**Advanced Corporate Finance Sample Project: Panera Bread**

INTRODUCTION:

The Panera Bread ® Company (Panera) is a national bakery-café restaurant with headquarters Saint Louis, MO that operates 1,541 company-owned and franchise-operated bakery-cafés in forty- two states, the District of Columbia, Ontario, Canada; Chile, Thailand, the Philippines, and Indonesia. Panera operates under names of the Panera Bread, Saint Louis Bread Co., and Paradise Bakery & Café and its bakery-cafés are located mostly in inner-city and suburban mall locations. The company has three business segments: bakery-café operations, franchise operations, and fresh dough and other product operations. (Panera Bread Company).

Panera Bread Corporation started in 1976 in Boston as Au Bon Pain, a showcase operation for Pavallier BVP SA, a French manufacturer of commercial ovens. In 1978, the company was bought by Louis I. Kane, who began expanding in the Boston area. Three years later, Ronald M. Shaich joined him, and they formed a partnership called Au Bon Pain Co. In 1987 the Rosenthal family of Kirkwood, Missouri started a bakery-café in which they used a sour dough baking method to produce what they called “St. Louis Bread.” The company expanded slowly, and seven years later they had only five stores. But in 1993 St. Louis Bread started to franchise and quickly expanded to twenty bakery-cafés. As a result, the firm appeared on *Inc.* magazine's list of the five hundred fastest-growing companies in the U.S (Panera Bread Company).

On June 6, 1991, Au Bon Pain went public, made its initial public offering (IPO), and continued its growth through expansion of its operations and acquisitions. This company, the future Panera Bread, made an initial public offering announcing 2.5 million Class A common shares through Morgan Stanley & Co. Inc. and Montgomery Securities, as managers of the underwriting group. Au Bon Pain offered 1.5 million shares, and additional 1 million were offered to some preferred investors. During its debut, 1.875 million new shares were sold at $9 per share, but the price grew to over $13 by that fall of 1991. Au Bon Pain was quoted on the NASDAQ National Market System under the symbol ABPC. Net proceeds from the sale of the Class A common stock were used to repay long-term and bank debt.

At the time of the initial IPO, Au Bon Pain was a Boston-based chain of 92 bakery cafés, 73 of which were company-operated and 19 of which were operated by franchisees. The proceeds were used to fund a series of acquisitions such as the 1992 acquisition of Warburton’s Bakery Café, Inc., a chain of over 100 units in Chicago, Pittsburgh and Boston with price tag of $16 million. The 1993 acquisition of Saint Louis Bread Co. cost $24 million ("Au Bon Pain to go public", 1991).

Prior to this acquisition, Au Bon Pain had performed well in upscale urban markets but struggled to conquer the suburban family market. Ron Shaich, the Founder and Executive Chairman of the Board of the Panera Bread Company, recalls the 1993 merger that changed the destiny of both companies: “Our investment bankers asked me to meet the owners of [the Midwestern sandwich chain] St. Louis Bread Co., who were struggling about whether to franchise or not. I realized this would be a gateway to the suburban marketplace for Au Bon Pain. So we bought it for $23 million [and renamed it Panera]” (DeBaise, 2011). At the time of the merger, St. Louis Bread owned and operated nineteen bakery-cafés and one franchised outlet. St. Louis Bread bakery-cafés kept this name in Missouri; however, everywhere else, they took a different name--Panera Bread. (Panera Bread Company).

The next major step for the Panera Bread Company happened in August 1998, when the company decided to sell its Au Bon Pain Division for $72 million to Bruckmann, Rosser, Sherrill & Co. LP., a New York investment firm, who also owned many other restaurant chains such as California Pizza Kitchen, Inc., Corner Bakery Café, Not Your Average Joe's, Inc., and Bravo Brio Restaurant Group, Inc. (Portfolio Companies, 2014). Although both Au Bon Pain and Saint Louis Bread used the same basic menu and concept, the new member differed from its parent corporation in both its locations and its target customer base. Saint Louis Bread was concentrated more in suburban areas and had a more family-oriented clientele. Through this acquisition, Au Bon Pain hoped to penetrate two previously under-exploited markets: the suburbs and the Midwest. But it was hard to do in practice, so in 1999, the company decided to sell all of Au Bon Pain Co., Inc.'s business units, which were more upscale, quick-service café niche concept. The company decided to follow Panera Bread’s concept with menu including freshly baked goods, made-to-order sandwiches, soups, salads and premium café beverages, which were similar to what we see today. By the time of sale, the Panera Bread/St. Louis Bakery Company had entered many new markets, continued to grow, and soon opened fifty-one company-owned bakery-cafés and forty- four franchise-operated units. In 1992, the company also began branching into foreign markets. (Panera Bread Company).

LETTER TO THE SHAREHOLDER (Company, 2013):

In their annul letters to shareholders published on April 22, 2014, the Panera Bread Company, declared that 2013 was another successful and productive year for the company because its earnings per share (EPS) grew 16%, the market cap was approximately $5 billion by the end of the year, which was a roughly $3.3 billion increase over the past five years; and they recorded 39.8% compound annual growth. Panera believes that this strong financial performance was a result of strategic investments, especially those that improved the customer experience and the quality of their food. Because of these changes, average unit volumes have grown from $1.6 million annually in 2000 to roughly $2.5 million as of 2013 (Company, 2013).

The CEO stated that Panera’s current strategic plan was introduced in 2010, when the company decided that to maintain continued growth they have to invest in technology, as part of a holistic and comprehensive plan to provide an even better experience for their guests. Since 2013, this comprehensive vision for Panera’s future began to take form, and it is now called Panera 2.0. The company is focused on the total quality management pattern to drive the operational integrity of their cafés. And they are focused on growth and continue to develop new growth platforms for Panera (Company, 2013).

Key Initiatives of 2014 highlight the potential they see in their business. In 2014, the company is focused on improving Panera’s competitive position, on expanding growth opportunities, on ensuring the necessary capabilities to improve their competitive position, on expanding growth opportunities, and finally on delivering Panera’s 2014 financial plan. The future of Panera lies with providing their customers a better alternative than their competitors (Company, 2013).

