CASE 29

Panera Bread Company:

RISING FORTUNES?

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BREAD, ESSENTIAL AND BASIC, BUT NONETHELESS SPECIAL, TRANSCENDS MILLENNIA. A master baker combines simple ingredients to create what has been an integral part of society and culture for over 6,000 years. Sourdough bread, a uniquely American creation, is made from a "culture," or "starter." Sourdough starter contains natural yeasts, flour, and water and is the medium that makes bread rise. In order to survive, a starter must be cultured, fed, and tended to by attentive hands in the right environment. Without proper care and maintenance, the yeast, or the growth factor, would slow down and die. Without a strong starter, bread would no longer rise.

Ronald Shaich, CEO and Chairman of Panera Bread Company, created the company's "starter." Shaich, the master baker, combined the ingredients and cultivated the leavening agent that catalyzed the company's phenomenal growth. Under Shaich's guidance, Panera's total systemwide (both company and franchisee) revenues rose from $350.8 million in 2000 to $977.1 million in 2003. However, new unit expansion fueled this growth. In total, 419 Panera bakery-cafes were opened between 1999 and 2003. New unit growth masked a slowdown in the growth of average annualized unit volumes (AUVs) and year-to-year comparable sales. In 2000, systemwide comparable sales and AUVs increased 9.1% and 12.0%, respectively. Growth of these two key metrics declined in each consecutive year thereafter. In 2003, systemwide comparable sales and AUVs increased only 0.2% and 0.5%. Clearly, growth has slowed. In order to continue to rise, Panera's "starter" needs to be fed and maintained. In addition to new unit growth, new strategies and initiatives must be folded into the mix.

History

Panera Bread Company's roots began with the company that could be considered the grandfather of the fast casual restaurant concept: Au Bon Pain. In 1976, French oven manufacturer Pavailler opened the first Au Bon Pain (a French colloquialism for "where good bread is") in Boston's Faneuil Hall as a demonstration bakery.[1] Struck by its growth potential, Louis Kane, a veteran venture capitalist, purchased the business in 1978.[2] Between 1978 and 1981, Au Bon Pain struggled; it had opened 13 and subsequently closed 10 stores in the Boston area and piled up $3 million in debt.[3] Kane was ready to declare bankruptcy when he gained a new business partner in Ronald Shaich.[4]

A recent Harvard Business graduate, Shaich had opened the Cookie Jar bakery in Cambridge, Massachusetts, in 1980.[5] Shortly after opening the Cookie Jar, Shaich befriended Louis Kane. Shaich was interested in adding bread and croissants to his menu to stimulate his morning sales. Shaich recalled that "50,000 people a day were going past my store, and I had nothing to sell them in the morning."[6] In February 1981, the two merged the Au Bon Pain bakeries and the cookie store to form one business, Au Bon Pain Co., Inc. The two served as Co-CEOs until Kane's retirement in 1994. They had a synergistic relationship that made Au Bon Pain successful: Shaich was the hard-driving, analytical strategist focused on operations, and Kane was the seasoned businessman with a wealth of real estate and finance connections.[7] Between 1981 and 1984, the team expanded the business, worked to decrease the company's debt, and centralized facilities for dough production.[8]

In 1985, the partners added sandwiches to bolster daytime sales, as they noticed a pattern in customer behavior: "We had all of these customers coming and ordering a baguette cut in half. Then they'd take out these lunch bags full of cold cuts and start making sandwiches. We didn't have to be marketing whizzes to know that there was an opportunity there," recalled Shaich.[9] It was a "eureka" moment and the birth of the fast casual restaurant category.[10] According to Shaich, Au Bon Pain was the "first place that gave white collar folks a choice between fast food and fine dining."[11] Au Bon Pain became a lunchtime alternative for urban dwellers who were tired of burgers and fast food. Differentiated from other fast food competitors by its commitment to fresh, quality sandwiches, bread, and coffee, Au Bon Pain attracted customers who were happy to pay more money ($5 per sandwich) than they would have paid for fast food.[12]

In 1991, Kane and Shaich took the company public. By that time, the company had $68 million in sales and was a leader in the quick service bakery segment. By 1994, the company had 200 stores and $183 million in sales, but that growth masked a problem. The company was built on a limited growth concept, what Shaich called, "high density urban feeding."[13] The main customers of the company were office workers in locations like New York, Boston, and Washington, DC. The real estate in such areas was expensive and hard to come by. This strategic factor limited expansion possibilities.[14]

Au Bon Pain acquired the St. Louis Bread Company in 1993 for $24 million.[15] Shaich saw this as the company's "gateway into the suburban marketplace."[16] The acquired company was founded in 1987 by Ken Rosenthal and consisted of a 19-store bakery-cafe chain located in the St. Louis area. The concept of the cafe was based on San Franciscan sourdough bread bakeries.[17] The acquired company would eventually become the platform for what is now Panera.

Au Bon Pain management spent two years studying St. Louis Bread Co., looking for the ideal concept that would unite Au Bon Pain's operational abilities and quality food with the broader suburban growth appeal of St. Louis Bread.[18] Scott Davis, Panera's Chief Concept Officer, recalled the time spent trying to figure out what the new business should look like. "We didn't just look at restaurants and coffee houses," he stated. "We spent a lot of time looking at retailers. That's where our front-of-the-house bakery displays came from. We knew that people buy with their eyes, so we wanted them to walk in and crave baked goods."[19]

The restaging and development of the St. Louis Bread Co. concept was also affected by the management team's understanding of a consumer backlash against the commoditization of food service—a trend that began in the 1950s and spawned a coast-to-coast sameness (e.g., McDonald's).[20] The management team understood that a growing number of consumers wanted a unique expression of tastes and styles. Shaich and his team wrote a manifesto that spelled out what St. Louis Bread would be, from the type of food it would serve to the kind of people behind the counters and the look and feel of the physical space.[21]

Au Bon Pain began pouring capital into the chain when Shaich had another "eureka" moment in 1995. He entered a St. Louis Bread store and noticed a group of business people meeting in a corner. The customers explained that they had no other place to talk.[22] This experience opened Shaich's eyes to the fact that the potential of the neighborhood bakery-cafe concept was greater than that of Au Bon Pain's urban store concept. The bakery-cafe concept capitalized on a confluence of current trends: the welcoming atmosphere of coffee shops, the food of sandwich shops, and the quick service of fast food.[23]

While Au Bon Pain was focusing on making St. Louis Bread a viable national brand, the company's namesake unit was faltering. Rapid expansion of its urban outlets had resulted in operational problems, bad real estate deals,[24] and debt over $65 million.[25] Operating margins were on a steady decline. For example, from 1993 to 1994, margins fell from 11.5% to 8.5%.[26] Margins continued to contract because of higher food costs, stagnant sales, and decreased comparable store sales. Stiff competition from bagel shops and coffee chains such as Starbucks compounded operational difficulties. Another concern was that the fast food ambiance of the stores was not appealing to customers who wanted to sit and enjoy a meal or a cup of coffee.[27] On the other hand, the cafe-style atmosphere of St. Louis Bread, which was known as Panera (Latin for "time for bread") outside the St. Louis area, was proving to be successful. In 1996, comparable sales at Au Bon Pain locations declined 3%, while same-store sales in the Panera unit were up 10%.[28]

Lacking the capital to overhaul the ambiance of the Au Bon Pain segment, the company decided to sell the unit. This left the company the time and resources to strategically focus solely on the more successful Panera chain. Unlike Au Bon Pain, Panera was not confined to a small urban niche and had greater growth potential. Panera's per-store profit of $1.3 million over Au Bon Pain's $1 million (at the time of the sale) also proved more promising. On May 16, 1999, Shaich sold the Au Bon Pain unit to investment firm Bruckman, Sherrill, and Co. for $73 million. At the time of the divestiture, the company changed its corporate name to Panera Bread Company. The sale left Panera Bread Company debt-free, and the cash allowed for the immediate expansion of its bakery-cafe stores.[29]

General Business

From what was once a small chain acquired by Au Bon Pain, Panera Bread Company grew into the leader in the fast casual dining industry. The Panera concept combined and exploited several food service qualities: (1) the casual atmosphere of coffee shops, (2) the quality food of sandwich shops, and (3) the quick service of fast food chains. The company specialized in meeting five consumer-dining needs: breakfast, lunch, daytime "chill-out," lunch in the evening, and take-home bread. Daytime chill-out is the time between breakfast and lunch and between lunch and dinner when customers stop in to take a break from their daily activities. This niche of consumers included seniors, matineegoers, shoppers, business and sales people, and students.[30] Panera provided diners with high-quality foods, including fresh baked goods, made-to-order sandwiches on fresh baked breads, soups, salads, custom roasted coffees, and other cafe beverages. Panera targeted suburban dwellers and workers by offering a premium specialty bakery and cafe experience with a neighborhood emphasis.[31] Panera was the first in the bakery-cafe segment, and its unique concept and operational strengths led it to its leading position in the fast casual dining category.

