

Chipotle Mexican Grill (CMG)

\$858.19 (As of 01/02/20)

Price Target (6-12 Months): **\$901.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 01/01/20)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: D

Growth: A

Momentum: A

Summary

Shares of Chipotle have outperformed the industry in a year's time. The company's focus on increasing food safety and enhancing customer experience, along with various sales-building and strategic initiatives are likely to drive the top line. In an effort to attract more customers, the company launched its loyalty program — Chipotle Rewards — nationwide. Despite its share of negative publicity from a food-borne illness, the company's viable business strategy bodes well. For 2019, management expects comps to grow in high-single digit. Earnings estimates for current quarter and 2020 have also witnessed upward revision over the past 60 days, reflecting investors' optimism regarding the stock. However, high costs and intense competition are concerning. Also, high costs of operations is an added concern for Chipotle.

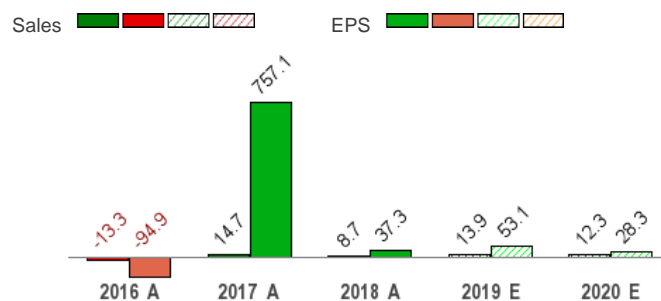
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$870.94 - \$441.28
20 Day Average Volume (sh)	281,726
Market Cap	\$23.9 B
YTD Price Change	2.5%
Beta	0.71
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Retail - Restaurants
Zacks Industry Rank	Top 26% (67 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	19.4%
Last Sales Surprise	1.8%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	02/04/2020
Earnings ESP	4.7%
P/E TTM	66.4
P/E F1	48.2
PEG F1	2.5
P/S TTM	4.4

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	1,464 E	1,605 E	1,583 E	1,567 E	6,225 E
2019	1,308 A	1,434 A	1,404 A	1,395 E	5,541 E
2018	1,148 A	1,267 A	1,225 A	1,225 A	4,865 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$4.01 E	\$5.24 E	\$4.56 E	\$4.00 E	\$17.79 E
2019	\$3.40 A	\$3.99 A	\$3.82 A	\$2.67 E	\$13.87 E
2018	\$2.13 A	\$2.87 A	\$2.16 A	\$1.72 A	\$9.06 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/02/2020. The reports text is as of 01/03/2020.

Overview

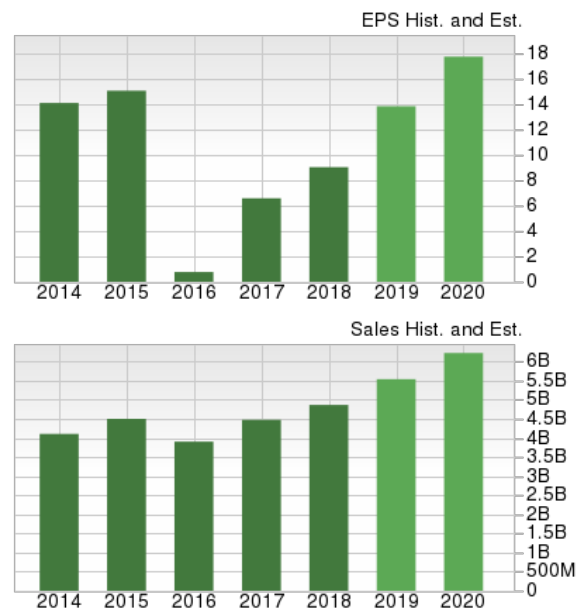
A Delaware corporation, Chipotle Mexican Grill Inc. (CMG), together with its subsidiaries operates quick-casual and fresh Mexican food restaurant chains. The company was founded in 1993 by Steve Eells who started with a single restaurant in Denver, CO. The company offers a focused menu of burritos, tacos, burrito bowls (a burrito without the tortilla) and salads. Chipotle restaurants feature free-range, hormone-free pork, natural chicken and other meat products cooked through traditional methods and served in a unique atmosphere. Chipotle classifies its restaurants as end-caps (at the end of a line of retail chains), in-lines (in a line of retail chains), free-standing units and others.