Panera 2.0 focuses on a digital future like a new app that is an integrated and comprehensive solution which brings together new capabilities for digital ordering, payment, operations, and, ultimately, consumption. The first Panera 2.0 café was opened in Boston in 2012, but since then they have opened 13 other test cafés, which have showed them that Panera 2.0 works – for the café managers, for associates and for Panera customers, generating store sales that were among the highest for the company in 2013. Panera 2.0’s Rapid Pick-Up and Mobile Order app with payment capabilities to better serve “to go” customers, are expected to be available for the all café system by the end of 2014. Panera has made a second critical improvement to their competitive position through operational excellence by delivering the following to their guests: speed, accuracy, clean and well-maintained cafés, and kindness. The third improvement is ongoing innovations to food, environment, and marketing. For instance, they announced flatbreads as a new food choice on the Panera menu as a part of a new more robust “snacking” platform. Through these food innovations together with their new menu boards and a number of other initiatives, they will amplify their “barbell pricing” structure. In 2013, they continued to develop their loyalty program MyPanera® to provide a more “personalized” experience for their guests and increase sales. Also, Panera plans to execute a more aggressive marketing strategy in 2014 that both reinforces their brand’s differentiation and seeks to boost market share, by launching the first national advertising campaign for broadcast television (Company, 2013).

Panera CEO Ron Shaich plans to make new investments to ensure expanded opportunities for growth such as opening between 115 and 125 additional new high-return locations in 2014. They are also trying to expand to high-traffic urban location by prototyping cafés designed to handle the volume that comes with high intensity, which would require new processes around baking and dough production. Another 2014 innovation is redesigning the “Panera-to-You™” delivery system. The success of this strategy depends on the reinvention of delivery hubs (formerly known as catering hubs). By the end of 2014, the company expects to have delivery hubs in place serving more than 10% of the company cafés. All these changes will require the necessary capabilities if they’re to deliver on the promise of these initiatives. Financial investments will be necessary, but Information Technology used to be a major cost expense; whereas right now IT functions as a potentially powerful competitive advantage tool and has a critical impact on the business. It serves as a barrier to entry against other restaurants that don’t offer guests technology-enabled solutions. But everything comes with a price and by the end of 2014, they expect to have spent roughly $42 million on the technology and infrastructure required to live in our digital future (Company, 2013).

BIOGRAPHY OF THE CEO

The current Chief Executive Officer of Panera Bread, Ronald Mark Shaich, is also a Chairman and one of its founders. He is 60 years old and a Boston native, who holds a Bachelor of Arts degree in psychology from Clark University and a Master of Business Administration degree from Harvard Business School. His successful business career started when, as he was a student at Clark, he opened a successful convenience store for students. After getting his MBA, he worked as an assistant to the president of Store 24, Inc. and then as an assistant to the vice president of marketing at CVS Stores.

Shaich’s career in the bakery industry started when he got a job as the regional manager of the Original Cookie Company and also opened his Cookie Jar bakery shops in Massachusetts. Then his path crossed with the original Au Bon Pain, a company started by a French oven manufacturer, which supplied bread for his Cookie Jar. Soon Shaich learned that the investor group that owned Au Bon Pain was ready to sell all three existing stores; he saw great opportunity and convinced a real estate investor, Louis I. Kane, to become his partner in this business venture; and his journey with this company, which would span three decades, started. .

From the beginning, Shaich was determined to change the way America eats, and his idea informed the successful restaurant concepts of Au Bon Pain and Panera Bread. Shaich changed the causal restaurant industry by offering an alternative to fast food – handmade, artisan food served in warm and welcoming environments suitable for young people and families. Shaich confessed in an interview with *St. Louis Post–Dispatch* that “[w]e’ve been considered the poster child for the collapse of McDonald’s; […] It's so ludicrous. McDonald's problems were created 10, 15 years ago.… They focused too much on convenience and not on the food people want” (Nicklaus, 2014). Under Shaich’s leadership, Panera Bread serves more than eight million people each week, employs over 80,000 associates, and is ranked number five in the foodservice category on Fortune’s “World’s Most Admired Companies” list. Shaich was awarded the 2011 MUFSO Pioneer Award for his contribution to the history of the foodservice industry. He was also awarded in the IFMA’s Gold Plate Award as an outstanding leader in the industry in 2005. Further, he received the Nation’s Restaurant News Golden Chain Award twice, and he has also been a national finalist for Ernst & Young’s Entrepreneur of the Year. As the Company’s Chairman and CEO, Shaich promotes a variety of tech innovation and strategic initiatives for Panera Bread. Shaich I a remarkable entrepreneur who grew his business from zero into a national chain of nearly 1,800 bakery-cafés all around the United States and internationally, and who is still is committed to improving it over the long term (Panera Bread Company).

MERGERS AND ACQUISITIONS

In 2007, Panera Bread acquired Paradise Bakery & Café®, a Phoenix-based chain with over seventy locations in ten west and southwest states. This is the classic example of a horizontal merger between two chains which were once competitors. When Panera purchased 51% interest in the Scottsdale-based Paradise Bakery & Café, both companies were able to benefit from this operating merger. Paradise Bakery & Café President David Birzon remembers the merger: “We still see ourselves as the bakery-café leader in terms of quality. Before becoming involved with Panera, we would describe ourselves as an upscale version of Panera. We’ve always thought our baby was a little bit better looking…There’s a great synergy between our companies in that we give them the opportunity to compete in smaller markets, too.” Panera Bread Co. decided to keep Paradise Bakery & Café as a separate entity, even after they bought the remaining 49 percent of the company in December 2008. (Paradise Bakery & Café, 2014).The most recent acquisition occurred on April 9, 2013 when Panera Bread Co. acquired The Florida Bakery-café for the purchase price of $2.7 million. According to the United States Securities and Exchange Commission, great synergy is expected from cost savings opportunities. Panera Bread stocks are also affected by other companies’ mergers. For example in 2010 when Starbucks' announced its accusation of La Boulange, the parent company of Bay Bread, Panera’s stock went down by 1.6%, and Starbucks gained 2.4%. Since Panera Bread is operating in a highly competitive restaurant market, the main challenge for Panera Bread Co is to determine how the company can continue to achieve high growth rates in the future and which mergers and acquisition are high and generate the most synergy ("Business Case: Panera Bread Company", 2014).

BANKRUPTCY

Panera Bread Co. has recently been defended in a few lawsuits:

• A September 12, 2013 class action lawsuit was filed in Cleveland's Ohio federal district court for allegedly violating the Fair Labor Standards Act and the Ohio Minimum Fair Wages Standards law.

