

Chipotle Mexican Grill (CMG)

\$925.83 (As of 05/08/20)

Price Target (6-12 Months): **\$787.00**

Long Term: 6-12 Months

Zacks Recommendation: Underperform

(Since: 04/06/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

5-Strong Sell

Zacks Style Scores:

VGM:D

Value: F

Growth: B

Momentum: B

Summary

Shares of Chipotle have outperformed the industry in the past year. The company reported first-quarter 2020 results, wherein both earnings and revenues surpassed the consensus estimate. While the bottom line beat the consensus estimate for the 10th straight quarter, the top line surpassed the same for the sixth consecutive time. Although comps increased in the quarter, the growth rate declined sharply due to the coronavirus outbreak. In March, comps declined 16% due to the pandemic. Chipotle has also withdrawn its 2020 comparable restaurant sales guidance due to the outbreak. As the company has closed dine-in services, its digital sales have witnessed a sharp increase. In the first quarter of 2020, digital sales grew 81% year over year. Of late, estimates for the current year and next have witnessed downward revisions.

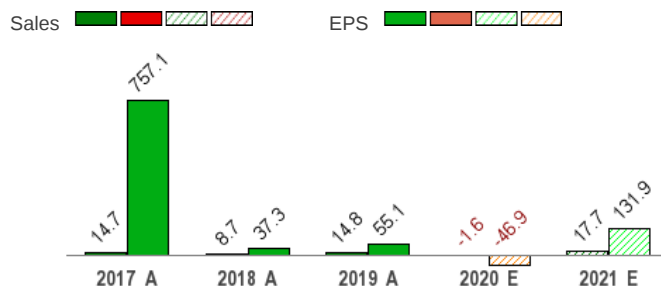
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$940.28 - \$415.00
20 Day Average Volume (sh)	645,653
Market Cap	\$25.8 B
YTD Price Change	10.6%
Beta	1.18
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Retail - Restaurants
Zacks Industry Rank	Bottom 32% (173 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	23.2%
Last Sales Surprise	0.8%
EPS F1 Est- 4 week change	-33.9%
Expected Report Date	NA
Earnings ESP	0.0%
P/E TTM	67.3
P/E F1	124.1
PEG F1	6.5
P/S TTM	4.5

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	1,549 E	1,635 E	1,633 E	1,690 E	6,467 E
2020	1,411 A	1,254 E	1,391 E	1,491 E	5,494 E
2019	1,308 A	1,434 A	1,404 A	1,440 A	5,586 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$3.93 E	\$4.59 E	\$4.65 E	\$4.70 E	\$17.30 E
2020	\$3.08 A	-\$0.56 E	\$2.10 E	\$3.14 E	\$7.46 E
2019	\$3.40 A	\$3.99 A	\$3.82 A	\$2.86 A	\$14.05 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 05/08/2020. The reports text is as of 05/11/2020.

Overview

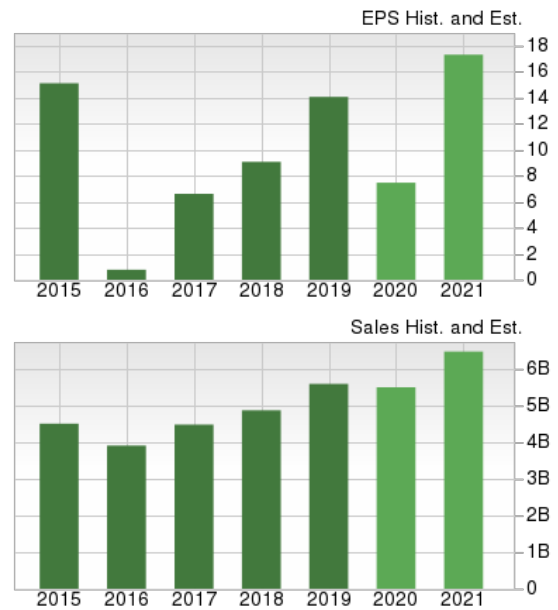
A Delaware corporation, Chipotle Mexican Grill, together with its subsidiaries operates quick-casual and fresh Mexican food restaurant chains. The company was founded in 1993 by Steve Eells who started with a single restaurant in Denver, CO. The company offers a focused menu of burritos, tacos, burrito 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 to using high-quality real ingredients, classic cooking techniques and distinctive interior design to serve customers. As of Mar 31, 2020, the company operated nearly 2,638 restaurants across the United States, Canada, the U.K., France and Germany.

