

# LONG CHIPOTLE



**TICKER: CMG**  
**CURRENT PRICE: \$280.90**  
**PRICE TARGET: \$371.94**  
**EXPECTED RETURN: 32%**

# COMPANY OVERVIEW

- Chipotle is a chain of fast casual restaurants across the U.S., Canada, France, Germany, and United Kingdom that offer tacos, salads, bowls and burritos
- Opened first store in 1993 with the idea that “food served fast didn’t have to be a ‘fast food’ experience”
- Industry: Restaurants
- Headquarters: Denver, CO
- Number of locations (as of 9/30/17): 2,374



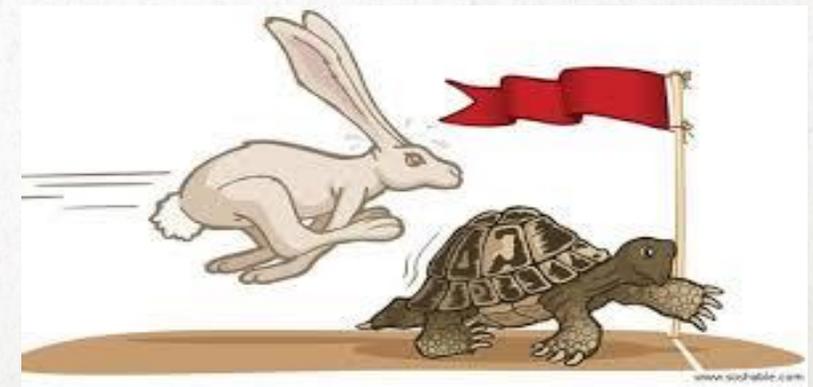
# THE 2015 E. COLI OUTBREAK

- Between October 2015 and December 2015 there were 5 outbreaks of E. Coli across the U.S.
- Almost 500 people were affected
- Chipotle created a strong brand by using the slogan “Food with Integrity” but E. Coli outbreak threatens this brand image
- Chipotle sees its first quarterly sales decline as sales in Q4 decline to \$998M from \$1.2B
- Profit falls to \$68M from \$145M as customers eat elsewhere



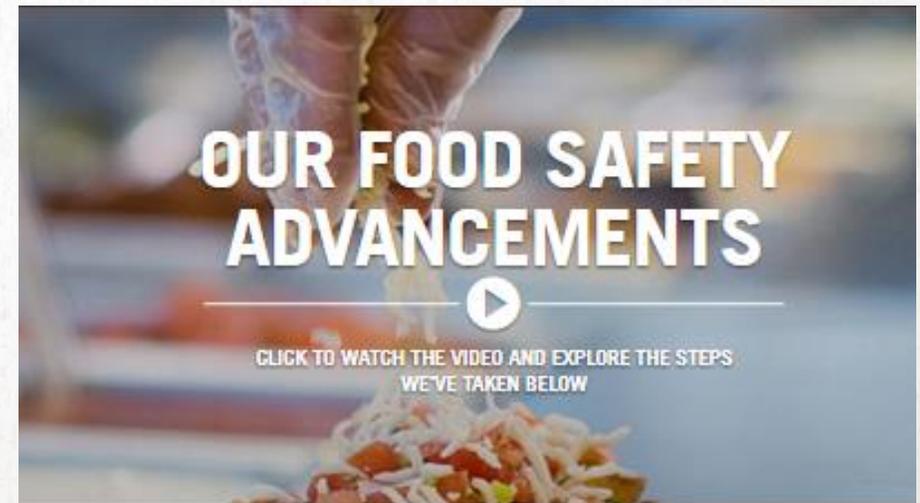
# 2017 - THIRD QUARTER MISSES

- Chipotle missed on revenue and earnings per share
- Adjusted EPS was estimated to be \$1.63 but was \$1.33
- Revenue was estimated at \$1.14 but was actually \$1.13
- Missed on comps which was expected to be 1.2% but was 1%
- Stock price dropped almost 15%
- Norovirus outbreak at one location in Virginia likely contributed to these quarter results
- There hasn't been any other Norovirus outbreaks reported besides this one location
- Adverse weather due to Hurricanes Harvey and Irma likely played a factor also
- Results were only for one quarter meanwhile changes will take more patience to transpire



# INVESTMENT THESIS

- Chipotle will recover from E. Coli scare in late 2015 and Q3 2017 earnings miss
- Earnings and free cash flow have already improved since the E. Coli outbreak in 2015
- Taco Bell in 2006 and Jack in the Box in 1993 both went through a similar situation with E. Coli outbreaks of their own and both recovered
- Chipotle has invested lots of money on training, technology, certifications for managers and inspections all to improve food safety
- There hasn't been disregard for the taste of the food but there has been in the safety, therefore I don't see a broken company. I see a company with a short-term problem that is solvable through time