• On July 26, 2013 in Boston, Massachusetts, an individual lawsuit was filed for wrongful termination and racial and disability discrimination (the employer seems to have strong case against former employee for missing shifts and inability to perform duties). This case will be heard in the front of a judge this fall.

• In April, 2011 Panera Bread was subject to Shareholder Derivative Litigation by shareholders who were damaged by, among other things, Panera’s overly aggressive expansion strategy. This case was favorably resolved in in April of 2011 and since then Panera Bread has been maintaining of mutually satisfactory relations with its controlling shareholder.

None of these lawsuits could force Panera Bread into bankruptcy. Shares of Panera Bread (NASDAQ:PNRA) have fallen by 13% so far in 2014, but they are still at $157.43 as of June 9, 2014. This decrease is the result of the company’s weak first-quarter earnings. The company reported declining sales growth and margin contraction that resulted in a decline in profits. The company is not opening as many stores in 2014 as it has in the past, and it is also not growing its store sales as rapidly as it did in previous years. However, analysts are still relatively optimistic. They are expecting shares to keep the average price target at about $175 per share, which is more than 10% above than the current average share price on the market price of $158 per share.

Panera is suffering from a variety of problems, but the company is far from a risk of bankruptcy, even if they have to pay off lawsuits.

LEASING AGREEMENTS:

Panera Bread Co., like most stores, has a lot of leases, both capital and operating. The company leases nearly all of its bakery-cafe locations and all of its fresh dough facilities. Lease terms for bakery-cafe and support center leases involve the initial non-cancelable lease clause plus one renewal option period, usually for 15 years. Terms for most fresh dough facility leases also have the initial non-cancelable clause plus the option of one or two renewal periods of 20 years each. Panera’s lease terms generally require them to pay a proportional share of real estate taxes, insurance, common area maintenance, and other operating costs. Many bakery-cafe leases have provisions for contingent rental or percentage rent payments when sales exceed specified amounts. Certain lease agreements involving the company provide for scheduled rent increases during the lease term or for rental payments commencing at a date other than the date of initial occupancy.

Fresh dough is the key to Panera’s high-quality, artisan bread; and fresh produce is essential to their quality salads and sandwiches. They distribute fresh dough and produce through a leased fleet of temperature controlled trucks operated by our associates. As of December 31, 2013, Panera leased 220 trucks. The optimal maximum distribution range is approximately 300 miles; however, when necessary, the distribution ranges may be up to 500 miles (Form 10-K for Panera Bread Co, 2014).

Panera Bread Co., like most retailers, has a lot of leases, and therefore its financial position is far weaker than could be guessed from GAAP financial statements. Operational leases and purchase commitments produce hidden debt. At the end of 2013, the company had $1.6B of hidden debt (Grosso, 2014).

Table 1: Panera Bread Leases

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | Less than 1 year | 1-3 years | 3-5 years | More than 5 years | Total |
| Operating leases | $134,614 | $264,561 | $254,616 | $676,126 | $1,329,917 |
| Capital lease obligations | $500 | $1,013 | $1,033 | $3,602 | $6,148 |
| Purchase obligations | $271,354 | $44 | --- | --- | $271,398 |
| Uncertain tax positions | $554 | $1,140 | $590 | $455 | $2,739 |
| Total | $407,022 | $266,758 | $256,239 | $680,183 | $1,610,202 |

VALUATION MODEL-PART 1:

Table2: Valuation Part 1

|  |  |
| --- | --- |
| Valuation of Panera Bread | |
| Present Value of FCFF in high growth phase | $227,502,141 |
| Present Value of Terminal Value of Firm | $3,100,601,275 |
| Value of operating assets of the firm | $2,873,099,134 |
| Value of Cash, Marketable Securities & Non-operating assets | $125,245,000 |
| Value of Firm | $2,747,854,134 |
| Market Value of outstanding debt | $1,685,239,160 |
| Minority Interests | $0 |
| Market Value of Equity | $4,433,093,293 |
| Value of Equity in Options | $0 |
| Value of Equity in Common Stock | $4,433,093,293 |
| Market Value of Equity/share | $160 |

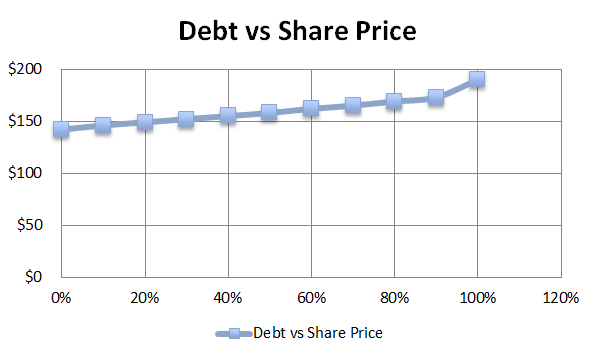
Assumptions are presented in Appendix Table 4A. All calculations are based on K-10 from 2013 as of December, 31, 2013, and they are available in Appendix Table 1-3A. The effective tax rate is 37.27%. The company reported the previous year revenue for 2013 as $2,385,002,000, and EBIT $309,756,000. Book value of debt is adjusted to include operational leases as a real debt of $1,716,019,686.33. Market price per share is set up as $176.69 as of December, 2013. The risk free rate is 3%, and it is taken from ThatsWacc.com

As of today, July 28th, 2014, the price of Panera Bread stock is $143.35 per share, but the Valuation-Model-calculated-price is $160, which appears to be fairly valued. The model determines the value of Panera Bread by analyzing the company’s fundamentals such as S27,672,839 Shares Outstanding, a Reinvestment Rate of 1%, and a Return on Capital of 18.81%--as well as by examining other financial indicators. Panera Bread Company is at this time projected to have a value of $2,747,854,134 with market capitalization of $4,433,093,293, debt of $1,685,239,160, and cash on hands of $125,245,000. This company had not issued any dividends in recent years. Valuation results are very close to that of Guru Focus (Panera Bread Co Inc, 2014), but these are only estimates and they may be inaccurate because they take only a few variables into consideration.