Chipotle, being one of the most recognized fast-casual Mexican restaurant chains in the United States, had a good share of negative publicity throughout 2016 due to an issue of food-borne illnesses that surfaced toward 2015-end. As a safety measure, the company was forced to close several outlets. In order to chalk out a viable business strategy, Chipotle discarded its former co-CEO model and appointed former Yum! Brands' executive Brian Niccol as the CEO.

The company is committed in using high-quality real ingredients, classic cooking techniques and distinctive interior design to serve customers. As of Dec 31, 2018, the company operated nearly 2,500 restaurants across the United States, Canada, the U.K., France and Germany. Notably, the company manages its operations and restaurants based on eleven regions that make one reportable segment.

Chipotle's marketing strategy shifted from a promotion driven decentralized approach in 2017 to a more central model designed to generate higher consumer awareness and attract guests. The company utilizes multiple marketing channels, including national television, digital marketing, social media, fundraising, events and sponsorships to reach consumers. Delivery services are mostly made by third party service providers.

In 2018, Chipotle launched a loyalty program called Chipotle Rewards, which provides customers with the opportunity to earn bonus points or free food. Earned rewards generally expire one to six months after they are issued, and points generally expire if an account is inactive for a period of six months.



Reasons To Buy:

▲ **Share Price Gains on Robust Earnings Trend:** Shares of Chipotle have gained over the past year, outperforming the industry's rally. The robust share price appreciation can be attributed to better-than-expected earnings in eight consecutive quarters. The company's trailing four-quarter average positive surprise was 16.1%. In the third quarter of 2019, adjusted earnings of \$3.82 per share surpassed the Zacks Consensus Estimate of \$3.20. The bottom line also improved 76.9% from the year-ago quarter driven by increased revenues and strong operating margins. For current quarter and 2020, earnings estimates have been revised upward over the past 60 days, reflecting analysts' optimism surrounding the company's earnings potential.

Chipotle's increased focus on food safety and enhancing customer experience, along with various sales-building and strategic initiatives bode well.

▲ **Efforts to Revive Brand Recognition:** Chipotle, being one of the most recognized fast-casual Mexican restaurant chains in the United States, had a good share of negative publicity throughout 2016 due to an issue of food-borne illnesses that surfaced toward 2015-end. As a safety measure, the company was forced to close several outlets. Ever since then, this fast-casual Mexican chain has been undertaking aggressive efforts to restore its economic model as well as regain customer trust. In order to chalk out a viable business strategy, Chipotle discarded its former co-CEO model and appointed former Yum! Brands' executive Brian Niccol as the CEO. Niccol's expertise in restaurant operations, digital technologies and branding significantly helped Chipotle in boosting earnings.

In order to strengthen its brand position, Chipotle pursued the Big Fix initiative, designed to revive restaurant standards. Through Cultivate University, the company trained its field leaders via an in-restaurant and in-classroom one-week training session, launched in April. This is expected to reinforce crew member engagement and drive consumer awareness of the brand.

▲ **Increased Focus on Food and Environment Safety:** As a part of its revival strategy, Chipotle fulfilled its pledge of using no added colors, flavors or preservatives of any kind in any of its ingredients. In fact, Chipotle has long been a pioneer in serving superior quality ingredients including the use of local and organically grown produce, dairy from cows raised on pasture, and meat from animals raised without hormones or antibiotics.