Panera's concept was designed around meeting the needs and desires of consumers, specifically the need for efficient, time-saving service and the desire for a higher-quality dining experience—something not delivered by traditional fast food chains. The company's goal was to make Panera Bread a nationally dominant brand. Its menu, quality of operations, and design and real estate strategies were vital to the company's success.

Fast Casual

Panera's predecessor Au Bon Pain was a pioneer of the fast casual restaurant category. Fast casual, also known as quick casual, emerged to fill the gap between fast food and full-service restaurants. Technomic Information Services originally coined the term to describe restaurants that offer the speed, efficiency, and inexpensiveness of fast food with the hospitality, quality, and ambiance of a full-service restaurant. Technomic defined a fast casual restaurant by whether it met the following four criteria. *One*, the restaurant had to offer a limited-service or self-service format. *Two*, the average check had to be between \$6 and \$9, whereas fast food checks averaged less than \$5. This pricing scheme placed fast casual between fast food and casual dining. The *third* criterion was that the food had to be made-to-order. Consumers perceived newly prepared, made-to-order foods as fresh. Fast casual menus usually also had more robust and complex flavor profiles than the standard fare at fast food restaurants. The *fourth* criterion required that the decor had to be upscale or highly developed. Decor inspired a more enjoyable experience for the customer as the environment of fast casual restaurants was more akin to that of a neighborhood bistro or casual restaurant. The decor also created a generally higher perception of quality.[32]

The fast casual market had enjoyed double-digit aggregate growth since 1999 and was expected to continue to grow by double digit figures.[33] Fast casual chain sales were expected to reach \$50 billion in the next decade.[34] This large growth in fast casual was expected to come at the expense of the fast food industry.

Diverse dining offerings and higher profitability contributed to the industry's growth. Food concepts within the fast casual category ranged from Mexican, to bakeries, to Chinese. Unlike fast food restaurants that construct stand-alone stores, fast casual chains locate in strip malls, on small-town main streets, and in preexisting properties. As a result, the opening costs of a fast casual store are about a third of its average annual sales volume of \$1.5 million.[35] The diversity and profitability of fast casual allowed many new players to enter the market offering new concepts and menu items.

The maturation of two large segments of the U.S. population, baby boomers and their children, was largely responsible for the growth in fast casual. Both segments had little time for cooking and grew tired of fast food, and they desired a high-quality, fresher, healthier dining experience, but did not have the time for a full dining experience. Dining trends caused fast casual to emerge as a legitimate trend in the restaurant industry as it bridged the gap between casual dining and the burgers-and-fries fast food industry.

Corporate Governance

Panera's corporate headquarters was located in St. Louis, Missouri.

Board of Directors

Shaich was the only internal board member. The biographical sketches for the board members are shown below[36]:

> ***Ronald M. Shaich*** *(age 50), Director since 1981, Co-Founder, Chairman of the Board since May 1999, Co-Chairman of the Board from January 1988 to May 1999, Chief Executive Officer since May 1994, and Co-Chief Executive Officer from January 1988 to May 1994. Shaich has served as a Director of Lown Cardiovascular Research Foundation.*
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> ***Larry J. Franklin*** *(age 55), Director since June 2001. Franklin has been the President and Chief Executive Officer of Franklin Sports, Inc., a leading branded sporting goods manufacturer and marketer, since 1986. Franklin joined Franklin Sports, Inc., in 1970 and served as its Executive Vice President from 1981 to 1986. Franklin has served on the Board of Directors of Bradford Soap International, Inc., The Sporting Goods Manufacturers Association, The Retail Industry Leadership Association, and The New England Chapter of the Juvenile Diabetes Research Foundation.*
>
> ***Fred K. Foulkes*** *(age 62), Director since June 2003. Professor Foulkes has been a Professor of Organizational Behavior and the Director of the Human Resources Policy Institute at Boston University School of Management since 1981 and has taught courses in human resource management and strategic management at Boston University since 1980. From 1968 to 1980, Professor Foulkes was a member of the Harvard Business School faculty. Foulkes has served on the Board of Directors of Bright Horizons Family Solutions and the Society for Human Resource Management Foundation.*
>
> ***Domenic Colasacco*** *(age 55), Director since March 2000. Colasacco has been President and Chief Executive Officer of Boston Trust & Investment Management, a trust company formed under Massachusetts state law, since 1992. He joined Boston Trust in 1974, after beginning his career in the research division of Merrill Lynch & Co. in New York City.*
>
> ***Thomas E. Lynch*** *(age 44), Director since June 2003. Lynch has been a Senior Managing Director of Mill Road Associates, a financial advisory firm that he founded in 2000. From 1997 through 2000, Lynch was the founder and Managing Director of Lazard Capital Partners, a private equity firm affiliated with the investment bank Lazard. From 1990 to 1997, Lynch was a Managing Director at the Blackstone Group, where he was a senior investment professional for Blackstone Capital Partners. Prior to Blackstone, Lynch was a senior consultant at the Monitor Company. Lynch has served on the Board of the City Center.*
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> ***George E. Kane*** *(age 99), Director since November 1988. Kane was also a company Director from December 1981 to December 1985 and a Director Emeritus from December 1985 to November 1988. Kane retired in 1970 as President of Garden City Trust Company (now University Trust Company) and served as an Honorary Director of University Trust Company from December 1985 to January 2000. Kane became a nonvoting Honorary Director Emeritus after May 2004.*

The Compensation Committee included Franklin, Foulkes, and Colasacco. The Committee on Nominations included Franklin, Lynch, and Kane. The Audit Committee included Foulkes, Colasacco, Lynch, and Kane.

Directors who were not employees received a quarterly fee ranging from \$3,000 to \$3,500 for serving on the Board, plus reimbursement of out-of-pocket expenses for attendance at each Board or committee meeting. Under the Directors' Plan, each Director who is not an employee or a principal stockholder received a one-time grant of an option to purchase 10,000 shares of Class A Common Stock when he or she was first elected. Each independent Director in office at the end of the fiscal year also received an option to purchase an additional 10,000 shares of Class A Common Stock.

Exhibit 1 shows the common stock ownership in the company. There were two classes of stock: (1) Class A Stock with 28,345,754 shares outstanding and one vote per share, and (2) Class B Common Stock with 1,761,521 shares outstanding and three votes per share.

EXHIBIT 1
Stock Ownership: Panera Bread Company

Name and, with Respect to Owner of More Than 5%, Address	Class A Common		Class B Common		Combined Voting Percentage
	Number	Percent	Number	Percent	
Ronald M. Shaich c/o Panera Bread Company 6710 Clayton Road Richmond Heights, MO 63117	601,660	2.1%	1,666,381	94.6%	16.5%
Domenic Colasacco	48,862	<1%	—	—	<1%
Larry J. Franklin	40,000	<1%	—	—	<1%
George E. Kane	45,912	<1%	—	—	<1%
Fred K. Foulkes	24,000	<1%	—	—	<1%
Thomas E. Lynch	20,000	<1%	—	—	<1%
Paul E. Twohig	1,000	<1%	—	—	<1%
Mark A. Borland	—	—	—	—	—
Michael E. Hood	—	—	—	—	—
Michael J. Nolan	—	—	—	—	—
All directors, director nominees, and executive officers as a group (14 persons)	818,771	2.8%	1,666,381	94.6%	17.0%
Brown Capital Management, Inc. 1201 N. Calvert Street Baltimore, MD 21202	2,014,695	7.1%	—	—	6.0%
FMR Corp 82 Devonshire Street Boston, MA 02109	4,209,696	17.9%	—	—	12.5%

SOURCE: *Panera Bread Company, Inc., 2004 Notice of Annual Meeting of Stockholders, pp. 16–17.*

Top Management

Key Executive Officers of Panera who did not also serve on the Board (as did Shaich) were as follows[37]:

> ***Paul E. Twohig** (age 50), Executive Vice President, Chief Operating Officer since January 2003. From 1993 to 2003, Twohig served as an executive at Starbucks Coffee Company, most recently as Senior Vice President responsible for retail operations development and human resources for more than 1,200 Starbucks stores in 17 states and 5 Canadian provinces. From 1986 to 1991, Twohig was a franchisee and owned and operated four Burger King units in West Palm Beach, Florida. From 1968 to 1986, Twohig was with Burger King Corporation, serving in a variety of roles, including regional manager in New England.*
>
> ***Neal J. Yanofsky** (age 46), Executive Vice President, Chief Administrative Officer, and Corporate Staff Officer since June 2003. From June 1999 to June 2003, Yanofsky was an independent business consultant with a practice focused on strategy development for high-growth firms, including Panera. From April 1990 to June 1999, Yanofsky was Vice President of Fidelity Ventures, the private equity arm of Fidelity Investments, and served in additional capacities with Fidelity Capital, including Chief Financial Officer at Boston Coach.*
>
> ***Mark A. Borland** (age 51), Senior Vice President, Chief Supply Chain Officer since August 2002. Borland joined the company in 1986 and held management positions within Au Bon Pain and Panera Bread divisions until 2000, including Executive Vice President, Vice President of Retail Operations, Chief Operating Officer, and President of Manufacturing Services. From*

2000 to 2001, Borland served as Senior Vice President of Operations at RetailDNA and then rejoined Panera as a consultant in the summer of 2001.

Scott G. Davis *(age 40), Senior Vice President, Chief Concept Officer since May 1999. Davis joined the company in 1987 and from May 1996 to May 1999 served as Vice President, Customer Experience. From June 1994 to May 1996, Davis served as Director of Concept Services and Customer Experience.*

Mark E. Hood *(age 51), Senior Vice President, Chief Financial Officer since April 2003. Hood joined the company in August 2002, and from August 2002 to April 2003 served as Senior Vice President, Finance and Administration. From August 2000 to April 2002, Hood served as the Chief Financial and Administrative Officer of the U.S. Loyalty Corporation. From June 1995 to September 1999, Hood served as an executive at Saks Fifth Avenue, most recently as Executive Vice President and Chief Financial and Administrative Officer. Prior to joining Saks, Hood held a number of financial positions with the May Department Stores Co. from 1983 to 1995.*

Michael J. Kupstas *(age 46), Senior Vice President, Chief Franchise Officer since September 2001. Kupstas joined the company in 1996. Between August 1999 and September 2001, Kupstas served as Vice President, Franchising and Brand Communication. Between January 1996 and August 1999, Kupstas was Vice President, Company and Franchise Operations. Between April 1991 and January 1996, Kupstas was Senior Vice President/Division Vice President for Long John Silver's, Inc.*

John M. Maguire *(age 38), Senior Vice President, Chief Company and Joint Venture Operations Officer since August 2001. Maguire joined the company in April 1993. From April 2000 to July 2001, Maguire served as Vice President, Bakery Operations. From November 1998 to March 2000, Maguire served as Vice President, Commissary Operations. From April 1993 to October 1998, Maguire was a Manager and Director of Au Bon Pain/Panera Bread/St. Louis Bread.*

Michael J. Nolan *(age 44), Senior Vice President, Chief Development Officer since he joined the company in August 2001. From December 1997 to March 2001, Nolan served as Executive Vice President & Director for John Harvard's Brew House, L.L.C., and Senior Vice President, Development, for American Hospitality Concepts, Inc. From March 1996 to December 1997, Nolan was Vice President of Real Estate & Development for Apple South Incorporated, and from July 1989 to March 1996, Nolan was Vice President of Real Estate and Development for Morrison Restaurants Inc. Prior to 1989, Nolan served in various real estate and development capacities for Cardinal Industries, Inc., and Nolan Development and Investment.*

Exhibit 2 shows the executive compensation for the five highest-paid principal executives.

Concept and Strategy[38]

The company's concept focused on the Specialty Bread/Bakery-Cafe category. Its artisan breads, which were breads made with all-natural ingredients and an artisan's attention to quality and detail, and overall award-winning bakery expertise were at the heart of the concept's menu. The concept was designed to deliver against the key consumer trends, specifically the need for a responsive and more special dining experience than that offered by traditional fast food. The company's goal was to make Panera Bread a nationally dominant brand name. Its menu, prototype, operating systems, design, and real estate strategy allowed it to compete successfully in several sub-businesses: breakfast, lunch, PM chill-out, lunch in the evening, and take-home bread. On a systemwide basis, annualized AUVs increased 0.7%, to $1,852,000, for the 52 weeks ended December 27, 2003, compared to $1,840,000 for the 52 weeks ended December 28, 2002 (see **Exhibit 3**).

The distinctive nature of the company's menu offerings, the quality of its bakery-cafe operations, the company's signature cafe design, and the prime locations of its cafes were integral to the company's success. The company believed its concept had significant growth potential, which it hoped to realize through a combination of company and franchise efforts.

EXHIBIT 2

Summary Compensation Table for Executives: Panera Bread Company

Name of Principal Position(s)	Year	Annual Compensation: Salary ($)	Annual Compensation: Bonus ($)	Annual Compensation: Other Annual Compensation ($)	Long-Term Compensation: Securities Underlying Options (#)
Ronald M. Shaich	2003	397,616	—	$49,881[2]	100,000
Chairman and Chief	2002	331,500	—[1]	$144,909[2]	40,000
Executive Officer	2001	338,000	375,000	—	—
Paul E. Twohig	2003	306,250	68,250	—	50,000
Executive Vice President,	2002	—	—	—	130,000
Chief Operating Officer	2001	—	—	—	—
Mark A. Borland	2003	238,462	47,304	—	—
Senior Vice President,	2002	120,536	30,777	—	50,000
Chief Supply Chain Officer	2001	—	—	—	—
Mark E. Hood	2003	243,365	35,551	—	5,000
Senior Vice President,	2002	83,077	18,300	—	80,000
Chief Financial Officer	2001	—	—	—	—
Michael J. Nolan	2003	238,462	51,684	—	5,000
Senior Vice President,	2002	196,153	40,000	—	—
Chief Development Officer	2001	6,539	15,821	—	80,000

Notes:

1. Shaich declined his $375,000 bonus for 2002 earned under the bonus plan approved by the Compensation Committee, in light of the chartered plane benefits he received during 2002.
2. Shaich received $144,909 in personal chartered air travel (based on the aggregate incremental cost of such travel to Panera), $5,500 in matching contributions to the 401(k) plan, and $1,947 in life insurance premiums.

SOURCE: *Panera Bread Company, Inc., 2004 Notice of Annual Meeting of Stockholders, p. 10.*

EXHIBIT 3

Selected Financial Information: Panera Bread Company (Dollar amounts in thousands)

A. Systemwide Bakery-Cafe Revenues

	For Fiscal Year Ending: December 27, 2003	December 28, 2002	December 29, 2001	December 30, 2000
Systemwide	$977,100	$755,400	$529,400	$350,800

B. Year-to-Year Comparable Sales

	Fifty-Two Weeks Ending: December 27, 2003	December 28, 2002	December 29, 2001	December 30, 2000	December 25, 1999
Company-owned	1.7%	4.1%	5.8%	8.1%	3.3%
Franchise-operated	**–0.4%**	**6.1%**	**5.8%**	**10.3%**	**2.0%**
Systemwide	**0.2%**	**5.5%**	**5.8%**	**9.1%**	**2.9%**

EXHIBIT 3
(Continued)

C. Annualized Unit Volume (AUVs)

	For Fiscal Year Ending				
	December 27, 2003	December 28, 2002	December 29, 2001	December 30, 2000	December 25, 1999
Company-owned	$1,831,000	$1,764,000	$1,636,000	$1,471,000	$1,330,000
Franchise-operated	$1,860,000	$1,871,000	$1,800,000	$1,710,000	$1,568,000
Systemwide	$1,850,000	$1,840,000	$1,748,000	$1,617,000	$1,444,000

D. Year Percentage Change in AUVs

	For Fiscal Year Ending			
	December 27, 2003	December 28, 2002	December 29, 2001	December 30, 2000
Company-owned	3.8%	7.8%	11.2%	10.6%
Franchise-operated	–0.6%	3.9%	5.3%	9.1%
Systemwide	0.5%	5.3%	8.1%	12.0%

SOURCES: *Panera Bread Company, Inc., Media Kit and 1999 Form 10-K through 2003 Form 10-K.*

Franchising was a key component of the company's success. Utilization of franchise operating partners enabled the company to grow more rapidly because of the added resources and capabilities they provided to implement the concepts and strategy developed by Panera. As of December 27, 2003, there were 429 franchised bakery-cafes operating and signed commitments to open an additional 409 bakery-cafes. In addition, there were 173 wholly or majority-owned company bakery-cafes operating at December 27, 2003. **Exhibit 4** shows the number of bakery-cafes for the last five years.