VALUATION MODEL-PART 2:

Table 3: Panera Debt Analysis

|  |  |
| --- | --- |
| Debt to Stock Price Ratio | |
| Debt % | Market Value of Equity/share |
| 0% | $122.19 |
| 10.0% | $130.14 |
| 20.0% | $138.73 |
| 30.0% | $148.02 |
| 40.0% | $158.07 |
| 50.0% | $168.97 |
| 60.0% | $180.78 |
| 70.0% | $193.60 |
| 80.0% | $207.52 |
| 90.0% | $222.65 |
| 100.0% | $239.11 |

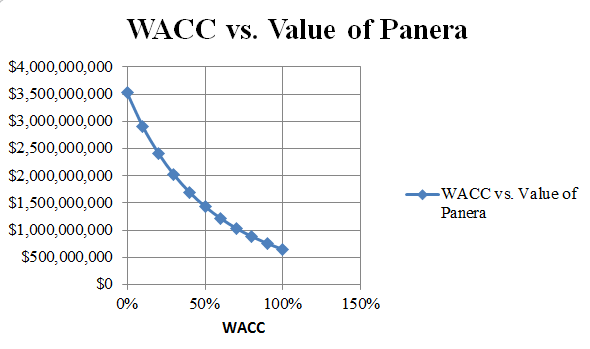


Panera Bread currently holds about $125,245,000 in cash and also has positive cash flow from operations, but the company currently holds $480,970,000 in liabilities with a Debt to Equity (D/E) ratio of 0.01, which may suggest the company is not taking enough advantage of borrowing and the price of stock suffers as result. Even if Operating Leases are calculated as liabilities, Panera Bread Company has a relatively low amount of debt. Panera debt analysis presented in Table 3 and graph below indicates that Panera Bread stock prices would increase if the company decided to use more debt. The highest price is observed at 100% of debt. Panera recently announced a buyback authorization for $600 million or about 15% of shares, and the company has also secured a five-year $100-million-term loan from Bank of America, Wells Fargo and TD Bank with a variable interest rate that is currently around 1.15%. Panera Bread Company plans to use the loan for general corporate purposes, including a range of growth initiatives such as the rollout of the Panera 2.0 in-store technology initiative (Panera Bread Co Inc, 2014). “This modest amount of debt is the next logical step in the evolution of our thinking around capital structure,” said Roger Matthews, Panera Bread's CFO. Matthews notes, “As we continue to grow our store base, invest in expanded growth opportunities and return capital to shareholders through consistent share repurchase, we expect this debt should allow us to achieve a range of objectives for shareholders. However, nothing has changed in our commitment to maintain modest leverage on the balance sheet as well as significant financial capacity to be opportunistic” (Yohannan, 2014).

WACC IMPACTS THE VALUE OF THE FIRM

Table 4: Calculations are made using Master Input and Valuation Model

|  |  |
| --- | --- |
| WACC | Value of Panera |
| 0% | $3,519,217,411 |
| 10% | $2,903,131,344 |
| 20% | $2,412,325,334 |
| 30% | $2,017,163,105 |
| 40% | $1,695,943,291 |
| 50% | $1,432,543,961 |
| 60% | $1,214,830,270 |
| 70% | $1,033,558,697 |
| 80% | $881,610,714 |
| 90% | $753,448,878 |
| 100% | $644,725,515 |



Maximizing the value of the firm is equivalent to minimizing the firm’s cost of capital. Capital structure affects WACC, and therefore firm value. From results presented above, there is obvious if WACC increases, firm value decreases; therefore, Panera should choose capital structure to obtain minimum cost of capital and this would make the firm worth the maximum possible amount.

ANALYST ASSESSMENT:

VALUE LINE:

Table 5: Value Line

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Value Line | | | | |
| Recent Price | | | | 153.15 |
| P/E Ratio | | | | 22.4 |
| Company’s Financial Strength | | | | A++ |
| Stock’s Price Stability | | | | 70 |
| Price Growth Persistence | | | | 85 |
| Earnings Predictability | | | | 95 |
| Timeliness | | | | 3 (Lowered 11/1/13) |
| Safety | | | | 2 (Raised 12/3/10) |
| Technical | | | | 1 Raised 5/16/14 |
| Beta | | | | 0.85 (1.00 = Market) |
| 2017-19 Projections | | | | |
|  | Price | Gain | Annual Total Return | |
| High | 280 | 85% | 16% | |
| Low | 210 | 35% | 8% | |

The Value Line estimates Panera’s Financial Strength as A++ and earning predictability as 95, which is fairly high. Panera’s Timelines Rank is 3, which is a measurement of probable price performance during the next six to 12 months, relative to other stocks. Panera’s result is in the middle since ranks are measured from 1-highest to 5-lowest. Safety Rank measures the company’s financial strength and the stock’s long-term price stability relative to other stocks, using the same 1 to 5 ranking system. Panera’s stocks are ranked 2, which mean that the stock is considerably less risky than those ranked 3, 4, or 5.

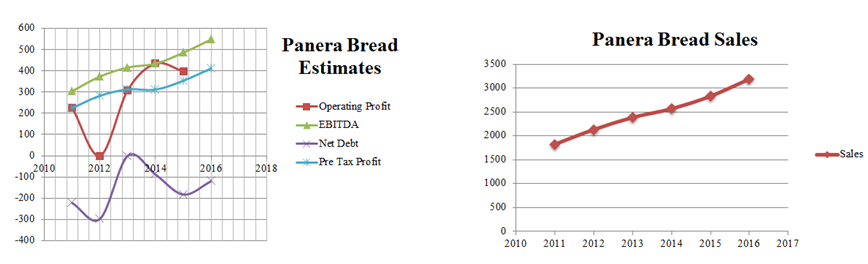
The Value Line indicates that Panera Bread’s first-quarter of 2014 results were a bit better than expected, especially because the beginning of the year was rough due to severe weather and slightly higher-than-expected food cost inflation, but later sales went up 0.1%. Overall Margins went down a bit because of an increase in compensation and higher investment and marketing spending. The Value Line predicts stronger results in the second half 2014 because of recent investments in marketing, the improvement of operations and customer service, and the addition of 115-125 new locations this year.

The Value Line prediction of Panera’s 2015-2019 Annual Total Return is between 8-16%. The projections for 2017-2019 suggest that PNRA will experience good capital appreciation potential over this time, but because of stiff competition among restaurants for consumers’ dollars, earnings predictability is uncertain (Spencer, 2014).