The company has also taken noteworthy steps to reduce the amount of food and packaging waste to be disposed of in landfills and has increased its diversion rate from 31% in 2015 to 40% in 2017. As announced, Chipotle is implementing practices like minimal food waste disposal during the preparation process, recycling as well as compost programs for food packages, use of reusable lids replacing plastic wraps and participation in the Harvest Program to donate leftover food to local communities. The company is also increasing composting convenience in its restaurants to 20% by 2020.

For ensuring food safety, the company introduced a crew bonus program to more than 2,600 employees during the last reported quarter which will pay its employees a bonus amount if they achieve their desired goal in food safety. Also, the company recently introduced the Debt-Free Degrees program in addition to its newly expanded tuition reimbursement program to develop a better restaurant culture.

▲ **Various Initiatives to Spur Growth:** Chipotle is working on strengthening its brand and recovering sales by shifting its strategy from giveaways, discounts and rewards to new menu items, operational excellence, enhancement of guest experience by retraining workers, technology-driven convenience, and more aggressive brand marketing. Roll out of queso substantially spurred sales. Additionally, Chipotle has been working on a new pipeline for its menu offerings. On Jan 2, Chipotle launched its first menu innovation called Lifestyle Bowls for mobile and web orders that resonated well with consumers. It generated over 1.3 billion earned media impressions in the first few days of January. Recently, the company introduced new kitchen ovens, which are improving the quality of its latest Quesadillas. The company is also testing queso blanco, salads in quesadillas that are gaining valuable feedback in various markets besides carne asada. Carne asada will be available for a limited time period and is also recently added in the Lifestyle Bowls.

Notably, the company's robust marketing activities, including a combination of brand-building efforts, as well as transaction-driving promotions and advertising, are resulting in a steady inflow of new customers. The company also partnered with a film director, David Gelb, for the carne asada launch. For 2019, the company's priorities will revolve around the five key initiatives namely, digital system investments such as pickup shelves, digitized make lines, loyalty and delivery; marketing programs focusing on cooking techniques; and menu innovation and operational excellence.

▲ **Strengthening Digital Capabilities:** Chipotle is prioritizing its e-Commerce program to gain customer confidence as part of its digital innovation. The company is aggressively trying to make digital ordering more appealing to customers and more efficient for its restaurants, in order to drive digital sales and retain customers. In the regard, Chipotle has redesigned and simplified its online ordering site, enabled online payment for catering, online meal customizations and collaborated with several well-known third-party providers for delivery.

The third quarter also saw particularly strong traction in delivery sales. In the third quarter, digital sales grew 88% year over year. Digital sales totaled \$257 million during the third quarter and represented 18.3% of sales. Also, since the rollout of its "Smarter Pickup Times" technology, there has been a significant increase in digital orders and higher guest satisfaction. As the company's digital orders are made on a second makeline, it allows it to deliver excellent throughput and enhance the experience of customers, who are increasingly shifting to digital ordering. As of now, Chipotle enabled digitized makelines in nearly 2,000 restaurants and expects to roll it out in all restaurants by the end of 2019. Meanwhile, the company is pressing ahead with enhancing its delivery system. Delivery remains a key driver for its digital growth. In fact, delivery is now available for more than 97% of its restaurants.

Reasons To Sell:

- ▼ **Food-Safety Issues Hurt Chipotle:** Throughout 2016 Chipotle's results continued to be affected by the negative publicity related to the food-borne illnesses, which surfaced toward 2015-end. As a safety measure, the fast-casual chain was forced to close several outlets. Although these were reopened later with fresh ingredients and extensive cleaning and sanitizing activities, these incidents dealt a severe blow to Chipotle's sales. Evidently, the company's earnings and revenues came under tremendous pressure in 2017. Though it is on the road to recovery, it expects comps increase in a mid-single-digit range in 2018. Thus, we believe, it will take time for the company to completely restore its economic model as well as regain customer trust. Moreover, the closure of a Washington-area outlet last July due to an apparent norovirus alert started a fresh round of food-safety scare. Evidence of rodents was found at a Dallas outlet, further adding to the woes.
- ▼ **Cost Issues Keeping Profits Under Pressure:** Chipotle continued efforts to connect with its customers in order to retrieve their trust and loyalty as well as bring them back to its stores on the back of high marketing and promo expenses, has been hurting its profitability. Moreover, costs to support the company's newly designed food safety program can weigh on the company's margins. Also, implementation of food safety practices has increased the amount of labor required to prepare and serve food, resulting in higher labor costs which may continue to keep profits under pressure. In the third quarter of 2019, general and administrative expenses increased 5.1% from the year-ago quarter.
- ▼ **Valuation Looks Stretched:** Chipotle's valuation looks a bit stretched compared with its industry average. Looking at the company's forward 12-month price-to-earnings (P/E) ratio, which is one of the most commonly used valuation ratios and is best suited for evaluating restaurants, investors might not want to pay any further premium. It currently has a forward 12-month P/E ratio of 61.77. So, the stock is relatively overvalued right now compared with its peers as the industry's average PE is 23.17 currently.
- ▼ **Industry Susceptible to Consumer Discretionary Spending:** Chipotle operates in the retail restaurant space that is highly dependent on consumer discretionary spending. Consumers' propensity to spend largely depends on the overall macroeconomic scenario. Although higher disposable income and increased wages are favoring the industry right now, it can change with the slightest disruption in the economy. The company, therefore, is highly vulnerable to the inconsistent nature of consumer discretionary spending. If it does not make pragmatic use of advanced technologies to innovate across value chains, it has high chances of fading out like many other restaurant retailers.

Food-safety issues and high costs associated with U.S. restaurant space remain potent headwinds.

Last Earnings Report

Chipotle Q3 Earnings & Revenues Surpass Estimates

Chipotle Mexican Grill reported third-quarter 2019 results, wherein both earnings and revenues surpassed the respective Zacks Consensus Estimate. While the bottom line beat the consensus estimates for the eighth straight quarter, the top line came ahead of the same for the fourth consecutive quarter.

The company's adjusted earnings of \$3.82 per share surpassed the Zacks Consensus Estimate of \$3.20. The bottom line also improved 76.9% from the year-ago quarter, driven by increased revenues and strong operating margins.

Chipotle's increased focus on augmenting customer experience by introducing food-safety programs, various sales-building initiatives and greater digital innovation resulted in revenue growth in the third quarter.

Quarter Ending **09/2019**

Report Date	Oct 22, 2019
Sales Surprise	1.76%
EPS Surprise	19.38%
Quarterly EPS	3.82
Annual EPS (TTM)	12.93

Revenues & Comparable Restaurant Sales

Quarterly revenues of \$1.4 billion surpassed the consensus estimates by 1.8% and improved 14.6% year over year. This upside is primarily attributable to improvement in comps and restaurant openings. In the quarter under review, Chipotle opened 25 restaurants and closed one, taking the total restaurant count to 2,546.

Comps in the third quarter rose 11%, driven by a rise of 7.5% in comparable restaurant transactions and an increase of 3.5% in average check.

Costs, Operating Highlights & Net Income

Food, beverage and packaging costs, as a percentage of revenues, decreased 20 basis points (bps) to 33.2% due to benefit of menu price increases, marginally negated by higher costs of ingredients.

Restaurant-level operating margin was 20.8%, up 210 bps from 18.7% in the year-ago quarter. This upside was primarily driven by comps growth, partially offset by wage inflation, increased food costs, and marketing and delivery expenses.

Net income in the reported quarter amounted to \$98.6 million, up from \$38.2 million in the prior-year quarter.

Balance Sheet

Cash and cash equivalents as of Sep 30, 2019, were \$386.6 million compared with \$250 million as of Dec 31, 2018.

Inventory totaled \$23.9 million as of Sep 30, 2019, down from \$21.6 million as of Dec 31, 2018. Goodwill, as a percentage of total assets, was 0.4% at the end of the third quarter compared with 1% at the end of 2018.

