3 Reasons For Continued Confidence In Shake Shack

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Summary

- Shake Shack remains on a roll.
- New store expansion will capitalize on pent-up demand for the brand.
- New ChickenShack product appeals to people’s growing interest in chicken at quick serve restaurants.
- Recent IPOs of other quick serve chains prove consumer demand for concepts like Shake Shack.

Shake Shack (NYSE: SHAK) is still on a roll. Last September I conveyed that the brand had the right combination of factors to justify strong optimism for the IPO it was going to offer. Its recently announced plans for a secondary offering have prompted me to revisit the brand, and to continue to have confidence in Shake Shack.

Three important developments have occurred since its record-busting IPO in January. Despite the skepticism each has generated, these developments actually provide additional indications that Shake Shack will be serving up strong growth alongside its popular burgers and shakes for a long time coming.

Shake Shack is growing its footprint, opening or announcing plans to open new stores in Illinois, Texas, Arizona, and California. This means the brand will be able to capitalize on the pent-up demand and buzz it has generated. It's grown its unit count from 21 to 63 in the past 3 years and these new plans will take it above 70 by year’s end. Some critics express concern over such rapid growth, pointing to other beloved chains including Krispy Kreme (NYSE: KKD) and Starbucks (NASDAQ: SBUX), which expanded too fast in the past. After alienating customers with poor quality and over-exposure, these chains were forced to retreat from their aggressive growth.

But a responsible approach to growth has been a hallmark of Shake Shack's leadership, and there's no indication they're straying from that strategy. I previously reported CEO Randy Garutti says they want Shake Shack to be the anti-chain chain and "We never talk in terms of 'units' or 'templates' or 'how fast can we go?"" Garutti recently told a Fast Company reporter that Chairman of the Board Danny Meyer "thinks long-term dollars better than anybody. It's really cool to know that there isn't pressure to just make money, make money, make money. If we build this brand right, we're all going to benefit."

Other skeptics point out that the chain's westward expansion puts the brand in the territory currently dominated by In-N-Out, another burger lovers' chain. But despite the taste tests and trash talking that has resulted from the rivalry between fans of each brand, there is enough demand for both. Consumers' appetite for burgers continues to rise, and the two brands are actually different enough to co-exist. In-N-Out embodies a more old-fashioned neighborhood hamburger stand personality, while Shake Shack is perceived to be more contemporary and urban. For years, In-N-Out has maintained a limited menu of hamburgers, cheeseburgers, fries, three flavors of shakes, and soft drinks, while Shake Shack's offerings include hot dogs, multiple shake options, and creative burger options offered for a limited time only and/or in specific locations.

Shake Shack's menu is the subject of a second significant development for the brand. Earlier in July it debuted a test of the ChickenShack, a fried chicken sandwich. While the addition represents a departure from the company's "classic" hamburger and hot dog stand foundation, it reflects people's growing interest in chicken at quick serve, as evidenced by the strong growth of Chick-fil-A and Popeye's Louisiana Kitchen.

Some may question if the brand is veering too far off its identity by adding chicken; others might worry about the
operational complexity resulting from adding a new ingredient and cooking process into Shack Shack's kitchen. But the company's handling of a failed new fry test should assuage these concerns. Back in 2013, Garutti and his team decided to replace its frozen fry product with a fresh one in an attempt to improve the freshness of its product line-up and brand image. But many customers didn't like the new fries and were very vocal in their rejection of the test. They took to social media with their complaints and wrote letters imploring the chain to switch back. Hearing this impassioned feedback, Shake Shack pronounced a public mea culpa, reversed course, and reinstated the old fry. That's one of the benefits the company enjoys from its strong brand identity and fanatically-loyal customer base -- its customers will keep it on track even if management makes a mistake.

The last development affecting Shake Shack of late is the IPOs of several other fast casual restaurant chains including Bojangles (NASDAQ:BOJA), Wing Stop (NASDAQ:WING), and rival hamburger chain Habit Restaurants (NASDAQ:HABT). Indeed there seems to be a run-up on restaurant stocks. And some people advance the opinion that Habit burger serves superior burgers and therefore poses a threat to Shake Shack.

But the recent attraction of fast casual restaurants indicates strength in the category, and therefore, another reason to be optimistic about Shake Shack. Fast casual remains the fastest-growing segment of the restaurant industry and shows no signs of stopping. Customers have demonstrated a sustained affinity for higher-quality products and better experiences than what traditional fast food restaurants can offer, and in fact many fast food chains are upgrading their offerings to be more like fast casual. Instead of competing over a static pie, the segment-wide expansion of fast casuals is growing the pie and Shake Shack is well-positioned to capture its fair share.

Because -- not despite -- of recent developments, Shake Shack is likely to continue to satisfy investors' appetites.

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