Competition[39]

The company experienced competition from numerous sources in its trade areas. The company's bakery-cafes competed based on customers' needs for breakfast, lunch, daytime chill-out, lunch in the evening, and take-home bread sales. The competitive factors included location, environment, customer service, price, and quality of products. The company competed for leased space in desirable locations. Certain competitors had capital resources that exceeded those available to the company. Primary competitors included specialty food and casual dining restaurant retailers, including national, regional, and locally owned concepts.

Menu[40]

The menu was designed to provide the company's target customers with products that built on the strength of the company's bakery expertise and met customers' new and ever-changing tastes. The key menu groups were fresh baked goods, made-to-order sandwiches, soups, and cafe beverages. Included within these menu groups were a variety of freshly baked bagels, breads, muffins, scones, rolls, and sweet goods; made-to-order sandwiches; hearty, unique soups; and custom roasted coffees and cafe beverages such as hot or cold espresso and cappuccino

EXHIBIT 4

Company-Owned and Franchise-Operated Bakery-Cafes: Panera Bread Company

	For Fiscal Year Ending				
	December 27, 2003	December 28, 2002	December 29, 2001	December 30, 2000	December 25, 1999
Number of bakery-cafes:[1]					
Company-owned:					
Beginning of period	132	110	90	81	70
Bakery-cafes opened	29	23	21	11	12
Acquired from franchisee	15	3	—	—	—
Bakery-cafes closed	(3)	(4)	(1)	(2)	(1)
End of period	173	132	110	90	81
Franchise operated:					
Beginning of period	346	259	172	102	47
Bakery-cafes opened	102	92	88	70	56
Sold to company[2]	(15)	(3)	—	—	—
Bakery-cafes closed	(4)	(2)	(1)	—	(1)
End of period	429	346	259	172	102
System-wide:					
Beginning of period	361	252	145	66	—
Bakery-cafes opened	131	115	109	81	68
Bakery-cafes closed	(7)	(6)	(2)	(2)	(2)
End of period	485	361	252	145	66

Notes:

1. Includes majority-owned.
2. In January 2002, the company purchased the area development rights and 3 existing bakery-cafes in the Jacksonville, Florida, market from franchisees. During fiscal 2003, the company acquired 15 operating bakery-cafes' area development rights in the Louisville/Lexington, Kentucky; Dallas, Texas; Toledo, Ohio; and Ann Arbor, Michigan, markets from franchisees.

SOURCES: *Panera Bread Company, Inc., 2003 Form 10-K, p. 2, and 2001 Form 10-K, pp. 2–3.*

drinks. The company's concept emphasized the sophisticated specialty and artisan breads that supported a take-home bread business.

The company regularly reviewed and revised its menu offerings to satisfy changing customer preferences and to maintain customer interest within its target customer groups, the "bread loving trend-setters" and the "bread loving traditionalists." Both of these target customer groups sought a quality experience that reflected their discriminating tastes. The major characteristic that set these two groups apart was the more enthusiastic embrace of new and nutritional menu items by the *trend-setters*. New menu items were developed in test kitchens and then introduced in a limited number of the company's bakery-cafes to determine customer response and verify that preparation and operating procedures maintained product consistency, high quality standards, and profitability. If successful, they were then introduced in the rest of the company's bakery-cafes and franchise bakery-cafes.

Franchises[41]

Panera management believed that its specialty bakery-cafe concept had significant growth potential, which it hoped to realize through a combination of owned, franchised, and joint venture–operated stores. Franchising was a key component of the company's growth strategy. Expansion through franchise partners had enabled the company to grow more rapidly as the franchisees contributed the resources and capabilities necessary to implant the concepts and strategies developed by Panera.

The company began a broad-based franchising program in 1996. The company was actively seeking to extend its franchise relationships beyond its current franchisees and annually filed a Uniform Franchise Offering Circular to facilitate sales of additional franchise development agreements. The company offered two types of franchise opportunities: independent third-party franchisees and Area Development Agreements (ADAs). ADAs transferred all development rights within a specified geographic area to the owner of that contract and required the developer to adhere to a predetermined development time line. Franchisees were required to develop a specified number of bakery-cafes on or before specific dates. If franchisees failed to develop bakery-cafes on schedule, the company had the right to terminate the ADA and to develop company-owned locations or develop locations through new ADA developers in that market.

The franchise agreement typically required the payment of an up-front franchise fee of \$35,000 (broken down into \$5,000 at the signing of the ADA and \$30,000 at or before the bakery-cafe opened) and continuing royalties of 4%–5% on sales from each bakery-cafe.

Franchise-operated bakery-cafes followed the same standards for product quality, menu, site selection, and bakery-cafe construction as did company-owned bakery-cafes. The franchisees were required to purchase all of their dough products from sources approved by the company. The company's fresh dough facility system supplied fresh dough products to most franchise-operated bakery-cafes. The company did not finance franchisee construction or ADA purchases. In addition, the company did not hold an equity interest in any of the franchised bakery-cafes.

The company had entered into franchise ADAs with 32 franchisee groups as of December 27, 2003. Also, as of December 27, 2003, there were 429 franchised bakery-cafes open and commitments to open 409 additional franchised bakery-cafes (see **Exhibit 5**). The company did not have any international franchise development agreements.

The high volume of franchise applicants allowed Panera to be very selective in granting franchises. Panera preferred executives with retail and restaurant franchising experience. The company chose only very strong and capable franchising partners, many of whom had experience with well-known chains, such as McDonald's and Burger King.[42] Franchisees needed to have access to financing since the company did not finance franchisee construction or ADA purchases.

Panera also saw potential in implementing a joint venture structure as an alternative to company-owned or franchised bakery-cafes to facilitate the development and operation of bakery-cafes. Unlike with franchise agreements, Panera was the major financier (where a specified interest is invested by the joint venture partner) of the bakery-cafes and earned revenues from operations. The joint venture partner managed the bakery-cafes and was entitled to a specified percentage of cash flows. The joint venture agreements forbade the partner from transferring or selling its interest to another party without the consent of Panera. After a specified term, the company had the right to purchase the joint venture partner's interest at a determined value, and the joint venture partner had the right to sell its interest back to the company at a lower value. The company saw the joint venture structure as an opportunity to attract and retain experienced and motivated operators who would want the opportunity to participate in the success of the bakery-cafes.

In 2001, Richard Postle, Panera's former Chief Operating Officer and President, left the company and through an indirect subsidiary entered into a joint venture agreement to develop 50 bakery-cafes in northern Virginia and central Pennsylvania. Under this agreement, there were 27 bakery-cafes operating in these markets at December 27, 2003. After October 2006, the company and the minority-interest owner would each have rights that could, if exercised, permit/require the company to purchase the bakery-cafes at contractually determined values based on multiples of cash flows.

EXHIBIT 5
Panera Bread/
St. Louis Bread Co.
Bakery-Cafes

State	Company Bakery-Cafes	Franchise-Operated Bakery-Cafes	Total Bakery-Cafes
Alabama	4	—	4
Arkansas	—	2	2
California	—	5	5
Colorado	—	14	14
Connecticut	1	4	5
Delaware	—	1	1
Florida	5	43	48
Georgia	8	6	14
Iowa	—	13	13
Illinois	34	32	66
Indiana	3	15	18
Kansas	—	14	14
Kentucky	4	1	5
Massachusetts	2	18	20
Maryland	—	18	18
Maine	—	2	2
Michigan	32	8	40
Minnesota	—	20	20
Missouri	36	16	52
North Carolina	1	17	18
Nebraska	—	7	7
Nevada	—	2	2
New Hampshire	—	7	7
New Jersey	—	25	25
New York	5	3	8
Ohio	6	55	61
Oklahoma	—	15	15
Pennsylvania	7	27	34
Rhode Island	—	3	3
South Carolina	—	2	2
Tennessee	1	9	10
Texas	2	9	11
Virginia	20	1	21
West Virginia	—	2	2
Wisconsin	—	15	15
Totals	171	431	602

SOURCE: *Panera Bread Company, Inc., 2003 Form 10-K, p. 8.*

Bakery Supply Chain[43]

According to Ronald Shaich, "Panera has a commitment to doing the best bread in America."[44] Freshly baked bread made with fresh dough was integral to honoring this commitment. Systemwide, bakery-cafes used fresh dough for sourdough and artisan breads and bagels. The company's fresh dough facility system supplied fresh dough to both company-owned and franchise-operated bakery-cafes daily. The company supplied both company-owned and franchise-operated bakery-cafes with fresh dough daily through its commissary system. The company's 16 commissaries (see **Exhibit 6**) prepared fresh, preservative-free dough daily.