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 Sell:

▼ **Coronavirus to Hurt Results:** Chipotle results in the coming quarters are likely to be impacted by the coronavirus outbreak. The restaurant industry has been facing declining traffic for quite some time now. We believe the coronavirus outbreak will further hurt traffic and sales in the coming quarter. The company has closed nearly 100 restaurants due to the pandemic, mostly in malls and shopping centers, as well as 17 locations in Europe. Moreover, the restaurants, which are open, are operating via to-go orders as dine-in services are closed.

High costs associated with U.S. restaurant space and the coronavirus outbreak remains potent headwinds.

Nonetheless, the company is following all guidelines provided by the CDC, FDA, state and local agencies to ensure safety of employees and guests. The steps include increased sanitization of high-touch, high-traffic areas, providing masks for employees and a tamper-evident packaging seal.

▼ **Comps Growth Rate Decline Due to Coronavirus:** Although the company's comparable restaurant sales were up 3.3% in first-quarter 2020, it was well below the 13.4% growth rate registered in the prior-year quarter. At the end of February, comps were up 14.4% in the first quarter. However, the metric witnessed a sharp decline of 16% in March due to the coronavirus outbreak. The company has withdrawn its comparable restaurant sales guidance due to the outbreak.

▼ **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.

▼ **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 84.25. So, the stock is relatively overvalued right now compared with its peers as the industry's average PE is 33.86 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.

Risks

- **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 2019. This is expected to reinforce crew member engagement and drive consumer awareness of the brand. Owing to the above-mentioned efforts, the company's earnings surpassed analysts' expectation in each of the trailing 10 quarters.

- **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.

Over the past few years, the company has strengthened many of its food-safety initiatives. These include wellness checks before every shift, availability of trained nurses to evaluate employee's health on the job and installation of advanced technology air purification systems to reduce the risk of viruses. It is also offering improved internal training and education as well as a third-party consultant to perform regular inspections of all restaurants. The company has also taken noteworthy steps to reduce the amount of food and packaging waste to be disposed of in landfills. As announced, Chipotle is implementing practices like minimal food waste disposal during the preparation process, recycling and 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, which will pay its employees a bonus amount if they achieve their desired goal in food safety. Further, the company recently introduced the Debt-Free Degrees program in addition to its newly expanded tuition reimbursement program to develop a better restaurant culture.

- **Strengthening Digital Capabilities:** Chipotle is prioritizing its e-commerce program to gain customer confidence. 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 during the coronavirus crisis. 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. During the first quarter, it also announced a successful national delivery partnership with Uber Eats.

Another initiative that has been benefiting the company is its rewards program. It has more than 11.5 million enrolled members. Over the past month, daily sign-ups spiked nearly four-fold, which is another sign that the company's digital platform is gaining traction. Clearly, 65% of newly-enrolled rewards members are new to the Chipotle brand, up from 51% pre-COVID-19. In the first quarter of 2020, digital sales grew 81% year over year to \$372 million and accounted for 26.3% of sales. The company has increased its focus on digital and delivery services owing to the shutting down of the dine-in facility in the wake of the virus outbreak. As a result, digital sales for the month of March grew 102.6% year over year and represented 37.6% of sales.

Also, since the rollout of its "Smarter Pickup Times" technology, there has been a significant increase in digital orders and guest satisfaction. Meanwhile, the company is pressing ahead with its plans to enhance delivery system. Delivery remains a key driver for digital growth. In fact, delivery is now available for more than 98% of its restaurants.

- **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.

Last year, Chipotle launched its first menu innovation called Lifestyle Bowls for mobile and web orders that resonated well with consumers. 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. Although it was receiving positive feedback, the launch has been delayed due to the global impact of COVID-19. The company is also trying hard to bring back carne asada. Moreover, introduction of other items has been postponed due to the crisis. 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 2020, the company's priorities will revolve around the five key initiatives, namely, use of stage gate process, leveraging digital programs to expand access and convenience, frequent customer interaction through loyalty program, and menu innovation and operational excellence. Notably, these factors will help customers to resonate more with the company. Moreover, the company is also focusing on unit expansion to drive growth. It expects to inaugurate 150-165 restaurants in 2020.

Last Earnings Report

Chipotle Q1 Earnings Top Despite Coronavirus

Chipotle Mexican Grill, reported first-quarter 2020 results, wherein earnings and revenues surpassed the Zacks Consensus Estimate. While the bottom line beat the consensus estimate for the 10th straight quarter, the top line surpassed the same for the sixth consecutive time.

The company's adjusted earnings of \$3.08 per share surpassed the Zacks Consensus Estimate of \$2.50. However, the bottom line declined 9.4% from \$3.40 reported in the year-ago quarter.

