

(BN) Steak Quesadillas Seen as Driving Yum Taco Bell Rebound: Retail

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By Leslie Patton

March 14 (Bloomberg) -- Tacos are trumping chicken and pizza at Yum! Brands Inc.

Just two years ago, the Louisville, Kentucky-based company's Taco Bell chain was warding off claims its beef wasn't real. Now the taco seller is Yum's fastest-growing brand in the U.S. Meanwhile, sister chain KFC is closing stores, and Pizza Hut is locked in a price war with Domino's Pizza Inc. and Papa John's International Inc. to sell pies as low as \$7.99.

Taco Bell's secret sauce? New upscale menu items and premium pricing to go with it. Taco Bell is having success appealing to young men and women with ranch- and nacho cheese- flavored taco shells and a Chipotle-esque menu of citrus-herb marinated chicken and cilantro rice. Sales at U.S. Taco Bell stores open at least a year jumped 5 percent in the three months ended Dec. 29, topping KFC and Pizza Hut, as well as fourth- quarter same-store sales at McDonald's Corp.

"We haven't seen this kind of a surge of same-store sales at Taco Bell in some time," Bryan Elliott, an Atlanta-based analyst at Raymond James Financial Inc., said in an interview. "What's working is more upscale pricing."

The home of the 89-cent nachos will this year introduce its most expensive single item yet -- fajitas for \$5.49. Taco Bell has been justifying the pricier fare with a series of TV commercials starring celebrity chef Lorena Garcia, who created the chain's Cantina Bell menu. As Garcia says in the ads: People "won't even believe it's Taco Bell."

Struggling Shares

Taco Bell's rebound comes as challenges in China weigh on the parent's shares. Yum is struggling to win back consumers in its biggest overseas market after a former supplier's chicken was found to contain high levels of antibiotics. In November, Yum was trading at a 64 percent premium to the Standard & Poor's

500 Index on a price-to-earnings basis, according to data compiled by Bloomberg. Now it's trading at a 37 percent premium.

The shares gained 4.4 percent this year through yesterday, while the S&P 500 Index has advanced 9 percent.

Taco Bell and its "Think Outside the Bun" slogan flourished in the mid-2000s until the downturn hurt sales. While same-store sales rose 2 percent in 2010, they dropped 2 percent the next year after an Alabama law firm filed a class action lawsuit claiming the chain was using beef that didn't contain enough real meat. While the suit was dropped, Taco Bell was forced to mount a national marketing campaign to make sure Americans knew its taco meat was 88 percent real beef, along with secret seasonings.

Mashup Buzz

Taco Bell sales began to pick up last year after its Doritos Locos Tacos mashup generated buzz even among food critics. The chain has sold about 375 million of the hard shell beef tacos, or more than one for every person in the U.S. This year, Taco Bell is expanding its Cantina Bell line from just burritos and bowls to include double-steak quesadillas for \$4.99 and fajitas for \$5.49, Taco Bell's Chief Executive Officer Greg Creed said in an interview.

“Cantina Bell was a great addition” to Taco Bell, Creed said. “Cantina makes us more relevant.”

While it has about 1,000 fewer stores than in 2000, Taco Bell is now poised for expansion. In December Creed told an investor conference that there is room for the chain to open another 2,000 restaurants in the U.S. in the next 10 years.

There were 5,695 U.S. Taco Bell stores at the end of last year, of which 18 percent were owned by Yum.

Hedge-fund manager David Einhorn has expressed confidence in Taco Bell, saying in October that the “resurgent” chain is poised to steal share from Chipotle Mexican Grill Inc. So far there is little evidence that this is happening.

Customer Overlap

There isn’t much overlap between Taco Bell and Chipotle customers, said Bob Goldin, executive vice president at Chicago-based researcher Technomic Inc.

“Chipotle is more good food and good for the environment - a different kind of message,” he said.

Taco Bell, long a favorite among the late-night party crowd, is also trying to attract customers in the morning. Last year, it began selling breakfast foods in about 820 locations in the western U.S., a strategy that pits the chain directly against McDonald’s, which dominates the morning fast-food rush.

The breakout product is the so-called A.M. Crunchwrap -- scrambled eggs, bacon or sausage, cheese and hash browns wrapped in a flour tortilla for \$2.49, Creed said. The chain, which is also hawking Cinnabon-branded doughnut bites to its morning patrons, is planning to introduce breakfast across the U.S. in

2014 and will advertise it nationally, Creed said.

Much of Taco Bell’s recent success boils down to smart marketing, according to Goldin.

“Their food looks pretty good in those ads,” he said.

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