2.0 and 3.5 percent at Panera bakery-cafés open at least one year. But despite the addition of more stores, management's profit forecast for 2015 was uninspiring; diluted earnings per share in 2015 were projected to be anywhere from flat to down mid- to high-single digits, far below the company's targeted long-term EPS growth rate of 15 to 20 percent annually.

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 such as 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 reconceived 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 two 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 chairman or co-chairman of the board of directors since 1988, transitioned to the role of executive chairman of the board. In addition to the normal duties of board chairman, 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 chairman of the board 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 Bill Moreton's time: Shaich became chairman of the board and CEO and Moreton was named executive vice chairman, 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* magazine 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.[1] 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.[2] 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' 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.[3]

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 made with a craftsman's 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.[4]

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 were handcrafted and baked daily at each café location
- Serving high-quality food at prices that represented 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 were aesthetically pleasing and inviting
- Offering patrons such a sufficiently satisfying dining experience that they were 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 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.

EXHIBIT 1

Selected Consolidated Financial Data for Panera Bread, 2009–2014 (in thousands, except for per-share amounts)

Income Statement Data	**2014**	**2013**	**2012**	**2011**	**2009**
Revenues:					
Bakery-café sales	$2,230,370	$2,108,908	$1,879,280	$1,592,951	$1,153,255
Franchise royalties and fees	123,686	112,641	102,076	92,793	78,367
Fresh dough and other product sales to franchisees	175,139	163,453	148,701	136,288	121,872
Total revenues	2,529,195	2,385,002	2,130,057	1,822,032	1,353,494
Bakery-café expenses:					
Food and paper products	669,860	625,622	552,580	470,398	337,599
Labor	685,576	625,457	559,446	484,014	370,595
Occupancy	159,794	148,816	130,793	115,290	95,996
Other operating expenses	314,879	295,539	256,029	216,237	155,396
Total bakery-café expenses	1,830,109	1,695,434	1,498,848	1,285,939	959,586
Fresh dough and other product cost of sales to franchisees	152,267	142,160	131,006	116,267	100,229
Depreciation and amortization	124,109	106,523	90,939	79,899	67,162
General and administrative expenses	138,060	123,335	117,932	113,083	83,169
Pre-opening expenses	8,707	7,794	8,462	6,585	2,451
Total costs and expenses	2,253,252	2,075,246	1,847,187	1,601,773	1,212,597
Operating profit	275,943	309,756	282,870	220,259	140,897
Interest expense	1,824	1,053	1,082	822	700
Other (income) expense, net	(3,175)	(4,017)	(1,208)	(466)	273
Income taxes	98,001	116,551	109,548	83,951	53,073
Less net income (loss) attributable to noncontrolling interest	---	---	---	---	801
Net income to shareholders	$179,293	$196,169	$173,448	$ 135,952	$ 86,050
Earnings per share					
Basic	$6.67	$6.85	$5.94	$4.59	$2.81
Diluted	6.64	6.81	5.89	4.55	2.78
Weighted average shares outstanding					
Basic	26,881	28,629	29,217	29,601	30,667
Diluted	26,999	28,794	29,455	29,903	30,979
Balance Sheet Data					
Cash and cash equivalents	$196,493	$125,245	$297,141	$ 222,640	$246,400
Current assets	406,384	302,716	478,842	353,119	322,084
Total assets	1,390,902	1,180,862	1,268,163	1,027,322	837,165
Current liabilities	352,712	303,325	277,540	238,334	142,259
Total liabilities	654,718	177,645	168,704	372,246	240,129
Stockholders' equity	736,184	699,892	821,919	655,076	597,036
Cash Flow Data					
Net cash provided by operating activities	$ 335,079	$ 348,417	$ 289,456	$ 236,889	$ 214,904
Net cash used in investing activities	(211,317)	(188,307)	(195,741)	(152,194)	(49,219)
Net cash (used in) provided by financing activities	(52,514)	(332,006)	(19,214)	(91,354)	6,005
Net (decrease) increase in cash and cash equivalents	71,248	(171,896)	74,501	(6,659)	171,690

Source: 2014 10-K report, pp. 41–43; 2013 10-K report, pp. 41–43; 2011 10-K Report, pp. 41–43; and 2010 10-K Report, pp. 29–30, 46–48.

EXHIBIT 2

Selected Operating Statistics, Panera Bread Company, 2009–2014

	2014	2013	2012	2011	2010	2009
Revenues at company-operated stores (in millions)	$2,230.4	$2,108.9	$1,879.3	$1,593.0	$1,321.2	$1,153.3
Revenues at franchised stores (in millions)	$2,282.0	$2,175.2	$1,981.7	$1,828.2	$1,802.1	$1,640.3
Systemwide store revenues (in millions)	$4,512.4	$4,284.1	$3,861.0	$3,421.2	$3,123.3	$2,793.6
Average annualized revenues per company-operated bakery-café (in millions)	$2.502	$2.483	$2.435	$2.292	$2.179	$2.031
Average annualized revenues per franchised bakery-café (in millions)	$2.455	$2.448	$2.419	$2.315	$2,266	$2.109
Average weekly sales, company-owned cafés	$48,114	$47,741	$46,836	$44,071	$41,899	$39,050
Average weekly sales, franchised cafés	47,215	47,079	46,526	$44,527	$43,578	$40,566
Comparable bakery-café sales percentage increases*						
Company-owned outlets	1.4%	4.5%	6.5%	4.9%	7.5%	2.4%
Franchised outlets	0.9%	3.9%	5.0%	3.4%	8.2%	2.0%
System-wide	1.1%	2.3%	5.7%	4.0%	7.9%	2.2%
Company-owned bakery-cafés open at year-end	925	867	809	740	662	585
Franchised bakery-cafés open at year-end	955	910	843	801	791	795
Total bakery-cafés open	1,880	1,777	1,652	1,541	1,453	1,380

*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).

Source: Company 10-K Reports for 2014, 2013, 2011, and 2010.

Except for bread and pastry products, Panera's strongest competitors were dining establishments in the so-called "fast-casual" restaurant category. Fast-casual restaurants filled the gap between fast-food outlets and casual, full table service restaurants. A fast-casual restaurant provided quick-service dining (much like fast-food enterprises) but was distinguished by enticing menus, higher food quality, and more inviting dining environments; typical meal costs per guest were in the $7–$12 range. Some fast-casual restaurants had full table service, some had partial table service (with orders being delivered to the table after ordering and paying at the counter), and some were 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 geographical 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 business around company-owned bakery-café operations, franchise operations, and fresh dough operations; the fresh bread unit supplied dough and other products to all Panera Bread stores, both company-owned and franchised.