EXHIBIT 6
Leased Fresh Dough Facilities: Panera Bread Company

Facility	Square Footage
Franklin, MA	40,300
Chicago, IL	30,900
Cincinnati, OH	14,000
Washington, DC (located in Beltsville, MD)	17,900
Warren, OH	16,300
St. Louis, MO	30,000
Orlando, FL	16,500
Atlanta, GA	18,000
Greensboro, NC	9,600
Kansas City, KS	17,000
Detroit, MI	13,500
Dallas, TX	7,800
Minneapolis, MN	8,900
Ontario, CA	13,900
Fairfield, NJ	20,200
Denver, CO	10,000

SOURCE: *Panera Bread Company, Inc., 2003 Form 10-K, p. 8.*

The commissaries assured product quality and consistency at both company-owned and franchised bakery-cafes. Panera's master artisan baker, Mile Marino, had been with the company since 1987 and oversaw all baking operations at the fresh dough facilities. A fleet of 98 temperature-controlled trucks leased by Panera and driven by Panera employees distributed the fresh dough to bakery-cafes. The optimal distribution limit was approximately 200 miles. An average distribution route delivered dough to 6 bakery-cafes. The fresh dough was then baked overnight in a $50,000 stone-bottom oven, standard in all bakery-cafes.

The company focused its expansion in areas served by commissaries in order to continue to gain efficiencies through leveraging the fixed cost of its current commissary structure. Panera selectively entered new markets that required the construction of additional facilities until a sufficient number of bakery-cafes could be opened to permit efficient distribution of the fresh dough.

The remaining baked goods that were not prepared with fresh dough (sweet goods) were prepared with frozen dough. In 1996, the company constructed a state-of-the-art frozen dough facility in Mexico, Missouri. In 1998, the company sold the facility and its frozen dough business to Bunge Food Corporation for approximately $13 million in cash. At the time of the sale, Panera entered into a five-year contract with Bunge for the supply of substantially all of its frozen dough. In November 2002, the company signed an agreement with Dawn Food Products, Inc., to prepare and deliver frozen dough from 2003 through 2007. The agreement was structured as a cost-plus agreement.

All frozen dough and related food materials were distributed to the bakery-cafes through independent distributors. Contract vendors delivered virtually all food products and supplies for retail operations (i.e. paper goods, coffee, smallwares) to the distributors, which then delivered to the individual bakery-cafes. Franchised bakery-cafes operated under individual contracts with either the company's distributor or other regional distributors. As of December 27, 2003, there were three primary distributors serving the Panera Bread system.

Marketing[45]

Panera did not rely heavily on advertising to promote its stores. In 2001, the company spent only $700,000 on media, a low 2.1% ad-to-sales ratio compared to the category average of 4%.[46] The company attempted to increase its per-location sales through menu development, product merchandising, and promotions at everyday prices and by sponsorship of local community charitable events. Advertising was intended to promote the company but not to create an identifiable image that would be synonymous with Panera, such as the McDonald's golden arches.

Franchised bakery-cafes contributed 0.4% of sales to a company-run national advertising fund and 0.4% of sales as a marketing administration fee and were required to spend 2.0% of sales in their local markets on advertising. The company contributed similar amounts from company-owned bakery-cafes toward the national advertising fund and marketing administration fee. The national advertising fund and marketing administration fee contributions received from franchised bakery-cafes were consolidated with company amounts in the company's financial statements. Liabilities for unexpended funds were included in accrued expenses in the consolidated balance sheets. The company's contributions to the national advertising fund and marketing administration fee, as well as its own media costs, were recorded as part of other operating expenses in the consolidated statements of operations. The company utilized external media when deemed appropriate and cost-effective in specific markets.

Most marketing was done through product promotion and word-of-mouth marketing. According to Shaich, "when a new store is opened in an established market, the new store benefits from the buzz and consumer familiarity created by existing locations."[47] This was akin to the "Krispy Kreme Phenomenon," which occurred when consumers greatly anticipated a new store opening in their neighborhood due to word-of-mouth praise for the quality of the food products.

Another way Panera used word-of-mouth marketing was through local charity and community work. Panera strove to add value to its surrounding neighborhoods through its products, service, employment opportunities, and citizenship and believed it had a responsibility to participate and sponsor local events. The company's most well-known program began in 1992. The "Operation Dough-Nation" program ensured that every purchase at Panera would give back in some way to the community. Cash donations could be made inside the store, with the amounts matched with fresh baked bread donated to local food drives. In addition, the company donated all unsold bread to local hunger relief agencies. The company's second community outreach program, "Dough for Funds," gave nonprofit groups a means to raise funds by profiting from the sales of Panera coupons.

The company did not compete on the basis of pricing only; its main selling point was its specialty dining experience. Yet pricing was key to promoting the company's concept. Pricing was structured so customers perceived good value with high-quality food at reasonable prices to encourage frequent visits. The company's average check per transaction at company-owned bakery-cafes for 2003 was $6.61. The average check per transaction varied by the time of day: breakfast, $4.86; lunch, $7.65; PM chill-out, $6.67; and lunch in the evening, $7.42 (see **Exhibit 7**).

The company used its store locations to market its brand image. When choosing a location to open a new store, the company carefully selected the geographic area. Better locations

EXHIBIT 7
Average Check per Transaction: Panera Bread Company

	2003	2002	2001	2000	1999
Breakfast	$4.86	$4.49	$4.30	$4.03	$3.76
Lunch	7.65	7.32	7.26	6.89	6.41
PM "Chill Out"	6.67	6.30	5.39	N/A	N/A
Evening lunch	7.42	7.02	N/A	N/A	N/A
Overall	6.61	6.26	6.19	5.80	5.44

SOURCES: *Panera Bread Company, Inc., 1999 Form 10-K through 2003 Form 10-K.*

EXHIBIT 8 Average Opening Costs and Square Footage: Panera Bread Company

	2003	2002	2001	2000	1999
Opening Costs	$850,000	$737,000	$760,000	$700,000	$656,000
Square Footage	4,330	4,400	4,250	4,000	3,500

SOURCES: *Panera Bread Company, Inc., 1999 Form 10-K through 2003 Form 10-K.*

needed less marketing, and the bakery-cafe concept relied on a substantial volume of repeat business. Management used demographic and competitive information to identify areas with the best opportunity for success and that best promoted Panera's neighborhood concept. Location, real estate, and marketing teams worked in conjunction to select ideal locations. In evaluating a potential location, the company studied the surrounding trade area, obtained demographic information within that area, and examined information on breakfast and lunch competitors. Based on analysis of this information, including utilization of predictive modeling using proprietary software, the company determined projected sales and return on investment. The Panera concept had proven successful in a number of different types of real estate (i.e., in-line strip centers, regional malls, and freestanding) in 35 states.

The company also used the actual bakery-cafe as a marketing tool to promote its brand image. The company designed each bakery-cafe to provide a differentiated environment and in many cases used fixtures and materials complementary to the neighborhood location of the bakery-cafe. Many locations incorporated the warmth of a fireplace and cozy seating areas and groupings that facilitated utilization as a gathering spot. The design visually reinforced the distinctive difference between the company's bakery-cafes and other bakery-cafes serving breakfast and lunch. Many of the company's cafes also featured outdoor cafe seating.

The average construction, equipment, furniture and fixture, and signage cost for the 29 company-owned bakery-cafes opened in 2003 was $850,000 per bakery-cafe after landlord allowances (see **Exhibit 8**). The average bakery-cafe size was 4,330 square feet (see **Exhibit 8**).