2019 Outlook

For 2019, management expects comps to grow in a high-single digit. The company estimates effective tax rate between 26% and 29%. It still expects to inaugurate 140-155 restaurants in 2019.

Valuation

Chipotle's shares are up 88.6% over the trailing 12 months. Stocks in the Zacks sub-industry and the Zacks Retail-Wholesale sector are up 19.9% and 22.6% over the past year, respectively.

The S&P 500 index is up 26.3% in the past year.

The stock is currently trading at 61.77x forward 12-month Price to Earnings value, which compares with 24.77x for the Zacks sub-industry, 26.73x for the Zacks sector and 19.07x for the S&P 500 index.

Over the past five years, the stock has traded as high as 206.3x and as low as 24.82x, with a 5-year median of 43.92x. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$901 price target reflects 64.87x forward 12-month Price to Earnings value.

The table below shows summary valuation data for CMG.

Valuation Multiples - CMG					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	61.77	24.77	26.73	19.07
	5-Year High	206.3	26.41	26.73	19.34
	5-Year Low	24.82	20.45	18.99	15.17
	5-Year Median	43.92	23.17	22.87	17.44
P/S F12M	Current	4.3	3.48	1.06	3.46
	5-Year High	4.64	3.85	1.1	3.46
	5-Year Low	1.44	2.91	0.8	2.54
	5-Year Median	2.79	3.24	0.9	3
P/CF	Current	36.69	16.71	14.26	22.59
	5-Year High	38.1	20.39	15.11	22.67
	5-Year Low	15.15	8.5	10.69	11.78
	5-Year Median	26.9	16.44	12.82	16.21

As of 01/02/2020

Industry Analysis Zacks Industry Rank: Top 26% (67 out of 253)



Top Peers

Arcos Dorados Holdings Inc. (ARCO)	Outperform
Bloomin Brands, Inc. (BLMN)	Neutral
Cracker Barrel Old Country Store, Inc. (CBRL)	Neutral
Dominos Pizza Inc (DPZ)	Neutral
Darden Restaurants, Inc. (DRI)	Neutral
Brinker International, Inc. (EAT)	Neutral
Restaurant Brands International Inc. (QSR)	Neutral
Yum! Brands, Inc. (YUM)	Neutral