MERGENT ONLINE ASSESSMENT:

Table 6: Earnings Actual and Estimated

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Panera Bread Co. (PNRA) | | | | | | |
| Earnings Estimates Actual (A) and Estimated (E) | | | | | | |
|  | **2011A** | **2012A** | **2013A** | **2014 E** | **2015 E** | **2016 E** |
| Earnings Per Share | 4.65 | 5.89 | 6.68 | 7 | 8.2 | 9.45 |
| Cash Flow Per Share | 7.92 | 9.83 | 0 | 11.57 | 13.41 | 0 |
| Sales | 1822.03 | 2130.06 | 2385 | 2564.65 | 2829.4 | 3188.75 |
| Operating Profit | 225.26 | 0 | 309.76 | 434.84 | 397.72 |  |
| EBITDA | 305.16 | 373.81 | 416.28 | 434.28 | 485.86 | 548.28 |
| Net Debt | -222.64 | -297.14 | 0 | -88.52 | -182.92 | -119.85 |
| Pre Tax Profit | 224.9 | 283 | 312.72 | 312.01 | 353.9 | 412 |



Mergent Online assessment takes into consideration the historical performance of Panera’s 2011-2013 earnings to predict 2014-2016 outcomes. Looking at estimated numbers, Mergent Online predicts Panera's share price in the $210-250 range by 2017-2019 because despite decreasing gross margins, PNRA has been able to consistently increase operating margins by 1.37% since 2004. The Panera 2.0 strategy should also increase operating margins in the future. Based on past data and future trends, Panera is expected to grow operating profits by 28% for the next three years, and this number is based on the estimation that company sales will grow 5%, produces revenue of 7%, and modest operating margin expansion.

The restaurant industry is extremely competitive; therefore, price, value, food quality, locations, customer service, environment, and overall customer experience are extremely important for any restaurant chain to differentiate itself from the competition and maintain current customers. Because the financial future of the company depends on competition as well, Mergent Online Assessment has a tool that allows for comparing Panera to its competition. Chipotle Mexican Grill is often mentioned as Panera’s biggest competitor since both chains stand out by serving only natural antibiotic free food. Panera must implement strong plans in these areas to maintain its competitive advantage and loyal clientele, especially because Chipotle has very strong financial numbers presented in the Table 7 below. These strong numbers include the Price Earnings Ratio (PE), Market Cap, Share Price, especially because Chipotle hires fewer people and both companies have similar assets and liabilities, even though Panera has more liabilities and fewer assets. Panera’s ability to successfully implement its growth plans and strategies will be important in the success of the company’s stock price going forward. But if Panera is unable to beat its competition in a cost effective manner, its results could be impacted. During the past few years Panera performed strongly and outperformed average of the restaurant industry, but right now looking only at numbers, Panera currently trades at about 21.9 times earnings, compared to the restaurant industry average of 29.4. Panera has a PEG ratio (price to earnings in relation to its growth rate) of around 1.1, making the stock fairly valued in comparison to its growth. Panera’s biggest competition, Chipotle, currently trades at 56.2 times earnings and has a PEG ratio of 1.7, which means that Chipotle is trading at nearly double its growth rate. Chipotle’s stock price may still rise, but it is not likely to increase much since the stock has already had its major growth. Panera, on other hand, has much more room for improvement, so Panera seems like the like a stronger investment option (Panera Bread , 2014).

Table 7: Panera Bread vs. Chipotle

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Comp. Name | Revenues | Gross Margin | Net Income | EBITDA | Total Assets | Total Liabilities | PE Ratio | Market Cap | Share Price |
| Panera | 2,385,002,000 | 22.95 | 196,169,000 | 410,973,000 | 1,180,862,000 | 480,970,000 | 21.33 | 3,739 M | 143.35 |
| Chipotle | 3,214,591,000 | 26.59 | 327,438,000 | 630,525,000 | 2,009,280,000 | 470,992,000 | 59.40 | 20,892M | 673.58 |

GURU FOCUS: The Guru Focus Valuation of Panera PNRA

According to Guru Focus, Fair Value of PNRA is $193.87 based on following data:

PNRA current free cash flow: Free Cash Flow Growth (%) 10 years (-1.0) 5 years (0.20) 12 moths (44.30)

Table 8: Guru Focus

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Per Share Data | Annuals (Year End) | | | Quarterly |
| Fiscal Period | December 2011 | December 2012 | December 2013 | March 2014 |
| Free Cash Flow | 4.31 | 5.89 | 6.81 | 1.55 |

Table 9: Guru Focus Fair Value of PNRA is $193.87 based on following data

|  |  |
| --- | --- |
| Earnings per Share | $6.81 |
| Growth rate in the next 10 years | 20% |
| Business predictability | 4.5 out of 5 |
| Terminal Growth Rate | 4% |
| Years of Terminal Growth | 10 |
| Discount Rate | 12% |
| Tangible Book Value | 17.87 |
| Growth Value | $101.49 |
| Terminal Value | $92.38 |
| Margin of Safety | 20% |

There are many ways to evaluate a stock to determine whether it is undervalued, fairly-valued, or overvalued, based on the most common valuation metrics: Earnings per Share, Growth Rate, Price to Book and Price/Earnings Growth Ratio (PEG), etc. Panera is priced lower than Chipotle (CMG). While Panera has a larger market cap of 3.9 billion, its PEG of 1.0 indicates that the stock price is undervalued. Other metrics also show that Panera's current stock price is undervalued relative to its competitors. If the amount of growth potential that Panera 2.0 generates is taken into consideration, it is obvious that Panera's current stock price of around $144.65 (as of July, 29, 2014) is rather undervalued.

Guru Focus ranks Financial Strength, which measures how strong a company’s financial situation is, based on these factors: debt, debt to revenue ratio, and Altman Z-score. Guru Focus estimated that Panera Bread has a Financial Strength Rank of 9, which is an indicator of strong financial strength—meaning that the company is unlikely to fall into distressed situations (Guru Focus, 2014).

Panera Bread Co.’s Earnings per Share Growth Rate for the quarter ending on Mar 9, 2014 was 9.40%. Panera Bread’s debt to revenue ratio for the quarter that ended in Mar. 2014 was 0.00. Panera Bread has a decreasing Gross Margin of, on average, 15.8% per year. The asset growth rate of 20% is faster than the revenue growth rate of 10.3% over past 5 years, which indicates that the company is getting less efficient. Revenue per share also declined. The company is planning to issue an acceptable amount of new debt. Panera Bread has enough cash to cover all of its debt, so its financial situation is stable (Guru Focus, 2014).