All company-owned bakery-cafes were in leased premises. Lease terms were typically 10 years, with one, two, or three 5-year renewal option periods thereafter. Leases typically had charges for minimum base occupancy, a proportionate share of building and common area operating expenses and real estate taxes, and contingent-percentage rent based on sales above a stipulated sales level.

Management Information Systems[48]

Each company-operated bakery-cafe had computerized cash registers to collect point-of-sale transaction data, which was used to generate pertinent marketing information, including product mix and average check. All product prices were programmed into the system from the company's corporate office. The company allowed franchisees who elected to do so to have access to certain proprietary bakery-cafe systems and systems support.

The company's in-store information system was designed to assist in labor scheduling and food cost management, to provide corporate and retail operations management quick access to retail data, and to reduce managers' administrative time. The system supplied sales, bank deposit, and variance data to the company's accounting department on a daily basis. The company used this data to generate weekly consolidated reports regarding sales and other key elements, as well as detailed profit and loss statements for each company-owned bakery-cafe every four weeks. Additionally, the company monitored the average check, customer count, product mix, and other sales trends. The fresh dough facilities had computerized systems that allowed the fresh dough facilities to accept electronic orders from the bakery-cafes and deliver the ordered product to the bakery-cafes. The company also used network/integration systems, encompassing e-mail and all major financial systems, such as general ledger database systems, and all major operational systems, such as store operating performance database systems.

Human Resources[49]

From the beginning, Panera realized that the quality of its employees was a critical part of a successful product and a unique company. It was the company's belief that the key ingredients in the successful development of Panera ranged from the type of food served to the kind of people behind the counters. Employees included full-time associates in general or administrative positions, commissary operators, bakers, and associates at the bakery-cafes. As of December 27, 2003, the company had 3,924 full-time associates (defined as associates who averaged 25 hours or more per week), of whom 344 were employed in general or administrative functions principally at or from the company's support centers (executive offices); 676 were employed in the company's fresh dough facility operations; and 2,904 were employed in the company's bakery-cafe operations as bakers, managers, and associates. The company also had 4,078 part-time hourly associates at the bakery-cafes. There were no collective bargaining agreements. The company considered its employee relations to be good. The company placed priority on staffing its bakery-cafes, fresh dough facilities, and support center operations with skilled associates and invested in training programs to ensure the quality of its operations. Incentive programs and bonuses were available to salaried employees. Employees also received product discounts and were invited to join employee stock ownership plans. Panera believed that providing bakery-cafe operators the opportunity to participate in the success of the bakery-cafe enabled the company to attract and retain experienced and highly motivated personnel, which resulted in a better customer experience. The company developed a program and began implementation in certain markets in 2003 to allow unit general managers and multi-unit managers to own a minority interest in a bakery-cafe. Prior to full implementation of the program, the company modified the program from an ownership structure to a multi-year bonus structure, which allowed operators to participate in the success of a bakery-cafe. The company expected to continue implementation of this bonus structure where appropriate as an alternative to its traditional company-owned or franchised bakery-cafes to facilitate the development and operation of bakery-cafes.

Finance[50]

Exhibits 9 through **11** show the consolidated statement of operations, common size income statement, and consolidated balance sheets, respectively, for the company for the fiscal years ended 1999 through 2003.

The company's revenues were derived from company-owned bakery-cafe sales, fresh dough sales to franchisees, and franchise royalties and fees. Fresh dough sales to franchisees were the sales of dough products to franchisees. Franchise royalties and fees included royalty income and franchise fees. The cost of food and paper products, labor, occupancy, and other operating expenses related to company-owned bakery-cafe sales. The cost of fresh dough sales related to the sale of fresh dough products and sweet goods to franchisees. General and administrative, depreciation, and pre-opening expenses related to all areas of revenue generation.

Systemwide bakery-cafe sales for the 52 weeks ended December 27, 2003, for the company increased 29.3%, to $977.1 million from $755.4 million, for the 52 weeks ended December 28, 2002. Comparable sales increases and increases in AUVs were lower during the 52 weeks ended December 27, 2003, than during the 52 weeks ended December 28, 2002 (see **Exhibit 3**).

EXHIBIT 9

Consolidated Statement of Operations: Panera Bread Company
(Dollar amounts in thousands, except per share information)

Year Ending	December 27, 2003	December 28, 2002	December 29, 2001
Revenues:			
Bakery-cafe sales	$265,933	$212,645	$157,684
Franchise royalties and fees	36,245	27,892	19,577
Fresh dough sales to franchisees	53,708	37,215	23,856
Total revenue	355,886	277,752	201,117
Costs and expenses:			
Bakery-cafe expenses:			
Cost of food and paper products	73,727	63,255	48,253
Labor	81,152	63,172	45,768
Occupancy	17,990	14,619	11,345
Other operating expenses	36,804	27,971	20,729
Total bakery-cafe expenses	209,673	169,017	126,095
Fresh dough cost of sales to franchisees	47,151	33,959	21,965
Depreciation and amortization	19,487	13,965	10,839
General and administrative expenses	28,140	24,986	19,589
Pre-opening expenses	1,531	1,051	912
Nonrecurring charge	—	—	—
Total costs and expenses	305,982	242,978	179,400
Operating profit	49,904	34,774	21,717
Interest expense	48	32	72
Other expense (income), net	1,227	287	213
Minority interest	365	180	8
Income before income taxes	48,264	34,275	21,424
Income taxes	17,616	12,510	8,272
Income (loss) before cumulative effect of accounting change and extraordinary items	30,648	21,765	13,152
Cumulative effect of accounting change, net	(239)	—	—
Extraordinary loss from early extinguishments of debt, net	—	—	—
Net Income (loss)	**$ 30,409**	**$ 21,765**	**$ 13,152**
Per share data:			
Basic earnings per common share:			
Before cumulative effect of accounting change	$ 1.03	$ 0.75	$ 0.47
Cumulative effect of accounting change	(0.01)	—	—
Net income (loss)	$ 1.02	$ 0.75	0.47
Diluted earnings per common share:			
Before cumulative effect of accounting change	$ 1.01	$ 0.73	$ 0.46
Cumulative effect of accounting change	(0.01)	—	—
Net income (loss)	$ 1.00	$ 0.73	$ 0.46
Weighted average shares of common and common equivalent shares outstanding:			
Basic	29,733	28,923	27,783
Diluted	30,423	29,891	28,886

SOURCES: *Panera Bread Company, Inc., 2003 Form 10-K, p. 30, and 2001 Form 10-K, p. 28.*

EXHIBIT 10

Common Size Statement: Panera Bread Company (Dollar amounts in thousands, except per share information)

Year Ending	December 27, 2003	December 28, 2002	December 29, 2001	December 30 2000	December 25, 1999[1]
Revenues:					
Bakery-cafe sales	74.7%	76.6%	78.4%	82.9%	91.5%
Franchise royalties and fees	10.2%	10.0%	9.7%	8.0%	4.3%
Fresh dough sales to franchisees	15.1%	13.4%	11.9%	9.1%	4.2%
Total revenue	100.0%	100.0%	100.0%	100.0%	100.0%
Costs and expenses:					
Bakery-cafe expenses:[1]					
Cost of food and paper products	27.7%	29.7%	30.6%	32.7%	33.4%
Labor	30.5%	29.7%	29.0%	28.9%	29.0%
Occupancy	6.8%	6.9%	7.2%	7.4%	9.9%
Other operating expenses	13.8%	13.2%	13.1%	12.8%	12.9%
Total bakery-cafe expenses	78.8%	79.5%	79.9%	81.8%	85.2%
Fresh dough cost of sales to franchisees[2]	87.8%	91.3%	92.1%	88.6%	89.7%
Depreciation and amortization	5.5%	5.0%	5.4%	5.6%	3.7%
General and administrative expenses	7.9%	9.0%	9.7%	10.8%	10.0%
Pre-opening expenses	0.4%	0.4%	0.5%	0.3%	0.0%
Non-recuring charge	0.0%	0.0%	0.0%	0.3%	3.2%
Operating profit	14.0%	12.5%	10.8%	7.1%	2.2%
Interest expense	0.0%	0.0%	0.0%	0.1%	1.6%
Other expense (income), net	0.3%	0.1%	0.1%	(0.3%)	0.4%
Minority interest	0.1%	0.1%	0.0%	0.0%	0.0%
Income before income taxes	13.6%	12.3%	10.7%	7.3%	0.2%
Income taxes	4.9%	4.5%	4.1%	2.8%	0.3%
Income (loss) before cumulative effect of accounting change and extraordinary items	8.6%	7.8%	6.5%	4.5%	(0.1%)
Cumulative effect of accounting change, net	(0.1%)	0.0%	0.0%	0.0%	0.0%
Extraordinary loss from early extinguishments of debt, net	0.0%	0.0%	0.0%	0.0%	0.2%
Net Income (loss)	8.5%	7.8%	6.5%	4.5%	(0.4%)

Notes:

1. As a percentage of bakery-cafe sales.
2. As a percentage of fresh dough facility sales to franchisees.

SOURCES: *Panera Bread Company, Inc., 2003 Form 10-K, p. 14, and 2001 Form 10-K, pp. 12–13.*

Total company revenues for the 52 weeks ended December 27, 2003, increased 28.1%, to $355.9 million compared to $277.8 million, for the 52 weeks ended December 28, 2002 (see **Exhibit 9**). The growth in total revenues for the 52 weeks ended December 27, 2003, as compared to the prior year, was primarily due to the opening of 131 new bakery-cafes in 2003, as well as the increase in systemwide average weekly sales (excluding closed locations) of 0.7% for the 52 weeks ended December 27, 2003.