Panera Bread's Product Offerings and Menu

Panera Bread's artisan signature breads were made from four ingredients: water, natural yeast, flour, and salt; no preservatives or chemicals were used. Carefully trained bakers shaped every step of the process, from mixing the ingredients, to kneading the dough, to placing the loaves on hot stone slabs to bake in a traditional European-style stone

EXHIBIT 3

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

Company	Number of Locations, 2013	Select 2013–2014 Financial Data	Key Menu Categories
Atlanta Bread Company	~100 company-owned and franchised bakery-cafés 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)	2,017 franchised locations in 49 states, 2 U.S. territories, and 15 countries outside the U.S.	2014 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, alcoholic beverages (about 12 percent of total sales)
Au Bon Pain	300+ company-owned and franchised bakery-cafés in 26 states and 5+ foreign countries	Not available (privately held company)	Baked goods (with a focus on croissants and bagels), soups, salads, sandwiches and wraps, coffee drinks
Bruegger's Bagels	300+ bakery-cafés in 26 states, the District of Columbia, and Canada	Not available (privately held company)	Fresh-baked New York–style bagels, breads, sandwiches, salads, soups, desserts, signature coffees
California Pizza Kitchen* (a subsidiary of Golden Gate Capital)	265 locations in 32 states and 10 other countries	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, assorted beverages
Chili's Grill and Bar* (a subsidiary of Brinker International)	1,262 locations in 50 states and 307 locations in 31 foreign countries and territories	2014 average revenues of ~$2.9 million per location; 2014 average check size per customer of $14.31	Chicken, beef, and seafood entrees, steaks, appetizers, salads, sandwiches, desserts, alcoholic beverages (14.1 percent of sales)
Chipotle Mexican Grill	1,770+ units	2014 revenues of $4.1 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 (a subsidiary of Roark Capital Group)	185 locations in 20 states and District of Columbia (planning to have 250+ locations by year-end 2015)	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, teas
Cracker Barrel*	634 combination retail stores and restaurants in 42 states	Restaurant-only sales of $2.14 billion in 2014; average sales per restaurant of $3.42 million; average guest check of $9.75; serves an average of ~1,000 customers per day per location	Two menus (all-day breakfast and lunch/dinner); named by Technomics in both 2013 and 2015 as the full restaurant category winner of its "Chain Restaurant Consumers' Choice Award"

Company	Number of Locations, 2013	Select 2013–2014 Financial Data	Key Menu Categories
Culver's	500+ locations in 22 states	Not available (a privately held company)	Signature hamburgers served on buttered buns, fried battered cheese curds, value dinners (chicken, shrimp, cod with potato and slaw), salads, frozen custard, milkshakes, sundaes, fountain drinks
Einstein Noah Restaurant Group (Einstein Bros. Bagels, Noah's New York Bagels, Manhattan Bagel)	~850 company-owned, franchised, and licensed locations in 40 states	Annual sales revenues $434 million; annual revenue per company-owned unit of ~$850,000	Fresh-baked bagels, hot breakfast sandwiches, made-to-order lunch sandwiches, creamed cheeses and other spreads, salads, soups, gourmet coffees and teas
Fazoli's (a subsidiary of Sun Capital Partners)	220+ locations in 26 states	2014 sales of ~$260 million	Spaghetti and meatballs, fettuccine Alfredo, lasagna, ravioli, submarines and panini sandwiches, pizza, entrée salads, garlic bread sticks, desserts
Firehouse Subs	860+ locations in 38+ states (plans for 2,000 locations by 2020	Average unit sales of $~800,000	Hot and cold subs, salads, sides, drinks, catering; ranked #2 in Sandelman and Associates Quick-Track® 2014 Awards of Excellence for Large Quick-Service Restaurant Chains (over 500 units)
Five Guys Burgers and Fries	~1,500+ locations in 47 states and 6 Canadian provinces	Not available (a privately held company)	Hamburgers (with choice of 15 toppings), hot dogs, fries, Coca-Cola, beverages
Fuddruckers (a subsidiary of Luby's Inc.; 2014 sales of $368.3 million)	~180 company-owned and franchised locations in 34 states, the District of Columbia, Puerto Rico, and Canada	Not available	Exotic hamburgers (the feature menu item), chicken and fish sandwiches, French fries and other sides, soups, salads, desserts
Jason's Deli	240+ locations in 28 states	Not available (a privately held company)	Sandwiches, extensive salad bar, soups, loaded potatoes, desserts, catering services, party trays, box lunches
Moe's Southwest Grill (a subsidiary of Roark Capital Group)	500+ locations in 37 states and the District of Columbia	2013 sales of $526 million; average annual sales per restaurant of ~$1.1 million	Burritos, quesadillas, fajitas, tacos, nachos, rice bowls (chicken, pork, or tofu), salads with a choice of two homemade dressings, a kid's menu, five side items (including queso and guacamole), two desserts (cookie or brownie), soft drinks, iced tea, bottled water, catering
McAlister's Deli (a subsidiary of Roark Capital Group)	341 locations in 24 states	Not available (a privately held company)	Deli sandwiches, loaded baked potatoes, soups, salads, and desserts, plus sandwich trays, lunch boxes, catering
Noodles & Company	440+ urban and suburban locations in 32 states and District of Columbia	2014 sales of $404 million; comparable store sales growth of 0.2% in 2014; average check size $8.00	Customizable Asian, Mediterranean, and American noodle/pasta entrees, soups, salads, sandwiches, alcoholic beverages

Company	Number of Locations, 2013	Select 2013–2014 Financial Data	Key Menu Categories
Qdoba Mexican Grill (a subsidiary of Jack-in-the-Box, Inc.)	638 company-owned and franchised locations in 47 states, District of Columbia, and Canada	Average unit sales per location of $1,090,000 in 2014; comparable store sales growth of 6.0% in 2014	Signature burritos, tacos, taco salads, quesadillas, three-cheese nachos, Mexican gumbo, tortilla soup, five signature salsas, breakfast selections at some locations
Ruby Tuesday*	744 company-owned and franchised locations in 44 states, 13 foreign countries, and Guam	Fiscal 2014 sales of $1.17 billion; average restaurant sales of $1.67 million; typical entrée price ranges of $7.49 to $19.99	Appetizers, handcrafted burgers, 35-item salad bar, steaks, fresh chicken, crab cakes, lobster, salmon, tilapia, ribs, desserts, nonalcoholic and alcoholic beverages, catering
Starbucks	~11,960 company-operated and licensed locations in the U.S. and 9,400+ international locations	2014 global revenues of $16.4 billion; sales of $1.29 million per company-operated location in the Americas	Italian-style espresso beverages, teas, sodas, juices, assorted pastries and confections; some locations offer sandwiches and salads
T.G.I. Friday's* (a subsidiary of Sentinel Capital Partners and TriArtisan Capital Partners)	930 locations in 60 foreign countries and territories	Not available (a privately held company)	Appetizers, salads, soups, burgers and other sandwiches, chicken, seafood, steaks, pasta, desserts, nonalcoholic and alcoholic beverages, party platters

*Denotes a full-service restaurant.

Source: Company web sites, accessed March 16, 2015.

deck bakery oven. Breads, as well as bagels, muffins, cookies, and other pastries, were baked fresh throughout the day at each café location. Exhibit 4 shows Panera's lineup of breads.

The Panera Bread menu was designed to provide target customers with products built on the company's bakery expertise, particularly its varieties of breads and bagels baked fresh throughout the day at each café location. The key menu groups were fresh baked goods, hot breakfast selections, bagels and cream cheese spreads, hot panini, made-to-order sandwiches and salads, soups, fruit smoothies, frozen drinks, beverages, and espresso bar selections. Exhibit 5 summarizes the menu offerings at Panera Bread locations as of March 2015.