A Fair Valuation (or Current Intrinsic value) of Panera can be estimated using a Discounted Cash Flow Model, where free cash flow is defined as operating cash flow minus capital expenditure. Number of shares outstanding is based on the latest Q1, 2014 financial report; discount rate is assumed to be 12%, terminal growth rate is set as 4%, and the span of terminal growth is 10 years. Based on the Fair Valuate Calculator, Panera should have a Revenue Growth Rate of 19.60% during the next ten years at $193.87 per share. The Fair Valuation is the most probable scenario considering that Panera's revenue growth rate is lower than it was in previous years due to stiff competition and the decreasing of Americans’ disposable income. Its revenue growth rate should increase once it implements Panera 2.0. Panera's stock is clearly undervalued and the market is irrational in its valuation, since Panera still has a lot of growth opportunities in its new menu, the new Panera 2.0 strategy, the MyPanera-loyalty program, and other innovations. Based on Guru Focus, Panera stock will increase soon (Guru Focus, 2014) because as Warren Buffett says, “If a business does well, the stock eventually follows” (Investopedia, 2014).

CONCLUSION:

Overall valuation of the financial strength of Panera Bread Co is encouraging for investors. Recent financial statements of Panera Bread from the end of 2013 and the first quarter of 2014 (Q1) show a recent descendent slide, slower growth, and potential lows based on the Price to Book ratio, but the long-term valuation for Panera is more positive because of solid balance sheets, favorable health trends, and strong management.

Panera’s business philosophy of selling fresh food and warm bread at reasonable price follows the general trend in dining to scale back on upscale ingredients. Panera has a strong number of loyal customers , good brand recognition, and a reputation as a place serving a modern public that appreciates free Wi-Fi and a comfortable space with fireplaces—and has no time limit for dining. Panera Bread Co., with charismatic and visionary CEO Ron Shaich, makes constant efforts to improve and find new growth. Recently the company unveiled plans for Panera 2.0 technology starting Q1 of 2014 to upgrade customers’ dining experience through online ordering, an in-store kiosk ordering, an improved website, and a mobile app. This strategy, if successful, will improve customers’ experience and the company’s financial margins.

The recent financial statements show that Panera currently has no debt, but the debt analysis shows it would be beneficial for the company to take on some amount of debt, to pay for technological innovations and lower the cost of capital, repurchase shares. According to Debt Impact calculation Price of Stock is only going up when debt percentage increases and the highest price is achieved at 100% of debt.

Past financial statements of Panera’s revenue growth over the last 10 years have been very impressive, with a yearly average growth revenue rate of 20%. These numbers have decreased significantly in the last 5-6 years, but this decrease is typical in business because when the company gets bigger it becomes harder to grow aggressively in size. Panera's gross margin also has decreased to 23%, but they have stayed steady since then. Panera's operating margins as a measure of its efficiency have been stable for the last decade, and they are around 12%. Panera's return on equity has been moderately good at approximately 19% and growing steadilyover the last decade, which shows that the company has ability to turn sales into income profitably over a long time period (Panera Bread , 2014).

The major recommendation to Panera would be take advantage of the market opportunity and expand even more in geographical regions in which the company has very little presence like the western and the southern states. Panera's management plans involve opening 115 to 125 stores in 2014, and this is recommended strategy. Even though investments in expansion decrease profits in short term, they are beneficial in long term. Panera also should consider international expansion, especially to Europe, in the next 10-15 years. Overall, Panera has the brand awareness, concept, and reputation to be able to e win the competition among casual restaurants (Panera Bread Co Inc, 2014).

Panera’s expansion and innovations such as Panera 2.0 require upfront capital investments, which will negatively affect the near-term earnings, and as a result, the earnings will be lower at least for the next 6-12 months. All of that will drive the prices of Panera shares down considerably; therefore, investors should invest in this company because overall prognostics are great. Panera currently performs an operational transformation, so the price of shares is low, but the company has a great business model and has been profitable for a very long time; it has a well-known brand, a positive cash flow, and no significant debt. All presented valuations and financial data support the argument that Panera is still considered to be a high growth company and it is good investment.

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Appendix:

**Table 1 A: PANERA BREAD COMPANY**

**CONSOLIDATED BALANCE SHEETS** (Form 10-K for PANERA BREAD CO , 2014)

**(in thousands, except share and per share information)**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |
|  | **December 31, 2013** | | |  | **December 25, 2012** | | |
| ASSETS |  | | |  |  | | |
| Current assets: |  | | |  |  | | |
| Cash and cash equivalents | $ | 125,245 |  |  | $ | 297,141 |  |
| Trade accounts receivable, net | 32,965 | |  |  | 43,843 | |  |
| Other accounts receivable | 51,637 | |  |  | 42,419 | |  |
| Inventories | 21,916 | |  |  | 19,714 | |  |
| Prepaid expenses and other | 43,064 | |  |  | 42,223 | |  |
| Deferred income taxes | 27,889 | |  |  | 33,502 | |  |
| Total current assets | 302,716 | |  |  | 478,842 | |  |
| Property and equipment, net | 669,409 | |  |  | 571,754 | |  |
| Other assets: |  | | |  |  | | |
| Goodwill | 123,013 | |  |  | 121,903 | |  |
| Other intangible assets, net | 79,768 | |  |  | 88,073 | |  |
| Deposits and other | 5,956 | |  |  | 7,591 | |  |
| Total other assets | 208,737 | |  |  | 217,567 | |  |
| Total assets | $ | 1,180,862 |  |  | $ | 1,268,163 |  |
| LIABILITIES |  | | |  |  | | |
| Current liabilities: |  | | |  |  | | |
| Accounts payable | $ | 17,533 |  |  | $ | 9,371 |  |
| Accrued expenses | 285,792 | |  |  | 268,169 | |  |
| Total current liabilities | 303,325 | |  |  | 277,540 | |  |
| Deferred rent | 65,974 | |  |  | 59,822 | |  |
| Deferred income taxes | 65,398 | |  |  | 60,655 | |  |
| Other long-term liabilities | 46,273 | |  |  | 48,227 | |  |
| Total liabilities | 480,970 | |  |  | 446,244 | |  |
| Commitments and contingencies (Note 13) |  | | |  |  | | |
| STOCKHOLDERS' EQUITY |  | | |  |  | | |
| Common stock, $.0001 par value per share: |  | | |  |  | | |
| Class A, 112,500,000 shares authorized; 30,573,851 shares issued and 26,290,446 shares outstanding at December 31, 2013 and 30,458,238 shares issued and 28,208,684 shares outstanding at December 25, 2012 | 3 | |  |  | 3 | |  |
| Class B, 10,000,000 shares authorized; 1,382,393 shares issued and outstanding at December 31, 2013 and 1,383,687 shares issued and outstanding at December 25, 2012 | — | |  |  | — | |  |
| Treasury stock, carried at cost; 4,283,405 shares at December 31, 2013 and 2,249,554 shares at December 25, 2012 | (546,570 | | ) |  | (207,161 | | ) |
| Preferred stock, $.0001 par value per share; 2,000,000 shares authorized and no shares issued or outstanding at December 31, 2013 and December 25, 2012 | — | |  |  | — | |  |
| Additional paid-in capital | 196,908 | |  |  | 174,690 | |  |
| Accumulated other comprehensive (loss) income | (333 | | ) |  | 672 | |  |
| Retained earnings | 1,049,884 | |  |  | 853,715 | |  |
| Total stockholders' equity | 699,892 | |  |  | 821,919 | |  |
| Total liabilities and stockholders' equity | $ | 1,180,862 |  |  | $ | 1,268,163 |  |