Bakery-cafe sales for the 52 weeks ended December 27, 2003, for the company increased 25.1%, to $265.9 million from $212.6 million, for the 52 weeks ended December 28, 2002. Bakery-cafe sales increased primarily due to the impact of a full year's operations of the 23 company-owned bakery-cafes opened in 2002, the opening of 29 company-owned bakery-cafes in 2003, and the 1.7% increase in comparable bakery-cafe sales for the 52 weeks ended December 27, 2003.

Franchise royalties and fees rose 29.7%, to $36.2 million, for the 52 weeks ended December 27, 2003, from $27.9 million for the 52 weeks ended December 28, 2002. The increase in royalty revenue was attributed to the impact of a full year's operations of the 92 franchised bakery-cafes opened in 2002 and the addition of 102 franchised bakery-cafes in 2003.

Fresh dough facility sales to franchisees increased 44.4%, to $53.7 million, for the 52 weeks ended December 27, 2003, from $37.2 million for the 52 weeks ended December 28, 2002. The increase was primarily driven by the increased number of franchise bakery-cafes opened, as well as a shift in certain products being distributed through the fresh dough facility system rather than third parties.

The cost of food and paper products included the costs associated with the fresh dough operations that sell fresh dough products to company-owned bakery-cafes, as well as the cost of food and paper products supplied by third-party vendors and distributors. The costs associated with the fresh dough operations that sell fresh dough products to the franchised bakery-cafes were excluded and are shown separately as fresh dough cost of sales to franchisees in the consolidated statements of operations. The cost of food and paper products decreased to 27.7% of bakery-cafe sales for the 52 weeks ended December 27, 2003, compared to 29.7% of bakery-cafe sales for the 52 weeks ended December 28, 2002. This decrease in the cost of food and paper products as a percentage of bakery-cafe sales was primarily due to the company's improved leveraging of its fresh dough manufacturing and distribution costs as it opened more bakery-cafes in fiscal 2003. For the 52 weeks ended December 27, 2003, there was an average of 32.7 bakery-cafes per fresh dough facility compared to an average of 27.3 for the 52 weeks ended December 28, 2002. Additionally, lower ingredient costs, including the benefits of a new sweet goods contract that commenced during the first quarter of fiscal 2003, further benefited food cost.

Labor expense was $81.2 million, or 30.5% of bakery-cafe sales, for the 52 weeks ended December 27, 2003, compared to $63.2 million, or 29.7% of bakery-cafe sales, for the 52 weeks ended December 28, 2002. The labor expense as a percentage of bakery-cafe sales increased between the 52 weeks ended December 27, 2003, and the 52 weeks ended December 28, 2002, primarily as a result of customer service initiatives in fiscal 2003 related to quality and speed of service as well as table delivery service testing and the continued commitment to training and staffing at bakery-cafes.

Occupancy costs were $18.0 million, or 6.8% of bakery-cafe sales, for the 52 weeks ended December 27, 2003, compared to $14.6 million, or 6.9% of bakery-cafe sales, for the 52 weeks ended December 28, 2002. The occupancy cost as a percentage of bakery-cafe sales declined for the 52 weeks ended December 27, 2003, due to the leveraging of these costs over higher sales volumes.

Other bakery-cafe operating expenses, which included advertising, retail field overhead, utilities, and other cafe expenses, were $36.8 million, or 13.8% of bakery-cafe sales, for the 52 weeks ended December 27, 2003, compared to $28.0 million, or 13.2% of bakery-cafe

EXHIBIT 11

Consolidated Balance Sheets: Panera Bread Company (Dollar amounts in thousands, except per share information)

Year Ending	December 27, 2003	December 28, 2002	December 29, 2001	December 30, 2000	December 25, 1999
ASSETS					
Current assets:					
Cash and cash equivalents	$ 42,402	$ 29,924	$ 18,052	$ 9,011	$ 1,936
Investments in government securities	5,019	4,102	—	—	—
Trade accounts receivable, net	9,646	7,462	4,559	3,105	2,686
Other accounts receivable	2,748	2,097	597	—	—
Inventories	8,066	5,191	3,459	2,442	1,880
Prepaid expenses	1,294	1,826	1,649	1,027	484
Refundable income taxes	—	—	—	474	98
Deferred income taxes	1,696	8,488	7,289	5,193	5,473
Other	—	172	399	—	—
Total current assets	70,871	59,262	36,004	21,252	12,557
Property and equipment, net	132,651	99,313	79,693	59,857	47,191
Other assets:					
Notes receivable	—	—	—	—	35
Investments in government securities	4,000	5,047	—	—	—
Goodwill	32,743	18,970	17,530	17,790	18,779
Deferred financing costs	—	—	—	24	88
Deposits and other	5,678	5,554	5,020	4,731	3,960
Deferred income taxes	—	294	5,687	8,035	8,419
Total other assets	42,421	29,865	28,237	30,580	31,281
Total assets	**$245,943**	**$188,440**	**$143,934**	**$111,689**	**$91,029**

LIABILITIES AND STOCKHOLDERS' EQUITY					
Current liabilities:					
Accounts payable	$ 8,072	$ 5,987	$ 5,271	$ 5,396	$ 3,535
Accrued expenses	35,552	24,935	16,433	12,086	12,237
Current portion of deferred revenue	1,168	1,403	677	—	—
Current portion of computer equipment financing	—	—	—	374	—
Total current liabilities	44,792	32,325	22,381	17,856	15,772
Deferred income taxes	328	—	—	—	—
Other long-term liabilities	1,115	262	1,125	2,245	2,011
Total liabilities	46,235	32,587	23,506	20,101	17,783
Minority interest	3,771	2,197	556	—	—
Stockholders' equity:					
Common stock, $.0001 par value: Class A, shares authorized 75,000,000; issued 28,296,581 and outstanding 28,187,581 in 2003 and issued 27,446,448 and outstanding 27,337,448 in 2002	3	3	3	1	1
Class B, shares authorized 10,000,000; issued and outstanding 1,847,221 in 2003 and 1,977,363 in 2002	—	—	—	—	—
Treasury stock, carried at cost	(900)	(900)	(900)	(900)	—
Additional paid-in capital	121,992	110,120	98,101	82,971	70,581
Retained earnings	74,842	44,433	22,668	9,516	2,664
Total stockholders' equity	195,937	155,853	120,428	91,588	73,246
Total liabilities and stockholders' equity	**$249,714**	**$188,440**	**$143,934**	**$111,689**	**$91,029**

SOURCES: *Panera Bread Company, Inc., 2003 Form 10-K, p. 29, and 2001 Form 10-K, p. 27.*

sales, for the 52 weeks ended December 28, 2002. The increase in other bakery-cafe operating expenses as a percentage of bakery-cafe sales for the 52 weeks ended December 27, 2003, was primarily due to increased organizational costs for field management, costs associated with new markets opened that did not yet have multi-unit leverage, and increased recruiting and training, repair and maintenance, and advertising costs.

For the 52 weeks ended December 27, 2003, fresh dough facility cost of sales to franchisees was $47.2 million, or 87.8% of fresh dough facility sales to franchisees, compared to $34.0 million, or 91.3% of fresh dough facility sales to franchisees, for the 52 weeks ended December 28, 2002. The decrease in the fresh dough cost of sales rate in fiscal 2003 was primarily due to favorable ingredient costs and the impact of the favorable change in the sweet goods supply agreement, which took effect during the first quarter of fiscal 2003.