Menu offerings were regularly reviewed and revised to sustain the interest of regular customers, satisfy changing consumer preferences, and be responsive to various seasons of the year. Special soup offerings, for example, appeared seasonally. Product development was focused on providing food that customers would crave and trust to be tasty. New menu items were developed in test kitchens and then introduced in a limited number of the bakery-cafés to determine customer response and verify that preparation and operating procedures resulted in product consistency and high quality standards. If successful, they were then rolled out systemwide. New product introductions were integrated into periodic or seasonal menu rotations, referred to as "Celebrations." Ten new menu items were introduced in 2010, 14 new or improved items appeared on the menu in 2011, 8 different selections (5 new ones and 3 that had been put back on the menu after being removed in prior periods) were featured on Panera's 2012 menu, 20 new menu items appeared on the menu during the course of 5 celebrations held throughout 2013, and 22 new and reintroduced selections were featured during the 5 celebrations in 2014.

Over the past 10 years, Panera had responded to growing consumer interest in healthier, more nutritious menu offerings. In 2004, whole grain breads were introduced, and in 2005, Panera switched to the use of natural antibiotic chicken in all of Panera's chicken-related sandwiches and salads. Other

EXHIBIT 4

Panera's Line of Fresh-Baked Breads, March 2015

Artisan Breads	**Specialty Breads**
Country A crisp crust and nutty flavor. *Available in loaf.*	Sourdough Panera's signature sourdough bread with no fat, oil, sugar, or cholesterol. *Available in loaf.*
French Slightly blistered crust, wine-like aroma. *Available in baguette, miche.*	Asiago Cheese Standard sourdough recipe with Asiago cheese baked in and sprinkled on top. *Available in demi, loaf.*
Ciabatta A moist, chewy crumb with a thin crust and light olive oil flavor. *Available in loaf.*	Honey Wheat Sweet and hearty with honey and molasses. *Available in loaf.*
Focaccia Italian flatbread baked with olive oil and topped with either asiago cheese or sea salt. *Available in loaf.*	All-Natural White Bread Soft and tender white sandwich bread. *Available in loaf.*
Rye With chopped rye kernels and caraway seeds. *Available in loaf.*	Tomato Basil Sourdough bread made with tomatoes and basil, and sweet streusel topping. *Available in XL loaf.*
Three Cheese Made with parmesan, romano, and asiago cheeses. *Available in loaf.*	Cinnamon Raisin Swirl Fresh dough made with flour, whole butter, and eggs, swirled with Vietnamese and Indonesian cinnamons, raisins, and brown sugar, topped with Panera's cinnamon crunch topping. *Available in loaf.*
Three Seed Sesame, poppy, and fennel seeds. *Available in demi.*	
Whole Grain Moist and hearty, sweetened with honey. *Available in loaf.*	Sprouted Whole Grain Roll *Available as single or pack of 6.*
Sesame Semolina Delicate, moist, and topped with sesame seeds. *Available in loaf.*	Soft Dinner Roll *Available as single or pack of 6.*

Source: www.panerabread.com, accessed March 17, 2015.

recent health-related changes included using organic and all-natural ingredients in selected items, using unbleached flours in its breads, adding a yogurt-granola-fruit parfait and reduced-fat spreads for bagels to the menu, introducing fruit smoothies, increasing the use of fresh ingredients (such as fresh-from-the-farm lettuces and tomatoes), and revising ingredients and preparation methods to yield zero grams of artificial trans fat per serving. All of the menu boards and printed menus at company-owned Panera bakery-cafés included the calories for each food item. Also, Panera's website had a nutritional calculator showing detailed nutritional information for each individual menu item or combination of menu selections.

Off-Premises Catering In 2004–2005, Panera Bread introduced a catering program to extend its market reach into the workplace, schools, and parties and gatherings held in homes, and grow their breakfast-, lunch-, and dinner-hour sales without making capital investments in additional physical facilities. The first menu consisted of items appearing on the regular menu and was posted for viewing at the company's website. A catering coordinator was available to help customers make menu selections, choose between assortments or boxed meals, determine appropriate order quantities, and arrange pick-up or delivery times. Orders came complete with plates, napkins, and utensils, all packaged and presented in convenient, ready-to-serve-from packaging.

EXHIBIT 5

Panera Bread's Menu Selections, March 2015

Bakery
Artisan and specialty breads (17 varieties), bagels (11 varieties), scones (4 varieties), sweet rolls (3 varieties), muffins and "muffies" (6 varieties), artisan pastries (7 varieties), brownies, cookies (7 varieties)
Bagels and cream cheese spreads (11 varieties of bagels, 8 varieties of spreads)
Hot breakfast
Breakfast sandwiches (10 varieties), baked egg soufflés (4 varieties)
Strawberry Granola Parfait
Steel-Cut Oatmeal
Power Almond Quinoa Oatmeal
Fruit smoothies (5 varieties)
Fresh fruit cup
Signature hot paninis
Frontega Chicken, Chipotle Chicken, Smokehouse Turkey, Steak and White Cheddar
Signature sandwiches
Napa Almond, Chicken Salad, Asiago Steak, Italian Combo, Bacon Turkey Bravo
Café sandwiches
Smoked Ham and Swiss, Roasted Turkey and Avocado BLT, Tuna Salad, Mediterranean Veggie, Sierra Turkey, Fontina Grilled Cheese, Classic Grilled Cheese, Smoked Turkey
Flatbread sandwiches
Turkey Cranberry, Mediterranean Chicken, Southwestern Chicken, Tomato Mozzarella
Signature pastas
Chicken Sorrentina, Chicken Tortellini Alfredo, Mac & Cheese, Pesto Sacchettini, Tortellini Alfredo, Pasta Primavera

Soups (5 selections varying daily, plus seasonal specialties)
Options include: Broccoli Cheddar, Bistro French Onion, Baked Potato, Low-Fat All-Natural Chicken Noodle, Cream of Chicken and Wild Rice, New England Clam Chowder, Low-Fat Vegetarian Garden Vegetable with Pesto, Low-Fat Vegetarian Black Bean, Vegetarian Creamy Tomato, All-Natural Turkey Chili
Café salads
Caesar, Classic, Greek
Signature salads
Chicken Cobb, Chicken Cobb with Avocado, Chicken Caesar, Asian Sesame Chicken, Fuji Apple Chicken, Thai Chicken, BBQ Chicken, Mediterranean Shrimp Couscous, Greek with Shrimp, Classic with Chicken, Greek with Chicken, Power Chicken Hummus Bowl, Steak and Blue Cheese
Broth bowls
Soba Noodle with Chicken, Soba Noodle with Edamame, Lentil Quinoa with Chicken, Lentil Quinoa with Cage-Free Egg
Panera Kids
Grilled Cheese Sandwich, Peanut Butter and Jelly Sandwich, Smoked Ham Sandwich, Smoked Turkey Sandwich, Mac & Cheese, Buttered Ribbon Noodles, 10 varieties of regular and seasonal soups, 3 salads
Beverages
Coffee (hot or iced), hot teas, iced tea, iced green tea, Pepsi beverages, Dr. Pepper, bottled water, San Pellegrino, organic milk, chocolate milk, orange juice, organic apple juice, lemonade, fruit punch, Sierra Mist fountain soda
Frozen drinks
Frozen Caramel, Frozen Mocha
Espresso Bar
Espresso, cappuccino, Caffe Latte, Caffe Mocha, Vanilla Latte, Caramel Latte, Skinny Caffe Mocha, Chai Tea Latte (hot or iced), Signature Hot Chocolate

Source: Menu posted at www.panerabread.com, accessed March 18, 2015.