The decline was primarily due to an increase in restaurant closure costs as well as costs related to restructuring of business due to the COVID-19 crisis. As a result of the pandemic, nearly 100 restaurants were temporarily shut.

Quarter Ending **03/2020**

Report Date	Apr 21, 2020
Sales Surprise	0.84%
EPS Surprise	23.20%
Quarterly EPS	3.08
Annual EPS (TTM)	13.75

Revenues & Comparable Restaurant Sales

Quarterly revenues of \$1.4 billion surpassed the consensus mark by 1.2% and improved 7.8% year over year. The upside can primarily be attributed to improvement in comps, digital sales and new restaurant openings. In the quarter under review, Chipotle opened 19 restaurants and closed two, taking the total restaurant count to 2,638.

Digital sales grew 80.8% year over year to \$371.8 million during the first quarter of 2020. Digital sales represented 26.3% of sales during the quarter. The company has increased its focus on digital and delivery services as the dine-in facility has been stopped due to the spread of the virus. As a result, digital sales for the month of March grew 102.6% year over year and represented 37.6% of sales.

Comps in the first quarter increased 3.3%, including a benefit of 1.3% related to leap day. The 4.9% increase in average check, which includes a 2.0% benefit from menu price increases that were implemented during 2019, partially offset by a 1.4% decrease in comparable restaurant transactions, also led to the upside.

Costs, Operating Highlights & Net Income

Food, beverage and packaging costs, as a percentage of revenues, increased 60 basis points (bps) to 32.8%, compared to 32.2% reported in the year ago quarter. It was primarily due to an increase in ingredient costs and food expenses related to Chipotle rewards, partially offset by an increase in menu prices and lower paper costs.

Restaurant-level operating margin of 17.6% declined 340 bps from 21% in the year-ago quarter. The downside was primarily due to wage inflation, increased food costs, high marketing and delivery expenses, partially offset by leverage in comps growth. Notably, the sudden change of its business structure due to COVID-19 in March resulted in a short term, outsized impact on labor and food costs.

Adjusted net income in the reported quarter amounted to \$87.2 million, compared with \$95.5 million in the prior-year quarter.

Balance Sheet

The company has \$909.2 million in cash, restricted cash, and short-term investments as of Mar 31, 2020. The company doesn't have any debt. A strong balance sheet will help the company tide over the coronavirus-induced crisis.

Inventory totaled \$23.3 million as of Mar 31, 2020, down from \$26.1 million as of Dec 31, 2019. Goodwill, as a percentage of total assets, was 0.4% at the end of the first quarter of 2020.

Other Updates

The company plans to open several new restaurants. However, with a pipeline of 49 restaurants under construction, the company has been experiencing construction delays on majority of its projects due to the spread of coronavirus.

2020 Outlook

Given the level of volatility and uncertainty revolving around the coronavirus impact, the company has withdrawn its 2020 guidance.

Recent News

Chipotle Partners With Uber Eats to Boost Delivery Services – Mar 18, 2019

In a bid to expand its digital and delivery business, Chipotle Mexican Grill announced a partnership with Uber Eats. This nationwide delivery plan will enable customers to order Chipotle food through the Uber Eats app as well as [ubereats.com](https://www.ubereats.com). Along with this partnership, the company also initiated tamper evident packaging seal to ensure safe food delivery. Notably, this partnership is likely to enhance the delivery experience of its customers.

Valuation

Chipotle's shares are up 10.6% in the year-to-date period and 34.7% over the trailing 12-month period. Stocks in the Zacks sub-industry is down by 10%, but the Zacks Retail-Wholesale sector is up by 2.9%, in the year-to-date period. Over the past year, the Zacks sub-industry is down by 6.5%, but sector is up by 13.8%.

The S&P 500 index is down 8.9% in the year-to-date period but up 4.1% in the past year.

The stock is currently trading at 84.25X forward 12-month earnings, which compares to 33.86X for the Zacks sub-industry, 30.1X for the Zacks sector and 21.16X for the S&P 500 index.

Over the past five years, the stock has traded as high as 206.3x and as low as 23.8x, with a 5-year median of 45.02x. Our Underperform recommendation indicates that the stock will perform worse-than the market. Our \$787 price target reflects 71.67x forward 12-month earnings.

The table below shows summary valuation data for CMG.