**Table 2 A: PANERA BREAD COMPANY**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

**(in thousands, except per share information)**

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | For the fiscal year ended | | | | | | | | | | |
|  | **December 31, 2013** | | |  | **December 25, 2012** | | |  | **December 27, 2011** | | |
| Revenues: |  | | |  |  | | |  |  | | |
| Bakery-cafe sales, net | $ | 2,108,908 |  |  | $ | 1,879,280 |  |  | $ | 1,592,951 |  |
| Franchise royalties and fees | 112,641 | |  |  | 102,076 | |  |  | 92,793 | |  |
| Fresh dough and other product sales to franchisees | 163,453 | |  |  | 148,701 | |  |  | 136,288 | |  |
| Total revenues | $ | 2,385,002 |  |  | $ | 2,130,057 |  |  | $ | 1,822,032 |  |
| Costs and expenses: |  | | |  |  | | |  |  | | |
| Bakery-cafe expenses: |  | | |  |  | | |  |  | | |
| Cost of food and paper products | $ | 625,622 |  |  | $ | 552,580 |  |  | $ | 470,398 |  |
| Labor | 625,457 | |  |  | 559,446 | |  |  | 484,014 | |  |
| Occupancy | 148,816 | |  |  | 130,793 | |  |  | 115,290 | |  |
| Other operating expenses | 295,539 | |  |  | 256,029 | |  |  | 216,237 | |  |
| Total bakery-cafe expenses | 1,695,434 | |  |  | 1,498,848 | |  |  | 1,285,939 | |  |
| Fresh dough and other product cost of sales to franchisees | 142,160 | |  |  | 131,006 | |  |  | 116,267 | |  |
| Depreciation and amortization | 106,523 | |  |  | 90,939 | |  |  | 79,899 | |  |
| General and administrative expenses | 123,335 | |  |  | 117,932 | |  |  | 113,083 | |  |
| Pre-opening expenses | 7,794 | |  |  | 8,462 | |  |  | 6,585 | |  |
| Total costs and expenses | 2,075,246 | |  |  | 1,847,187 | |  |  | 1,601,773 | |  |
| Operating profit | 309,756 | |  |  | 282,870 | |  |  | 220,259 | |  |
| Interest expense | 1,053 | |  |  | 1,082 | |  |  | 822 | |  |
| Other (income) expense, net | (4,017 | | ) |  | (1,208 | | ) |  | (466 | | ) |
| Income before income taxes | 312,720 | |  |  | 282,996 | |  |  | 219,903 | |  |
| Income taxes | 116,551 | |  |  | 109,548 | |  |  | 83,951 | |  |
| Net income | $ | 196,169 |  |  | $ | 173,448 |  |  | $ | 135,952 |  |
|  |  | | |  |  | | |  |  | | |
| Earnings per common share: |  | | |  |  | | |  |  | | |
| Basic | $ | 6.85 |  |  | $ | 5.94 |  |  | $ | 4.59 |  |
| Diluted | $ | 6.81 |  |  | $ | 5.89 |  |  | $ | 4.55 |  |
|  |  | | |  |  | | |  |  | | |
| Weighted average shares of common and common equivalent shares outstanding: |  | | |  |  | | |  |  | | |
| Basic | 28,629 | |  |  | 29,217 | |  |  | 29,601 | |  |
| Diluted | 28,794 | |  |  | 29,455 | |  |  | 29,903 | |  |
|  |  | | |  |  | | |  |  | | |
| Other comprehensive income (loss), net of tax: |  | | |  |  | | |  |  | | |
| Foreign currency translation adjustment | $ | (1,005 | ) |  | $ | 364 |  |  | $ | 33 |  |
| Other comprehensive (loss) income | $ | (1,005 | ) |  | $ | 364 |  |  | $ | 33 |  |
| Comprehensive income | $ | 195,164 |  |  | $ | 173,812 |  |  | $ | 135,985 |  |