In 2010, Panera boosted the size of its catering sales staff and introduced sales training programs and other tools—factors that helped drive a 26 percent increase in catering sales in 2010. In 2011, Panera introduced an online catering system that catering customers could use to view the catering menu, place orders, specify whether the order was to be picked up or delivered to a specified location, and pay for purchases. The 65-item catering menu in 2015 included breakfast assortments, bagels and spreads, sandwiches and boxed lunches, salads, soups, pasta dishes, pastries and sweets, and a selection of beverages. In large geographic locations with multiple bakery-cafés, Panera operated catering-only "delivery hubs" to expedite deliveries of customer orders. Going forward, top executives at Panera believed that off-premise catering was an important revenue growth opportunity for both company-operated and franchised locations.

The MyPanera Loyalty Program In 2010, Panera initiated a loyalty program to reward customers who dined frequently at Panera Bread locations. The introduction of the MyPanera program was completed systemwide in November, and by the end of December, some 4.5 million customers had signed up and become registered card members. Members presented their MyPanera card when ordering. When the card was swiped, the specific items being purchased were automatically recorded to learn what items a member liked. As Panera got an idea of a member's preferences over the course of several visits, a member's card was "loaded" with such "surprises" as complimentary bakery-café items, exclusive previews and tastings, cooking and baking tips, invitations to special events, ideas for entertaining, or recipe books. On a member's next visit, when an order was placed and the card swiped, order-taking personnel informed the member of the surprise award. Members could also go online at www.MyPanera.com and see if a reward was waiting on their next visit. In March 2015, the company's MyPanera program had over 19 million members, and in both 2013 and 2014, approximately 50 percent of the transactions at Panera Bread bakery-cafés were attached to a MyPanera loyalty card.

Management believed that the loyalty program had two primary benefits. One was to entice members to dine at Panera more frequently and thereby deepen the bond between Panera Bread and its most loyal customers. The second was to provide Panera management with better marketing research data on the purchasing behavior of customers and enable Panera to refine its menu selections and market messages.

The Panera 2.0 Marketing Initiative In 2012, Panera began testing a newly developed Panera 2.0 app that enabled digital ordering and payment by customers and that included capabilities store employees and managers could use to perform an assortment of internal operating activities. The app was adaptable to the differentiated needs of dine-in, to-go, and large-order delivery customers The tests in 14 bakery-cafés were such a huge success that Panera began rolling out the full Panera 2.0 experience to its entire network of company-operated and franchised bakery cafés in 2013, a process that management expected to complete in 2016. Introduction of the "Rapid Pickup" component of Panera 2.0, which featured mobile ordering and payment for customers picking up orders at a particular bakery-café, was completed systemwide in early 2015. Management expected the Panera 2.0 technology to enhance the guest experience, aid the introduction of marketing innovations, permit cost-efficient handling of a growing number of customer transactions volumes, and pave the way for greater operating efficiencies in its bakery-cafés.

Panera's Nonprofit Pay-What-You-Want Bakery-Café Locations In May 2010, Panera Bread converted one of its restaurants in a wealthy St. Louis suburb into a nonprofit pay-what-you-want Saint Louis Bread Cares bakery-café with the idea of helping to feed the needy and raising money for charitable work. A sign in the bakery-café said, "We encourage those with the means to leave the requested amount or more if you're able. And we encourage those with a real need to take a discount." The menu board listed "suggested funding levels," not prices. Payments went into a donation box, with the cashiers providing change and handling credit card payments. The hope was that enough generous customers would donate money above and beyond the menu's suggested funding levels to subsidize discounted meals for those who were experiencing economic hardship and needed help. The restaurant was operated by Panera's charitable Panera Bread Foundation; all profits from the store were donated to community programs.

After several months of operation, the Saint Louis Bread Cares store was judged to be successful enough that Ron Shaich, who headed the Panera Bread Foundation, opted to open two similar Panera Cares cafés—one in the Detroit suburb of Dearborn, Michigan, and one in Portland, Oregon. At one juncture, Panera statistics indicated that roughly 60 percent of store patrons left the suggested amount; 20 percent left more, and 20 percent less.[5] Of course, there were occasional instances in which a patron tried to game the system. Ron Shaich cited the case of a college student who ordered more than $40 worth of food and charged only $3 to his father's credit card; Shaich, who happened to be working in the store behind the counter, had to restrain himself, saying "I wanted to jump over the counter."[6] One person paid $500 for a meal, the largest single payment. Although in May 2011, Panera had intentions to open a new pay-what-you-want store every three months or so, the company still had only three pay-what-you-want café locations as of April 2012, but two locations were added in the next nine months—one in Chicago and one in Boston. Panera expected to serve over 1 million people at the five pay-what-you-can locations in 2013.[7] Statistics showed that in 2013, about 60 percent of store patrons left the suggested amount, 20 percent left more, and 20 percent less, often significantly less.[8]

In March 2013, Panera introduced a special "Meal of Shared Responsibility"—turkey chili in a bread bowl—at a suggested retail price of $5.89 (tax included) at 48 locations in the St. Louis area. The idea was that the needy could get a nutritious 850-calorie meal for whatever they could afford to pay, while those who pay above the company's cost make up the difference.[9] The program was supported by heavy media coverage at launch, extensive in-store signage, and employees explaining how the meal worked. For the first three weeks, customers on average paid above the retail value, but then payments dropped off to an average of around 75 percent of retail value. After six weeks, in-store signage was taken down to promote other meal options and the conversation about the "Meal of Shared Responsibility" faded into the background. Then in July 2013, after serving about 15,000 of the turkey chili meals, Panera canceled the program, chiefly because few needy people were participating—an outcome attributed largely to most Panera locations in the St. Louis area being located in middle-class and affluent neighborhoods. Management indicated it would rethink its approach to social responsibility and possibly retool the program. Later in 2014, the Chicago location of Panera Cares was closed, but the other four locations were still open in March 2015.

Marketing

In the company's early years, marketing had played only a small role in Panera's success. Brand awareness had been built on customers' satisfaction with their dining experience at Panera and their tendency to share their positive experiences with friends and neighbors. From time to time, Panera had utilized focus groups to determine customer food and drink preferences and price points. In 2006, Panera's marketing research indicated that about 85 percent of consumers who were aware that there was a Panera Bread bakery-café in their community or neighborhood had dined at Panera on at least one occasion; 57 percent of consumers who had "ever tried" dining at Panera Bread had been customers in the past 30 days.[10] Panera's research also showed that people who dined at Panera Bread very frequently or moderately frequently typically did so for only one part of the day, although 81 percent indicated "considerable willingness" to try dining at Panera Bread at other parts of the day.