Industry Comparison Industry: Retail - Restaurants				Industry Peers		
	CMG Neutral	X Industry	S&P 500	BLMN Neutral	QSR Neutral	YUM Neutral
VGM Score	B	-	-	A	D	D
Market Cap	23.85 B	427.00 M	23.76 B	1.92 B	19.29 B	30.90 B
# of Analysts	16	5	13	6	11	8
Dividend Yield	0.00%	0.00%	1.78%	1.81%	3.09%	1.64%
Value Score	D	-	-	A	C	D
Cash/Price	0.04	0.04	0.04	0.03	0.09	0.02
EV/EBITDA	54.59	14.52	13.97	11.25	14.33	16.76
PEG Ratio	2.53	2.09	2.02	1.32	2.04	2.01
Price/Book (P/B)	14.70	2.72	3.38	12.66	4.75	NA
Price/Cash Flow (P/CF)	52.37	11.38	13.70	5.46	11.22	27.07
P/E (F1)	48.58	21.88	18.83	12.92	21.78	24.58
Price/Sales (P/S)	4.44	0.91	2.68	0.46	3.50	5.66
Earnings Yield	2.07%	4.53%	5.30%	7.74%	4.59%	4.07%
Debt/Equity	1.63	0.94	0.72	15.62	3.18	-1.30
Cash Flow (\$/share)	16.39	1.53	6.94	4.05	5.77	3.77
Growth Score	A	-	-	C	C	C
Hist. EPS Growth (3-5 yrs)	-6.46%	7.71%	10.56%	7.11%	29.98%	0.29%
Proj. EPS Growth (F1/F0)	28.24%	8.25%	7.41%	8.69%	10.29%	12.46%
Curr. Cash Flow Growth	29.44%	7.73%	14.83%	4.05%	19.29%	-9.66%
Hist. Cash Flow Growth (3-5 yrs)	1.62%	7.10%	9.00%	2.17%	32.62%	-11.09%
Current Ratio	1.51	0.63	1.23	0.27	1.09	1.57
Debt/Capital	61.96%	61.12%	42.92%	93.98%	76.05%	NA
Net Margin	5.77%	3.14%	11.08%	2.75%	11.64%	20.88%
Return on Equity	23.97%	8.47%	17.10%	89.62%	32.20%	-11.69%
Sales/Assets	1.30	1.17	0.55	1.27	0.26	1.18
Proj. Sales Growth (F1/F0)	12.35%	3.09%	4.20%	2.11%	5.01%	4.77%
Momentum Score	A	-	-	C	F	C
Daily Price Chg	2.52%	0.47%	0.33%	0.14%	1.46%	1.43%
1 Week Price Chg	0.27%	0.00%	0.13%	-1.45%	-0.52%	1.30%
4 Week Price Chg	4.69%	0.12%	3.31%	-1.38%	-2.43%	3.70%
12 Week Price Chg	3.68%	0.00%	9.70%	18.43%	-9.13%	-10.64%
52 Week Price Chg	95.29%	7.43%	30.28%	22.57%	24.11%	14.62%
20 Day Average Volume	281,726	168,204	1,603,615	926,423	2,349,951	1,429,486
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.02%	0.00%	0.00%	0.00%	-0.00%	0.41%
(F1) EPS Est 12 week change	3.59%	-0.61%	-0.57%	1.41%	-0.61%	-2.30%
(Q1) EPS Est Mthly Chg	0.25%	0.00%	0.00%	0.00%	0.49%	0.00%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	D
Growth Score	A
Momentum Score	A
VGM Score	B

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

Disclosures

This report contains independent commentary to be used for informational purposes only. The analysts contributing to this report do not hold any shares of this stock. The analysts contributing to this report do not serve on the board of the company that issued this stock. The EPS and revenue forecasts are the Zacks Consensus estimates, unless indicated otherwise on the reports first page. Additionally, the analysts contributing to this report certify that the views expressed herein accurately reflect the analysts personal views as to the subject securities and issuers. ZIR certifies that no part of the analysts compensation was, is, or will be, directly or indirectly, related to the specific recommendation or views expressed by the analyst in the report.

Additional information on the securities mentioned in this report is available upon request. This report is based on data obtained from sources we believe to be reliable, but is not guaranteed as to accuracy and does not purport to be complete. Any opinions expressed herein are subject to change.

ZIR is not an investment advisor and the report should not be construed as advice designed to meet the particular investment needs of any investor. Prior to making any investment decision, you are advised to consult with your broker, investment advisor, or other appropriate tax or financial professional to determine the suitability of any investment. This report and others like it are published regularly and not in response to episodic market activity or events affecting the securities industry.

This report is not to be construed as an offer or the solicitation of an offer to buy or sell the securities herein mentioned. ZIR or its officers, employees or customers may have a position long or short in the securities mentioned and buy or sell the securities from time to time. ZIR is not a broker-dealer. ZIR may enter into arms-length agreements with broker-dealers to provide this research to their clients. Zacks and its staff are not involved in investment banking activities for the stock issuer covered in this report.

ZIR uses the following rating system for the securities it covers. **Outperform-** ZIR expects that the subject company will outperform the broader U.S. equities markets over the next six to twelve months. **Neutral-** ZIR expects that the company will perform in line with the broader U.S. equities markets over the next six to twelve months. **Underperform-** ZIR expects the company will underperform the broader U.S. equities markets over the next six to twelve months.

No part of this report can be reprinted, republished or transmitted electronically without the prior written authorization of ZIR.