### Table 3 A: PANERA BREAD COMPANY

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(in thousands)**

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | | | | | | | | | | | |
|  |  |  |  |  |  |  |  |  |  |  |  |
|  | **For the fiscal year ended** | | | | | | | | | | |
|  | **December 31, 2013** | | |  | **December 25, 2012** | | |  | **December 27, 2011** | | |
| Cash flows from operations: |  | | |  |  | | |  |  | | |
| Net income | $ | 196,169 |  |  | $ | 173,448 |  |  | $ | 135,952 |  |
| Adjustments to reconcile net income to net cash provided by operating activities: |  | | |  |  | | |  |  | | |
| Depreciation and amortization | 106,523 | |  |  | 90,939 | |  |  | 79,899 | |  |
| Stock-based compensation expense | 10,703 | |  |  | 9,094 | |  |  | 9,861 | |  |
| Tax benefit from exercise of stock options | (8,100 | | ) |  | (8,587 | | ) |  | (4,994 | | ) |
| Deferred income taxes | 10,356 | |  |  | 20,334 | |  |  | 1,351 | |  |
| Loss on disposals of property and equipment | 5,764 | |  |  | 3,995 | |  |  | 1,789 | |  |
| Other | 589 | |  |  | 475 | |  |  | 634 | |  |
| Changes in operating assets and liabilities, excluding the effect of acquisitions and dispositions: |  | | |  |  | | |  |  | | |
| Trade and other accounts receivable, net | 3,021 | |  |  | (31,414 | | ) |  | (16,369 | | ) |
| Inventories | (2,186 | | ) |  | (2,440 | | ) |  | (2,183 | | ) |
| Prepaid expenses and other | (841 | | ) |  | (10,995 | | ) |  | (7,323 | | ) |
| Deposits and other | 1,449 | |  |  | 161 | |  |  | 117 | |  |
| Accounts payable | 8,162 | |  |  | (6,513 | | ) |  | 8,538 | |  |
| Accrued expenses | 13,372 | |  |  | 49,246 | |  |  | 19,630 | |  |
| Deferred rent | 5,868 | |  |  | 5,718 | |  |  | 6,081 | |  |
| Other long-term liabilities | (2,432 | | ) |  | (4,005 | | ) |  | 3,906 | |  |
| Net cash provided by operating activities | 348,417 | |  |  | 289,456 | |  |  | 236,889 | |  |
| Cash flows from investing activities: |  | | |  |  | | |  |  | | |
| Additions to property and equipment | (192,010 | | ) |  | (152,328 | | ) |  | (107,932 | | ) |
| Acquisitions, net of cash acquired | (2,446 | | ) |  | (47,951 | | ) |  | (44,377 | | ) |
| Purchase of investments | (97,919 | | ) |  | — | |  |  | — | |  |
| Proceeds from sale of investments | 97,936 | |  |  | — | |  |  | — | |  |
| Proceeds from sale of property and equipment | — | |  |  | — | |  |  | 115 | |  |
| Proceeds from sale-leaseback transactions | 6,132 | |  |  | 4,538 | |  |  | — | |  |
| Net cash used in investing activities | (188,307 | | ) |  | (195,741 | | ) |  | (152,194 | | ) |
| Cash flows from financing activities: |  | | |  |  | | |  |  | | |
| Repurchase of common stock | (339,409 | | ) |  | (31,566 | | ) |  | (96,605 | | ) |
| Exercise of employee stock options | 573 | |  |  | 4,455 | |  |  | 3,193 | |  |
| Tax benefit from exercise of stock options | 8,100 | |  |  | 8,587 | |  |  | 4,994 | |  |
| Proceeds from issuance of common stock under employee benefit plans | 2,842 | |  |  | 2,462 | |  |  | 2,040 | |  |
| Capitalized debt issuance costs | — | |  |  | (1,097 | | ) |  | — | |  |
| Payment of deferred acquisition holdback | (4,112 | | ) |  | (2,055 | | ) |  | (4,976 | | ) |
| Net cash used in financing activities | (332,006 | | ) |  | (19,214 | | ) |  | (91,354 | | ) |
| Net (decrease) increase in cash and cash equivalents | (171,896 | | ) |  | 74,501 | |  |  | (6,659 | | ) |
| Cash and cash equivalents at beginning of period | 297,141 | |  |  | 222,640 | |  |  | 229,299 | |  |
| Cash and cash equivalents at end of period | $ | 125,245 |  |  | $ | 297,141 |  |  | $ | 222,640 |  |

**Table 4 A: Assumptions**

|  |  |
| --- | --- |
| Inputs |  |
| From Current Financials | Panera Bread |
| Current EBIT = | $309,756,000 |
| Current Interest Expense = | $1,053,000 |
| Current Capital Spending | $192,010,000 |
| Current Depreciation & Amortization | $106,523,000 |
| Effective tax rate (for use on operating income) | 37.27% |
| Marginal tax rate (for use on cost of debt) | 37% |
| Current Revenues = | $2,385,002,000 |
| Current Non-cash Working Capital = | ($125,854,000) |
| Chg. Working Capital = | ($30,015,000) |
| Book Value of Debt = | $1,716,019,686.33 |
| Book Value of Equity = | $699,892,000 |
|  |  |
| Cash & Marketable Securities = | 125,245,000 |
|  |  |
| Market Data for your firm |  |
| Is your stock currently traded? | Yes |
| *If yes, enter the following:* |  |
| Current Stock Price = | 176.69 |
| Number of shares outstanding = | 27,672,839 |
| Market Value of Debt = | $0 |
| *If no, enter the following* |  |
| Would you like to use the book value debt ratio? | No |
| If no, enter the debt ratio to use in valuation | 0.01% |
|  |  |
| *General Market Data* |  |
| Long Term Risk free rate= | 3.00% |
| Risk premium for equity = | 12.93% |
|  |  |
| *Ratings* |  |
| Do you want to estimate the firm's synthetic rating = | Yes |
| If yes, choose the type of firm | 1 |
| If not, what is the current rating of the firm? | A++ |
| Enter the cost of debt associated with the rating = | 0.00% |
|  |  |
| *Options* |  |
| Do you have equity options (management options, warrants) outstanding? | No |
| If yes, enter the number of options | 0.00 |
| Average strike price | $0.00 |
| Average maturity | 0 |
| Standard Deviation in stock price | 0% |
| Do you want to use the stock price to value the option or your estimated value? | Current Price |
|  |  |
| Valuation Inputs |  |
| *High Growth Period* |  |
| Length of high growth period = | 5 |
| Beta to use for high growth period for your firm= | 0.81 |
| Return on Capital = | 18.81% |
| Reinvestment Rate = | 1.00% |
|  |  |
| Do you want me to gradually adjust your high growth inputs in the second half? | Yes |
|  |  |
| *Stable Growth Period* |  |
| Growth rate during stable growth period = | 10.00% |
| Beta to use in stable growth period = | 1.00 |
| Risk premium for equity in stable growth period = | 7.00% |
| Debt Ratio to use in stable growth period = | 30.00% |
| Pre-tax cost of debt in stable growth period = | 9.00% |
| Tax Rate to use in stable growth period = | 37.00% |