# FINANCIAL POSITION

- Financial position is stable because there are no debt and the company has \$548M in cash and short term investments
- Despite bad news from the media, net income has always been positive except for Q1 2016
- Free cash flow has been positive also. Only 1 quarter over the last 10 of negative free cash flow and that was only a loss of \$1M
- Free cash has been trending upwards over the last twelve months

<i>In millions</i>	Q3 2017	Q2 2017	Q1 2017	Q4 2016	Q3 2016	Q2 2016
Operating Cash Flow	135	93	151	68	101	118
Cap Ex	-52	-57	-57	-67	-66	-64
Free Cash Flow	83	36	94	1	35	54

<i>In millions</i>	TTM	2016	2015	2014	2013	2012
Operating Cash Flow	447	349	683	682	529	420
Cap Ex	-232	-259	-257	-253	-200	-197
Free Cash Flow	215	90	426	429	329	223



# ROIC AND ROE ARE GOOD DESPITE CONCERNS

- Return on invested capital hasn't returned to pre-2015 E. Coli outbreak levels when it was in the mid to low 20's, but is still high at current rate of 10% over the last 12 months
- Same for return on equity as it is at 10% also
- This is due to an increase in operating profit and net profit as Chipotle is starting to win back customers
- Operating profit and net profit have increased every quarter this year so far

<i>In millions of USD except percentages</i>	TTM	2016	2015	2014	2013
Net Income	148.00	23.00	476.00	445.00	327.00
Equity	1,387.00	1,402.00	2,128.00	2,012.00	1,538.00
Return on Equity	10.67%	1.64%	22.37%	22.12%	21.26%
Return on Invested Capital	10.50%	1.30%	22.97%	25.09%	23.52%

Source: My own calculations and Morningstar

<i>In millions of USD</i>	2017 Q3	2017 Q2	2017 Q1	2016 Q4	2016 Q3	2016 Q2	2016 Q1
Operating Income	31	107	73	31	10	41	-47
Net Income	20	67	46	16	8	26	-26

Source: Morningstar



# KEY VALUATION METRICS

- Market Cap: \$7.9B
  - Cash: \$548M
  - Debt: 0
  - Enterprise Value: \$7.35B
  - Price/TTM Sales: 1.8
  - Price/TTM Earnings: 53.3
  - Price/TTM Free Cash Flow: 36
  - EV/EBIT: 30.5
- TTM Sales: \$4.4B
- TTM Earnings: \$148M
- TTM Free Cash Flow: \$215M

\*Multiples are high due to depressed earnings but as earnings improve, as I believe they will, the multiples won't have looked so high post recovery



# VALUATION ASSUMPTIONS

- TTM Free Cash Flow: \$215M
- Expected Free Cash Flow at 2018: \$350M\*
- Multiple: 30
- Value: \$10.5B
- Shares Outstanding: 28.23M
- Value Per Share: \$371.94
- Current Price Per Share: 280.90
- Expected Return: 32%

\* 2018 expected free cash flow is based on new store openings and improved customer traffic close to what was seen in 2014-early 2015



# CATALYSTS

- Almost 2 years have passed since the 2015 E. Coli outbreak and costumers are starting to return and profitability is picking up suggesting the bottom was likely in 2016
- Pershing Square led by Bill Ackman initiated a 9.9% stake in the company and has added 4 new directors and named Steve Ells sole CEO
- Despite the health scares, the food is still good and as time passes the news will subside
- Working hard to rebuild the brand name by investing in food safety
- Has tested new products and ideas with the new Queso dip and the new mobile app for Android and Apple to make ordering easier. Other menu items such as dessert and margaritas are only two other ideas that could be initiated at some point to increase sales
- Expansion more into the U.S. and international over the next 2-5 years



# RISKS

- Fail to revive the “food with integrity” brand image
- Sensitive to negative media regarding health concerns. Actor Jeremy Jordan – whom I have never heard of before - claims he “almost died” eating at Chipotle sending the shares down 2.7% on November 13, 2017
- Recent class-action lawsuit over unpaid wages by employees
- Competitors such as Qdoba, Moe’s, Dos Toros, or others take away market share



# SUMMARY

- Chipotle has gotten a first mover advantage by being one of the first fast casual concepts and have established good real estate to position stores effectively
- From what I see during my lunch break in Manhattan, customers are starting to return as lines form and seats fill up.
- This also shows in the improving free cash flow and profit from 2016
- Stores aren't as filled up as they were before the outbreak in 2015 but there is room to reach these levels as management works to rebuild the brand image
- \$548M in cash with no debt and positive earnings help protect the downside
- Increased customer traffic and new store openings can bring free cash flow back to where it was in 2014 to early 2015
- This results in a value per share of \$371.94 and 32% upside over the next year

- THANK YOU FOR READING!
- Disclosure: I am long Chipotle