This data prompted management to pursue three marketing initiatives during 2006–2007. One aimed at raising the quality of awareness about Panera by continuing to feature the caliber and appeal of its breads and baked goods, by hammering home the theme "food you crave, food you can trust," and by enhancing the appeal of its bakery-cafés as a neighborhood gathering place. A second initiative sought to raise awareness and boost customer trials of dining at Panera Bread at multiple meal times (breakfast, lunch, "chill out" times, and dinner). The third initiative was to increase perception of Panera Bread as a viable evening meal option by introducing a number of new entrée menu selections. Panera avoided hard-sell or "in your face" marketing approaches, preferring instead to employ a range of ways to softly drop the Panera Bread name into the midst of consumers as they moved through their lives and let them "gently collide" with the brand. The idea was to let consumers "discover" Panera Bread and then convert them into loyal repeat customers by providing a very satisfying dining experience when they tried Panera bakery-cafés for the first time or opted to try dining at Panera at a different part of the day, particularly during breakfast or dinner as opposed to the busier lunchtime hours. These initiatives were only partially successful, partly because of the difficult economic environment that emerged in 2008–2009 and partly because the new dinner entrées that were introduced did not prove popular enough to significantly boost dinner-hour traffic and were dropped from the menu; in 2011–2012, the only hot entrée on the menu was Mac & Cheese. But in 2013–2014, new entrees appeared in growing numbers during the five annual celebration periods.

Panera management was committed to growing sales at existing and new unit locations, continuously improving the customer experience at its restaurants, and encouraging frequent customer visits via the new menu items featured during the periodic celebrations, increased enrollment of patrons in the MyPanera loyalty programs, and efforts to strengthen relationships with customers who, management believed, would then recommend dining at Panera to their friends and acquaintances. Panera hired a new chief marketing officer and a new vice president of marketing in 2010; both had considerable consumer marketing experience and were playing an important role in crafting the company's long-term marketing strategy to increase awareness of the Panera brand, develop and promote appealing new menu selections, expand customer participation in the MyPanera loyalty program, and otherwise make dining at Panera bakery-cafés a pleasant and satisfying experience.

To promote the Panera brand and menu offerings to target customer groups, Panera employed a mix of radio, billboards, social networking, the Internet, and periodic cable television advertising campaigns. In recent years, Panera had put considerable effort into (a) improving its advertising messages to better capture the points of difference and the soul of the Panera concept and (b) doing a better job of optimizing the media mix in each geographic market.

Whereas it was the practice at many national restaurant chains to spend 3 to 5 percent of revenues on media advertising, Panera's advertising expenses had typically been substantially lower, running as low as 0.6 percent of systemwide sales at company-owned and franchised bakery-cafés in 2008. But in the past five years, Panera had started upping its advertising effort to help spur sales growth. Advertising expenses totaled $33.2 million in 2011 (1.00 percent of systemwide bakery-café sales), $44.5 million in 2012 (1.15 percent of systemwide bakery-café sales), $55.6 million in 2013 (1.30 percent of systemwide bakery-café sales), and $65.5 million in 2014 (1.45 percent of systemwide bakery-café sales). The increased advertising expenses in 2014 were to support Panera's first-ever national television advertising campaign, an initiative that was financed by both Panera and its franchisees.

Panera's franchise agreements required franchisees to contribute a specified percentage of their net sales to advertising. In 2013, Panera's franchise-operated bakery-cafés were required to contribute 1.8 percent of their sales to a national advertising fund and to pay Panera a marketing administration fee equal to 0.4 percent of their sales; Panera contributed the same net sales percentages from company-owned bakery-cafés toward the national advertising fund and the marketing administration fee. Franchisees were also required in 2013 to spend amounts equal to 1.6 percent of their net sales on advertising in their local markets. Over the past eight years, Panera had raised the contribution of both company-owned and franchised bakery cafés to the national advertising fund—from 0.4 percent of net sales prior to 2006 to 0.7 percent beginning January 2006 to 1.2 percent beginning July 2010 to 1.6 percent starting April 2012. However, to help offset these increases, the amounts franchisees were expected to spend for local advertising had been reduced from 2.0 percent of net sales beginning July 2010 to 1.6 percent of net sales beginning April 2012. Under the terms of its franchise agreements, Panera had the right to increase national advertising fund contributions to a maximum of 2.6 percent of net sales.

To support the new national advertising campaign beginning in 2014, Panera exercised its right to require franchisees to pay the maximum 2.6 percent of net sales to the company's national advertising fund. However, the marketing administration fee of 0.4 percent of net sales remained unchanged and the required percentage franchisees had to spend on advertising in their respective local market areas was reduced from 1.6 percent to 0.8 percent beginning January 2014.

Franchise Operations

Opening additional franchised bakery-cafés was a core element of Panera Bread's strategy and management's initiatives to achieve the company's revenue growth and earnings targets. Panera Bread did not grant single-unit franchises, so a prospective franchisee could not open just one bakery-café. Rather, Panera Bread's franchising strategy was to enter into franchise agreements that required the franchise developer to open a number of units, typically 15 bakery-cafés in a period of six years. Franchisee candidates had to be well-capitalized, have a proven track record as excellent multi-unit restaurant operators, and agree to meet an aggressive development schedule. Applicants had to meet eight stringent criteria to gain consideration for a Panera Bread franchise:

- Experience as a multi-unit restaurant operator
- Recognition as a top restaurant operator
- Net worth of $7.5 million
- Liquid assets of $3 million
- Infrastructure and resources to meet Panera's development schedule for the market area the franchisee was applying to develop
- Real estate experience in the market to be developed
- Total commitment to the development of the Panera Bread brand
- Cultural fit and a passion for fresh bread

Exhibit 6 shows estimated costs of opening a new franchised Panera Bread bakery-café. The franchise agreement typically required the payment of a $5,000 development fee for each bakery-café contracted for in a franchisee's "area development agreement," a franchise fee of $30,000 per bakery-café (payable in a lump sum at least 30 days prior to the scheduled opening of a new bakery-café), and continuing royalties of 5 percent on gross sales at each franchised bakery-café. Franchise-operated bakery-cafés followed the same standards for in-store operating standards, product quality, menu, site selection, and bakery-café construction as did company-owned bakery-cafés. Franchisees were required to purchase all of their dough products from sources approved by Panera Bread. Panera's fresh dough facility system supplied fresh dough products to substantially all franchise-operated bakery-cafés. Panera did not finance franchisee construction or area development agreement payments, or hold an equity interest in any of the franchise-operated bakery-cafés. All area development agreements executed after March 2003 included a clause allowing Panera Bread the right to purchase all bakery-cafés opened by the franchisee at a defined purchase price at any time five years after the execution of the franchise agreement. In 2010, Panera purchased 37 bakery-cafés from the franchisee in the New Jersey market and sold 3 bakery-cafés in the Mobile, Alabama, market to an existing franchisee. In 2011, Panera completed the purchase of 25 bakery-cafés owned by its Milwaukee franchisee and 5 bakery-cafés owned by an Indiana franchisee; also in 2011, Panera sold 2 Paradise Bakery & Café units to a Texas franchisee and terminated the franchise agreements for 13 Paradise bakery-cafes that were subsequently rebranded by the former franchisee. In 2012, Panera acquired 16 bakery-cafés from a North Carolina franchisee, and in 2013, it acquired 1 bakery-café from a Florida franchisee.