Depreciation and amortization was $19.5 million, or 5.5% of total revenue, for the 52 weeks ended December 27, 2003, compared to $14.0 million, or 5.0% of total revenue, for the 52 weeks ended December 28, 2002. The increase in depreciation and amortization as a percentage of total revenue for the 52 weeks ended December 27, 2003, compared to the 52 weeks ended December 28, 2002, was primarily due to the impact of a full year's depreciation of the prior year's capital expenditures and increased capital expenditures in the current year.

General and administrative expenses were $28.1 million, or 7.9% of total revenue, and $25.0 million, or 9.0% of total revenue, for the 52 weeks ended December 27, 2003, and December 28, 2002, respectively. The decrease in the general and administrative expense rate between 2003 and 2002 resulted primarily from higher revenues, which helped leverage general and administrative expenses, and from decreased bonus costs.

Pre-opening expenses, which consisted primarily of labor and food costs incurred during in-store training and preparation for opening, exclusive of manager training costs, which were included in other operating expenses, of $1.5 million, or 0.4% of total revenue, for the 52 weeks ended December 27, 2003, were consistent with the $1.1 million, or 0.4% of total revenue, of pre-opening expenses for the 52 weeks ended December 28, 2002.

Profit for the 52 weeks ended December 27, 2003, increased to $49.9 million, or 14.0% of total revenue, from $34.8 million, or 12.5% of total revenue, for the 52 weeks ended December 28, 2002. Operating profit for the 52 weeks ended December 27, 2003, rose as a result of operating leverage that results from opening 29 company bakery-cafes in 2003 as well as the factors described above.

Other expenses for the 52 weeks ended December 27, 2003, increased to $1.2 million, or 0.3% of total revenue, from $0.3 million, or 0.1% of total revenue, for the 52 weeks ended December 28, 2002. The increase in other expense resulted primarily from increased operating fee payments to the minority interest owners. Minority interest represented the portion of the company's operating profit that was attributable to the ownership interest of the minority interest owners. The provision for income taxes increased to $17.6 million for the 52 weeks ended December 27, 2003, compared to $12.5 million for the 52 weeks ended December 28, 2002. The tax provisions for the 52 weeks ended December 27, 2003, and December 28, 2002, reflects a consistent combined federal, state, and local effective tax rate of 36.5%.

Net income for the 52 weeks ended December 27, 2003, increased $8.6 million, or 39.7%, to $30.4 million, or $1.00 per diluted share, compared to net income of $21.8 million, or $0.73 per diluted share, for the 52 weeks ended December 28, 2002. The increase in net income in 2003 is consistent with the factors described above.

NOTES

1. Hoover's Inc., "Overview: Panera Bread Company."
2. Hoover's Inc., "Overview: Panera Bread Company."
3. L. Tischler, "Vote of Confidence," *Fast Company*, No. 65 (December 2002), pp. 102–112.
4. P. O. Keegan, "Louis I. Kane & Ronald I. Shaich: Au Bon Pain's Own Dynamic Duo," *Nation's Restaurant News*, Vol. 28, No. 37 (September 19, 1994), p. 172.
5. Ibid.

6. Quoted in L. Tischler, "Vote of Confidence," *Fast Company*, No. 65 (December 2002), pp. 102–112.
7. P. O. Keegan, "Louis I. Kane & Ronald I. Shaich: Au Bon Pain's Own Dynamic Duo," *Nation's Restaurant News*, Vol. 28, No. 37 (September 19, 1994), p. 172.
8. R. L. Allen, "Au Bon Pain's Kane Dead at 69; Founded Bakery Chain," *Nation's Restaurant News*, Vol. 34, No. 26 (June 26, 2000), pp. 6–7.
9. Quoted in P. O. Keegan, "Louis I. Kane & Ronald I. Shaich: Au Bon Pain's Own Dynamic Duo," *Nation's Restaurant News*, Vol. 28, No. 37 (September 19, 1994), p. 172.
10. L. Tischler, "Vote of Confidence," *Fast Company*, No. 65 (December 2002), pp. 102–112.
11. Quoted in Ibid.
12. P. Kemp, "Second Rising," *Forbes*, Vol. 166, No. 13 (November 13, 2000), p. 290.
13. L. Tischler, "Vote of Confidence," *Fast Company*, No. 65 (December 2002), pp. 102–112.
14. Ibid.
15. Hoover's Inc., "Overview: Panera Bread Company."
16. Ibid.
17. Ibid.
18. L. Tischler, "Vote of Confidence," *Fast Company*, No. 65 (December 2002), pp. 102–112.
19. Ibid.
20. Ibid.
21. Ibid.
22. C. Y. Kwok, "Bakery-Café Idea Smacked of Success from the Very Beginning; Concept Gives Rise to Rapid Growth in Stores, Stock Price," *St. Louis Dispatch* (May 20, 2001), p. E1.
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24. R. L. Allen, "Au Bon Pain Co. Pins Hopes on New President, Image," *Nation's Restaurant News*, Vol. 30, No. 47 (December 2, 1996), pp. 3–4.
25. P. Kemp, "Second Rising," *Forbes*, Vol. 166, No. 13 (November 13, 2000), p. 290.
26. R. L. Papiernik, "Au Bon Pain Mulls Remedies, Pares Back Expansion Plans," *Nation's Restaurant News*, Vol. 29, No. 34 (August 28, 1995), pp. 3–4.
27. "Au Bon Pain Stock Drops 11% on News That Loss Is Expected," *Wall Street Journal* (October 7, 1996), p. B2.
28. Ibid.
29. A. Caffrey, "Heard in New England: Au Bon Pain's Plan to Reinvent Itself Sits Well with Many Pros," *Wall Street Journal* (March 10, 1999), p. NE.2.
30. M. Sheridan, "Time Trials," *Restaurants & Institutions*, Vol. 112, No. 12 (May 15, 2002), pp. 93–102.
31. G. LaVecchia, "Fast Casual Enters the Fast Lane," *Restaurant Hospitality*, Vol. 87, No. 2 (February 2003), pp. 43–47.
32. Ibid.
33. M. Pethokoukis, "Bye-Bye Burgers," *US News & World Report*, Vol. 133, No. 21 (December 2002), p. 36.
34. Ibid.
35. S. Brooks, "Feeling Hot, Hot, Hot," *Restaurant Business*, Vol. 101, No. 15 (September 2002), p. 36.
36. Panera Bread Company, Inc., *2004 Notice of Annual Meeting of Stockholders*, pp. 4–6.
37. Ibid., pp. 7–8.
38. Panera Bread Company, Inc., *2003 Form 10-K*, p. 3. This was directly quoted, with minor editing.
39. Ibid., p. 5.
40. Ibid., p. 4.
41. Panera Bread Company, Inc., *2003 Form 10-K*, pp. 6–7. Some sentences in this section were directly quoted, with minor editing.
42. B. R. Hook and A. Stevenson, "Rising Dough," *Kiplinger's Personal Finance*, Vol. 56, No. 1 (January 2002), p. 71.
43. Panera Bread Company, Inc., *2003 Form 10-K*, pp. 5–6. Some sentences in this section were directly quoted, with minor editing.
44. L. Tischler, "Vote of Confidence," *Fast Company*, No. 65 (December 2002), pp. 102–112.
45. Panera Bread Company, Inc., *2003 Form 10-K*, pp. 4–5. Some paragraphs and sentences in this section were directly quoted, with minor editing.
46. B. Sperber, "Fast Casual Dining Ahead," *Brandweek*, Vol. 43, No. 31 (September 2, 2002), pp. 16–20.
47. J. Peters, "No Loafing Around: Panera Bread Raises Projections for Unit Growth," *Nation's Restaurant News*, Vol. 36, No. 23 (June 10, 2002), p. 12.
48. Panera Bread Company, Inc., *2003 Form 10-K*, p. 6. This section was directly quoted, with minor editing.
49. Panera Bread Company, Inc., *2003 Form 10-K*, pp. 3, 6. Sentences 4 through 8 of the first paragraph and the entire second paragraph were directly quoted, with minor editing.
50. Panera Bread Company, Inc., *2003 Form 10-K*, pp. 13–19. This section was directly quoted, with minor editing.