An Expensive Meal: JAB Holding to Acquire Panera Bread for $7.5bn

JAB Holding Company – privately held business group
Panera Bread (NASDAQ: PNRA) - market cap as of 07/04/2017: $7.08bn

Introduction

On April 5, 2017, Panera Bread agreed to be bought and taken private by the European holding JAB. This is the latest in a series of acquisitions executed by the firm and comes with a 30% price premium. The purchase is thought to further enhance JAB's portfolio of American food brands and improve the competitive position of the firm.

About JAB Holding Company

Headquartered in Luxembourg, JAB Holding Company is a privately held group focused on long-term investments in few specific industries. JAB is the holding company owned mainly by the German family - Reimann.
The group's investment strategy targets primarily companies with premium brands, strong growth opportunities and relevant margins. Senior Partners Peter Harf, Bart Becht and Olivier Goudet are responsible for the management of the holding company.

Through many investment vehicles, the group owns participations in different industries, such as fashion, consumer goods, food, coffee and cafés. As for the fashion industry, JAB owns a 36% stake in American beauty company Coty Inc, a majority stake in London-based luxury company Jimmy Choo, and other relevant stakes in Belstaff and Bally. Moreover, the holding company owns an 8% stake, worth about € 4.5bn, in London-listed consumer goods company Reckitt Benckiser. However, the most relevant among JAB's participations are in the coffee and food industries: Keurig Green Mountain Inc represents the main specialty coffee and coffee brewer brand owned by JAB Holdings. Moreover, JAB owns some leading premium retail coffee brands, like US-based Caribou Coffee and Peet's Coffee, and Northern European Espresso House as well as Baresso.
Another strategically relevant participation is the one in Krispy Kreme, a leading international premium retailer of sweet treats.

With more than €21bn in AUM, nearly €16bn of which in equity, the group reported consolidated total comprehensive income attributable to equity-holders for the FY2016 of €1.3bn, down from €2.64bn in FY2015 (49% decrease Y-o-Y).

About Panera Bread

Headquartered in St Louis, Missouri (USA), Panera Bread is a leading chain of bakery-café fast casual restaurants operating in the USA and in Canada. The company, listed on the Nasdaq since 1991, was founded in 1987 by Ronald M. Shaich, who is currently President and CEO.

Through its network of more than 2000 franchised-operated bakery-cafes, Panera Bread sells hot and cold drinks as well as various types of food, such as salads, sandwiches, pasta and pastries. Its target customers are mainly health conscious individuals, willing to pay a premium for high quality fresh food.

Panera has recently implemented a program called "Concept Essence", based on the quality of its products and locations, to increase its customer base and to raise its customer retention. For this purpose, the company has made relevant investments in technology. For instance, through the online platform MyPanera, customers can now order days in advance, pay directly online, and then collect their food or drink directly at the table in-store or at a rapid pick-up spot for to-go-orders. Panera has also recently invested in new production equipment and systems, displays and fast checkout kiosks.

The company's constant effort into organic growth has produced a stable positive revenue growth over the last 5 years. According to Morningstar, Panera expects to close FY2016 recording about $2.8bn revenue (4% Y-o-Y increase), and an implied 2012-2016 CAGR of 7%. Over the last 5 years, Panera reported average operating margin and profit margin of about 11% and 7% respectively, with a downward trend for both measures.

Industry overview

National Restaurant Association predicts the US restaurant industry to reach $799bn revenue in 2017, a 4.3% increase in comparison with the total estimated sales of FY 2016. In this regard, the fast-casual segment accounted for less than 8% of the total market share. In sharp contrast, it is the fastest-growing business and is expected to further accelerate in the future. The fast-casual restaurant sector has been booming across the country by growing over 500% since 1999. As a prove of the recent success of the companies operating in this segment, total sector sales grew by 13.5% in 2014 and reported a 10.4% increase in 2015. On the contrary, the whole restaurant industry sales rose respectively by 5.3 % and 5.7%.

Within the fast-casual market it is possible to observe an additional segmentation by product's origin, namely North America, Italian and Mexican food. In this market, which is forecasted to target $67bn in 2020 (10% CAGR), North American food will likely maintain a dominant position. At the same time, Mexican food will probably be the fastest-growing segment thanks to the rising popularity of Tex-Mex.
There are currently five leading players in the fast-casual market: Chipotle, Panera Bread, Panda Express, Five Guys and Fivehouse Restaurants.

The success of the fast-casual segment is driven by several factors. First, fast-casual restaurant chains are constantly introducing new healthier meals to address more conscious consumers while satisfying their need of a quick service. Second, vendors in the market are working hard to develop innovative solutions for home delivery. Furthermore, they are investing heavily in social media promotions and online advertisement to entice millennials, who use online platforms for obtaining information about fast-casual food options.

Deal structure

On April 5, 2017, JAB completed its acquisition of Panera with an all-cash transaction valued at $7.5bn.

Panera's purchase was executed by the combined forces of JAB and JAB Consumers. The first is the Reimann family backed investment firm while the latter is a separate fund comprising outside investors among which BDT Capital Partners, GIC, and more. Considering that JAB has been on an acquisition spree in the past decade with more than $30bn spent in takeovers, this team effort may represent the birth of a new investment vehicle. In fact, it shows JAB's interest to continue with the acquisitions in a similar fashion to 3G Capital and SoftBank's platforms.

The price represents a 30% premium on the 30-day average and yields an impressive P/E multiple of 41x and EV/EBITDA multiple of 16x. Furthermore, Panera's $340m debt is also included in the price and will be assumed by the investment group.

The high valuation is speculated by analysts to be due to Panera Bread's inclusion of an online app and to the increasing revenues generated via online purchases (second only to Domino's). Furthermore, Starbucks has in the past shown interest to purchase Panera. While they did not go through with a deal, this too might have contributed to the high premium. Finally, Panera's stock had experienced a c. 25% increase from the beginning of 2017 until the end of March.

Deal rationale

The deal is supported by a strong rationale: With this deal JAB has the possibility to further consolidate its coffee empire and to bolster its presence in the US. The Luxemburg-based conglomerate had previously invested $40bn to acquire US coffee brands and had to find a way for distributing its brands. Consequently, by acquiring Panera, JAB will strengthen its position and seriously challenge Nestlé's global leadership in the coffee industry.

Additionally, the deal makes sense for at least two other reasons: (1) The acquisition will give JAB the chance to benefit from cross-selling opportunities (by offering other brands' products across Panera's stores) and (2) cost-cutting by exploiting the shared distribution network.

On the other side, Panera will take advantage of the delisting by better focusing on its core capabilities and developing its long-term strategy. As other famous companies going private (such as Burger King and Heinz), the transaction will let Panera avoid suffering the headaches of analysts' expectations for continuous growth and good financial results. Panera will take advantage of a less strict regulation by working on innovative projects (e.g. more delivery options) and expanding gradually to compete with Starbucks. Last but not least, Panera will leverage on the newly vertical integrated entity to increase its mobile order platform's scale (e.g. by extending it to the other group's brands).

On a cultural standpoint, the deal should not cause problems: JAB has a successful history of external acquisitions both in the coffee industry and in the food chains sector. Moreover, the conglomerate will enable Panera and its management team to operate with a relevant degree of autonomy, thus making the integration easier and not interfering with Panera's innovative culture.

Market reaction

Between the 1st and the 7th of April, Panera's share price went up 20%, closing at $312 per share on Friday. The pre-announcement price hike suggests that it is possible that some information leaked.

Advisors

JPMorgan and Bank of America Merrill Lynch advised JAB, while Panera was advised by Morgan Stanley.