As of January 2015, Panera Bread had agreements with 37 franchise groups that operated 955 bakery-cafés. Panera's largest franchisee operated nearly 200 bakery-cafés in Ohio, Pennsylvania, West Virginia, Kentucky, and Florida. The company's franchise groups had committed to opening an additional 106 bakery-cafés. If a franchisee failed to develop bakery-cafés on schedule, Panera had the right to terminate the franchise agreement and develop its own company-operated locations or develop locations through new franchisees in that market. However, Panera from time to time agreed to modify the commitments of franchisees to open new locations when unfavorable market conditions or other circumstances warranted the postponement or cancellation of new unit openings.

Panera provided its franchisees with support in a number of areas: market analysis and site selection assistance, lease review, design services and new store opening assistance, a comprehensive 10-week initial training program, a training program for hourly employees, manager and baker certification, bakery-café certification, continuing education classes, benchmarking data regarding costs and profit margins, access to company-developed marketing and advertising programs, neighborhood marketing assistance, and calendar planning assistance.

Site Selection and Café Environment

Bakery-cafés were typically located in suburban, strip mall, and regional mall locations. In evaluating

EXHIBIT 6

Estimated Initial Investment for a Franchised Panera Bread Bakery-Café, 2012

Investment Category	Actual or Estimated Amount	To Whom Paid
Development fee	$5,000 per bakery-café contracted for in the franchisee's Area Development Agreement	Panera
Franchise fee	$35,000 ($5,000 of the development fee was applied to the $35,000 franchise fee when a new bakery-café was opened)	Panera
Real property	Varies according to site and local real estate market conditions	
Leasehold improvements	$334,000 to $938,500	Contractors
Equipment	$198,000 to $310,000	Equipment vendors, Panera
Fixtures	$32,000 to $54,000	Vendors
Furniture	$28,500 to $62,000	Vendors
Consultant fees and municipal impact fees (if any)	$51,500 to $200,250	Architect, engineer, expeditor, others
Supplies and inventory	$19,150 to $24,350	Panera, other suppliers
Smallwares	$24,000 to $29,000	Suppliers
Signage	$15,000 to $84,000	Suppliers
Additional funds (for working capital and general operating expenses for 3 months)	$175,000 to $245,000	Vendors, suppliers, employees, utilities, landlord, others
Total	**$917,150 to $1,984,100, plus real estate and related costs**	

Source: www.panerabread.com, accessed April 5, 2012.

a potential location, Panera studied the surrounding trade area, demographic information within that area, and information on nearby competitors. Based on analysis of this information, including utilization of predictive modeling using proprietary software, Panera developed projections of sales and return on investment for candidate sites. Cafés had proven successful as free-standing units and as both in-line and end-cap locations in strip malls and large regional malls.

The average Panera bakery-café size was approximately 4,500 square feet. Most all company-operated locations were leased. Lease terms were typically for 10 years, with one, two, or three 5-year renewal option periods. Leases typically entailed charges for minimum base occupancy, a proportionate share of building and common area operating expenses and real estate taxes, and a contingent percentage rent based on sales above a stipulated amount. Some lease agreements provided for scheduled rent increases during the lease term. The average construction, equipment, furniture and fixture, and signage cost for the 65 company-owned bakery-cafés opened in 2014 was $1,400,000 (excluding capitalized development overhead expenses), compared to average costs of $750,000 for 42 company-owned bakery-cafés opened in 2010 and $920,000 for 66 company-owned bakery-cafés opened in 2005.

Each bakery-café sought to provide a distinctive and engaging environment (what management referred to as "Panera Warmth"), in many cases using fixtures and materials complementary to the neighborhood location of the bakery-café. All Panera cafés used real china and stainless silverware, instead of paper plates and plastic utensils. In 2005–2006, the company had introduced a new café design aimed at further refining and enhancing the appeal of Panera bakery-cafés as a warm and appealing neighborhood gathering place. The design incorporated higher-quality furniture, cozier seating, comfortable gathering areas, and relaxing décor. A number of locations had fireplaces to further create an alluring and hospitable atmosphere that patrons would flock to on a regular basis, sometimes for a meal with or without friends and acquaintances and sometimes to take a break for a light snack or beverage. Many locations had outdoor seating, and all company-operated and most franchised locations had free wireless Internet to help make the bakery-cafés community gathering places where people could catch up on some work, hang out with friends, read the paper, or just relax (a strategy that Starbucks had used with great success).

In 2006, Panera began working on store designs and operating systems that would enable free-standing and end-cap locations to incorporate a drive-thru window. In 2010–2011, increasing numbers of newly opened locations, both company-owned and franchised, featured drive-thru windows. Some existing units had undergone renovation to add a drive-thru window. Going into 2012, about 50 Panera Bread locations had drive-thru windows. Sales at these locations ran about 20 percent higher on average than units without drive-thru capability.

Bakery-Café Operations

Panera's top executives believed that operating excellence was the most important element of Panera Warmth and that without strong execution and operational skills and energized café personnel who were motivated to provide pleasing service, it would be difficult to build and maintain a strong relationship with the customers patronizing its bakery-cafés. Additionally, top management believed high-quality restaurant management was critical to the company's long-term success. Bakery-café managers were provided with detailed operations manuals, and all café personnel received hands-on training, both in small group and individual settings. The company had created systems to educate and prepare café personnel to respond to a customer's questions and do their part to create a better dining experience. Management strived to maintain adequate staffing at each café and had instituted competitive compensation for café managers and both full-time and part-time café personnel (who were called associates).

Panera executives had established a "Joint Venture Program," whereby selected general managers and multi-unit managers of company-operated bakery cafés could participate in a bonus program based upon a percentage of the store profit of the bakery-cafés they operated. The bonuses were based on store profit percentages generally covering a period of five years, and the percentages were subject to annual minimums and maximums. Panera management believed the program's multiyear approach (a) improved operator quality and management retention, (b) created team stability that generally resulted in a higher level of operating consistency and customer service for a particular bakery-café, (c) fostered a low rate management turnover, and (d) helped drive operating improvements at the company's bakery-cafés. In 2013–2014, approximately 45 percent of the bakery-café operators Panera's company-owned locations participated in the Joint Venture Program.

Going into 2014, Panera Bread had approximately 45,400 employees. Approximately 42,700 were employed in Panera's bakery-cafe operations as bakers, managers, and associates, approximately 1,400 were employed in the fresh dough facility operations, and approximately 1,300 were employed in general or administrative functions, principally in the company's support centers. Roughly 25,500 employees worked, on average, at least 25 hours per week. Panera had no collective bargaining agreements with its associates and considered its employee relations to be good.

