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Panera Bread's Strong Run

Fading Starbucks Gives Way to Panera's Bread and Butter

By JOHN JANNARONE

History is studded with restaurants whose stars stayed aligned for long stretches while rivals struggled. And then abruptly plunged back to Earth. There was McDonald's in the 1980s, then Starbucks for 15 years following its 1992 initial public offering.

Reuters

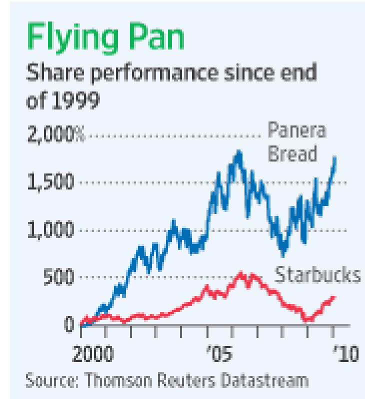
Panera Bread's saturation point may be a ways off.

Today such performers are rare, with many restaurants still recovering from overexpansion during the last decade. Starbucks Wednesday said sales rose 4% last quarter at stores open at least a year. While that's an encouraging performance, it was made easier by a 9% decline in the same period a year earlier. Casual restaurants have fared even worse. Same-store sales fell 3.1% last quarter at Chili's operator Brinker International, having fallen 4.5% a year earlier.

At least one high-flyer remains: Panera Bread has seen its shares outperform every major restaurant stock over the last 10 years. Wednesday evening, the company said same-store sales rose 7.4% in the December quarter, well above guidance for growth between 3% and 5%. The growth has averaged 3.5% over the last four years. The stock rose 8% Thursday and Friday.

How long can Panera's run last? In a way, its store growth looks similar to the rapid expansion that eventually triggered catastrophes for the likes of Brinker and Starbucks. Panera added about 70 stores in 2009 and plans another 100 or so this year.

But with around 1,500 stores in the U.S. and Canada, Panera's saturation point may still be a ways off. It operates in a niche between fast-food and casual dining, which can likely accommodate more capacity. In contrast, the casual dining segment occupied by the likes of Chili's and Olive Garden has more than 10% excess capacity, reckons John Glass of Morgan Stanley. Fast-food restaurants such as McDonald's and Burger King are currently under pressure, with many facing a decline in same store sales. But now that demand has started to stabilize, the number of restaurants looks reasonably balanced, he says.



Panera's top line has also held up because it avoided discounts during the recession. Chili's and McDonalds have both relied on specially-priced deals that squeezed margins and may be tough to remove from menus.

Panera and Starbucks have little room for error, with both stocks trading around 21 times this calendar year's consensus earnings. Each company also has operating margins around 10%. Panera still has room to expand for a few years without eating into demand from its existing restaurants or resorting to marginal locations. Starbucks, however, is opening new stores at a slower pace and it needs to execute with near perfection at existing shops. Of the two, Panera has a brighter glow.