Panera's Bakery-Café Supply Chain

Panera operated a network of 24 facilities (22 company-owned and 2 franchise-operated) to supply fresh dough for breads and bagels on a daily basis to almost all of its company-owned and franchised bakery-cafés; one of the company's 22 facilities was a limited production operation co-located at a company-owned bakery-café in Ontario, Canada, that supplied dough to 12 Panera bakery-cafés in that market. All of the company's facilities were leased. Most of the 1,400 employees at these facilities were engaged in preparing dough for breads and bagels, a process that took about 48 hours. The dough-making process began with the preparation and mixing of starter dough, which then was given time to rise; other all-natural ingredients were then added to create the dough for each of the different bread and bagel varieties (no chemicals or preservatives were used). Another period of rising then took place. Next, the dough was cut into pieces, shaped into loaves or bagels, and readied for shipment in fresh dough form. There was no freezing of the dough, and no partial baking was done at the fresh dough facilities. Trained bakers at each bakery-café performed all of the baking activities, using the fresh doughs delivered daily.

Distribution of the fresh bread and bagel doughs (along with tuna, cream cheese spreads, and certain fresh fruits and vegetables) was accomplished through a leased fleet of about 225 temperature-controlled trucks operated by Panera personnel. The optimal maximum distribution route was approximately 300 miles; however, routes as long as 500 miles were sometimes necessary to supply cafés in outlying locations. In 2013–2014, the various distribution routes for regional facilities entailed making daily deliveries to eight to nine bakery-cafés.

Panera obtained ingredients for its doughs and other products manufactured at its regional facilities. While a few ingredients used at these facilities were sourced from a single supplier, there were numerous suppliers of each ingredient needed for fresh dough and cheese spreads. Panera contracted externally for the manufacture and distribution of sweet goods to its bakery-cafés. After delivery, sweet good products were finished with fresh toppings and other ingredients (based on Panera's own recipes) and baked to Panera's artisan standards by professionally trained bakers at each café location.

Panera had arrangements with several independent distributors to handle the delivery of sweet goods products and other items to its bakery-cafés, but the company had contracted with a single supplier to deliver the majority of ingredients and other products to its bakery-cafés two or three times weekly. Virtually all other food products and supplies for their bakery-cafés, including paper goods, coffee, and smallwares, were contracted for by Panera and delivered by the vendors to designated independent distributors for delivery to the bakery-cafés. Individual bakery-cafés placed orders for the needed supplies directly with a distributor; distributors made deliveries to bakery-cafés two or three times per week. Panera maintained a list of approved suppliers and distributors that all company-owned and franchised cafés could select from in obtaining food products and other supplies not sourced from the company's regional facilities or delivered directly by contract suppliers.

Although many of the ingredients and menu items sourced from outside vendors were prepared to Panera's specifications, the ingredients for a big majority of menu selections were generally available and could be obtained from alternative sources when necessary. In a number of instances, Panera had entered into annual and multiyear contracts for certain ingredients in order to decrease the risks of supply interruptions and cost fluctuation. However, Panera had only a limited number of suppliers of antibiotic-free chicken; because there were relatively few producers of meat products raised without antibiotics—as well as certain other organically grown items—it was difficult or more costly for Panera to find alternative suppliers.

Management believed the company's fresh dough-making capability provided a competitive advantage by ensuring consistent quality and dough-making efficiency (it was more economical to concentrate the dough-making operations in a few facilities dedicated to that function than it was to have each bakery-café equipped and staffed to do all of its baking from scratch). Management also believed that the company's growing size and scale of operations gave it increased bargaining power and leverage with suppliers to improve ingredient quality and cost, and that its various supply-chain arrangements entailed little risk that its bakery-cafés would experience significant delivery interruptions from weather conditions or other factors that would adversely affect café operations.

The fresh dough made at the regional facilities was sold to both company-owned and franchised bakery-cafés at a delivered cost not to exceed 27 percent of the retail value of the product. Exhibit 7 provides financial data relating to each of Panera's three business segments: company-operated bakery-cafés, franchise operations, and the operations of the regional facilities that supplied fresh dough and other products. The sales and operating profits of the fresh dough and other products segment shown in Exhibit 7 represent only those transactions with franchised bakery-cafés. The company classified any operating profit of the regional facilities stemming from supplying fresh dough and other products to company-owned bakery-cafés as a reduction

EXHIBIT 7

Business Segment Information, Panera Bread Company, 2009–2014 (in thousands of dollars)

	2014	2013	2012	2011	2009
Segment revenues:					
Company bakery-café operations	$2,230,370	$2,108,908	$1,879,280	$1,592,951	$1,153,255
Franchise operations	123,686	112,641	102,076	92,793	78,367
Fresh dough and other product operations at regional facilities	370,004	347,922	312,308	275,096	216,116
Intercompany sales eliminations	(194,865)	(184,469)	(163,607)	(138,808)	(94,244)
Total revenues	$2,529,195	$2,385,002	$2,130,057	$1,822,032	$1,353,494
Segment operating profit:					
Company bakery-café operations	$400,261	$413,474	$380,432	$307,012	$193,669
Franchise operations	117,770	106,395	95,420	86,148	72,381
Fresh dough and other product operations at regional facilities	22,872	21,293	17,695	20,021	21,643
Total segment operating profit	$540,903	$541,162	$493,547	$413,181	$287,693
Depreciation and amortization:					
Company bakery-café operations	$103,239	$ 90,872	$78,198	$68,651	$55,726
Fresh dough and other product operations at regional facilities	8,613	8,239	6,793	6,777	7,620
Corporate administration	12,257	7,412	5,948	4,471	3,816
Total	$124,109	$106,523	$90,939	$79,899	$67,162
Capital expenditures:					
Company bakery-café operations	$167,856	$153,584	$122,868	$ 94,873	$46,408
Fresh dough and other product operations at regional facilities	12,178	11,461	13,434	6,483	3,681
Corporate administration	44,183	26,965	16,026	6,576	4,595
Total capital expenditures	$224,217	$192,010	$152,328	$107,932	$54,684
Segment assets:					
Company bakery-café operations	$953,896	$867,093	$807,681	$682,246	$498,806
Franchise operations	13,145	10,156	10,285	7,502	3,850
Fresh dough and other product operations at regional facilities	65,219	62,854	60,069	47,710	48,616
Total segment assets	$1,390,902	$940,103	$878,035	$737,458	$551,272

Source: Panera Bread's 2014 10-K Report, p. 66; 2013 10-K Report, p. 67; and 2011 10-K Report, p. 69.

in the cost of food and paper products. The costs of food and paper products for company-operated bakery-cafés are shown in Exhibit 1.

Panera Bread's Management Information Systems

Each company-owned bakery-café had programmed point-of-sale registers that collected transaction data used to generate transaction counts, product mix, average check size, and other pertinent statistics. The prices of menu selections at all company-owned bakery-cafés were programmed into the point-of-sale registers from the company's data support centers. Franchisees were allowed access to certain parts of Panera's proprietary bakery-café systems and systems support; they were responsible for providing the appropriate menu prices, discount rates, and tax rates for system programming.

The company used in-store enterprise application tools and the capabilities of the Panera 2.0 app to (1) assist café managers in scheduling work hours for café personnel and controlling food costs in order to provide corporate and retail operations management with quick access to retail data, (2) enable café managers to place online orders with distributors, and (3) reduce the time café managers spent on administrative activities. The information collected electronically at café registers was used to generate daily and weekly consolidated reports regarding sales, transaction counts, average check size, product mix, sales trends, and other operating metrics, as well as detailed profit-and-loss statements for company-owned bakery-cafés. This data was incorporated into the company's "exception-based reporting" tools.

Panera's regional facilities had software that accepted electronic orders from bakery-cafés and monitored delivery of the ordered products back to the bakery-cafés. Panera also had developed proprietary digital software to provide online training to employees at bakery-cafés and online baking instructions for the baking personnel at each café.

Most of Panera's bakery-cafés provided customers with free Internet access through a managed WiFi network that was among the largest free public WiFi networks in the United States.

New Developments at Panera Bread, April 2015

In mid-April 2015, following a "constructive dialogue" with activist shareholder Luxor Capital Group, Panera Bread announced that it would (a) expand its share-repurchase plan from $600 million to $750 million, (b) sell 73 of its 925 company-owned bakery-cafés to franchisees to raise money to help fund the added expenditures on repurchasing outstanding shares of the company's common stock, and (c) borrow $500 million to help fund the share-buyback plan. Panera's stock price jumped nearly 12 percent on the day of the announcement. In February 2015, Panera had warned that it expected earnings per share in 2015 would, at best, be flat in comparison to the $6.64 the company earned in 2014.

Luxor, a hedge fund based in New York, had previously been a part of an activist shareholder group that had prodded another restaurant chain to make operating improvements and repurchase shares of stock, partly using debt to fund the share buyback. Analysts said the pressure Luxor put on Panera could spur management to increase its efforts to make needed operating improvements in its stores: some diners and Panera's bakery cafés had complained about long lines to pay for food and slow delivery of orders to diners' tables. While Panera's rollout of Panera 2.0 was intended to speed service and checkout, as well as enable other operating efficiencies, some investors were concerned that Panera 2.0 was being implemented too slowly and were skeptical whether the new software would actually improve internal operating efficiency and boost customer traffic outside the lunch hour by as much as Panera executives hoped.

The Restaurant Industry in the United States

According to the National Restaurant Association, total food-and-drink sales at some 1 million food service locations of all types in the United States were projected to reach a record $709 billion in 2014, up 3.8 percent over 2014 and up from $379 billion in 2000 and $239 billion in 1990.[11] Of the projected $709 billion in food-and-drink sales industry-wide in 2014, about $471 billion were expected to occur in commercial restaurants, with the remainder divided among bars and taverns, lodging place restaurants, managed food service locations, military restaurants, and other types of retail, vending, recreational, and mobile operations with food service capability. In 2012, unit sales averaged $875,000 at full-service restaurants and $803,000 at quick-service restaurants; however, very popular restaurant locations achieved annual sales volumes in the $2.5 million to $5 million range.

Restaurants were the nation's second largest private employer in 2014 with almost 14 million employees. Nearly half of all adults in the United States had worked in the restaurant industry at some point in their lives, and close to one out of three adults got their first job experience in a restaurant. More than 90 percent of all eating-and-drinking place businesses had fewer than 50 employees, and more than 70 percent of these places were single-unit operations.

Even though the average U.S. consumer ate 76 percent of their meals at home, on a typical day, about 130 million U.S. consumers were food service patrons at an eating establishment. Sales at commercial eating places were projected to average about $1.9 billion daily in 2015. Average household expenditures for food away from home in 2013 were $2,625, equal to about 40 percent of total household expenditures for food.[12]

The restaurant business was labor-intensive, extremely competitive, and risky. Industry members pursued differentiation strategies of one variety of another, seeking to set themselves apart from rivals via pricing, food quality, menu theme, signature menu selections, dining ambiance and atmosphere, service, convenience, and location. To further enhance their appeal, some restaurants tried to promote greater customer traffic via happy hours, lunch and dinner specials, children's menus, innovative or trendy dishes, diet-conscious menu selections, and beverage/appetizer specials during televised sporting events (important at restaurants/bars with big-screen TVs). Most restaurants were quick to adapt their menu offerings to changing consumer tastes and eating preferences, frequently featuring heart-healthy, vegetarian, organic, low-calorie, and/or low-carb items on their menus. Research conducted by the National Restaurant Industry in 2014 indicated that:[13]

- 64 percent of consumers considered themselves to be more adventurous in their restaurant food choices than they were two years ago.
- 76 percent of consumers were more likely to visit a restaurant that offered healthy menu options.
- 79 percent of consumers say restaurant technology increases convenience.

It was the norm at many restaurants to rotate some menu selections seasonally and to periodically introduce creative dishes in an effort to keep regular patrons coming back, attract more patrons, and remain competitive.

The profitability of a restaurant location ranged from exceptional to good to average to marginal to money-losing. Consumers (especially those that ate out often) were prone to give newly opened eating establishments a trial, and if they were pleased with their experience, they might return, sometimes frequently; loyalty to existing restaurants was low when consumers perceived there were better dining alternatives. It was also common for a once-hot restaurant to lose favor and confront the stark realities of a dwindling clientele, forcing it to either reconceive its menu and dining environment or go out of business. Many restaurants had fairly short lives. There were multiple causes for a restaurant's failure: a lack of enthusiasm for the menu or dining experience, inconsistent food quality, poor service, a poor location, meal prices that patrons deemed too high, and being outcompeted by rivals with comparable menu offerings.

ENDNOTES

[1]Harris Interactive press releases, March 16, 2011 and May 10, 2012, and information posted at www.harrisinteractive.com (accessed March 7, 2014).

[2]"Zagat Announces 2012 Fast-Food Survey Results," www.prnewswire.com, September 27, 2012 (accessed March 7, 2014).

[3]Sandelman and Associates Quick-Track surveys and Fast-Food Awards of Excellence Winners, and information included in "Press Kit" posted at www.panerabread.com (accessed March 7, 2014).

[4]As stated in a presentation to securities analysts, May 5, 2006.

[5]Ron Ruggless, "Panera Cares: One Year Later," *Nation's Restaurant News,* May 16, 2011, posted at www.nrn.com (accessed July 19, 2011).

[6]Sean Gregory-Clayton, "Sandwich Philanthropy," *Time,* August 2, 2010, posted at www.time.com. (accessed July 19, 2011).

[7]Annie Gasparro, "A New Test for Panera's Pay-What-You-Can," *Wall Street Journal,* June 4, 2013, posted at www.wsj.com (accessed March 7, 2014).

[8]Ibid.

[9]Jim Salter, "Panera Suspends Latest Pay-What-You-Can Experiment in Stores," www.huffingtonpost.com, July 10, 2013 (accessed March 7, 2014).

[10]As cited in Panera Bread's presentation to securities analysts on May 5, 2006.

[11]The statistical data in this section is based on information posted at www.restaurant.org (accessed July 26, 2011, April 8, 2012, and March 18, 2015).

[12]Bureau of Labor Statistics, news release, September 9, 2014 (accessed at www.bls.gov, March 18, 2015).

[13]National Restaurant Industry, "2015 Restaurant Industry Pocket Factbook," posted at www.restaurant.org (accessed March 18, 2015).v