Valuation Multiples - CMG					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	84.25	33.86	30.1	21.16
	5-Year High	206.3	33.86	10.1	21.16
	5-Year Low	23.8	20.49	19.06	15.19
	5-Year Median	45.02	23.07	23.17	17.44
P/S F12M	Current	4.42	3.57	1.03	3.3
	5-Year High	4.6	3.93	1.11	3.44
	5-Year Low	1.44	2.82	0.8	2.54
	5-Year Median	2.77	3.3	0.93	3.01
P/CF	Current	36.36	15.48	14.51	15.21
	5-Year High	38.1	20.59	15.21	22.67
	5-Year Low	15.15	8.61	10.76	11.67
	5-Year Median	26.78	16.81	12.86	16.42

As of 05/08/2020

Industry Analysis Zacks Industry Rank: Bottom 32% (173 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
Arcos Dorados Holdings Inc (ARCO)	Neutral	3
Bloomin Brands Inc (BLMN)	Neutral	3
Cracker Barrel Old Country Store Inc (CBRL)	Neutral	3
Dominos Pizza Inc (DPZ)	Neutral	2
Darden Restaurants Inc (DRI)	Underperform	5
Brinker International Inc (EAT)	Underperform	5
Restaurant Brands International Inc (QSR)	Underperform	4
Yum Brands Inc (YUM)	Underperform	4

Industry Comparison Industry: Retail - Restaurants				Industry Peers		
	CMG	X Industry	S&P 500	BLMN	QSR	YUM
Zacks Recommendation (Long Term)	Underperform	-	-	Neutral	Underperform	Underperform
Zacks Rank (Short Term)	5	-	-	3	4	4
VGM Score	D	-	-	B	F	C
Market Cap	25.82 B	273.94 M	20.19 B	979.29 M	15.51 B	25.94 B
# of Analysts	17	6	14	7	10	9
Dividend Yield	0.00%	0.00%	2.12%	4.47%	4.03%	2.18%
Value Score	F	-	-	A	F	F
Cash/Price	0.04	0.07	0.06	0.07	0.11	0.05
EV/EBITDA	41.29	10.75	11.95	7.72	12.32	18.19
PEG Ratio	6.46	4.42	2.60	NA	2.96	2.49
Price/Book (P/B)	15.44	1.80	2.75	5.48	4.13	NA
Price/Cash Flow (P/CF)	42.16	6.93	10.78	2.67	10.37	21.34
P/E (F1)	124.11	34.54	19.85	NA	27.02	30.77
Price/Sales (P/S)	4.54	0.62	2.03	0.24	2.79	4.63
Earnings Yield	0.81%	0.76%	4.83%	-17.25%	3.70%	3.25%
Debt/Equity	1.65	1.05	0.75	12.97	3.49	-1.34
Cash Flow (\$/share)	21.96	1.81	7.01	4.19	4.98	4.04
Growth Score	B	-	-	C	D	B
Hist. EPS Growth (3-5 yrs)	7.65%	7.72%	10.87%	6.60%	25.85%	0.51%
Proj. EPS Growth (F1/F0)	-46.92%	-87.62%	-9.87%	-225.51%	-29.71%	-21.10%
Curr. Cash Flow Growth	34.05%	4.82%	5.88%	-2.22%	2.55%	3.60%
Hist. Cash Flow Growth (3-5 yrs)	1.89%	6.59%	8.55%	-0.02%	30.84%	-6.71%
Current Ratio	1.62	0.64	1.24	0.35	2.08	1.33
Debt/Capital	62.31%	65.09%	44.23%	92.84%	77.74%	NA
Net Margin	5.95%	3.60%	10.68%	3.15%	11.72%	19.89%
Return on Equity	23.90%	7.09%	16.36%	74.91%	31.08%	-12.97%
Sales/Assets	1.14	1.05	0.55	1.17	0.25	1.07
Proj. Sales Growth (F1/F0)	-1.65%	-10.12%	-2.26%	-25.34%	-13.76%	-3.58%
Momentum Score	B	-	-	C	F	B
Daily Price Chg	3.16%	3.54%	2.40%	13.31%	2.58%	1.87%
1 Week Price Chg	-0.86%	5.07%	0.53%	12.46%	3.27%	-2.42%
4 Week Price Chg	20.08%	12.73%	2.68%	22.75%	17.70%	7.23%
12 Week Price Chg	1.41%	-32.87%	-19.20%	-47.27%	-22.18%	-17.95%
52 Week Price Chg	31.30%	-43.91%	-8.44%	-44.00%	-22.89%	-14.45%
20 Day Average Volume	645,653	281,263	2,398,409	3,854,189	4,289,251	2,162,194
(F1) EPS Est 1 week change	-3.24%	0.00%	0.00%	15.60%	-3.49%	-0.59%
(F1) EPS Est 4 week change	-33.89%	-46.02%	-6.95%	-710.18%	-9.13%	-9.54%
(F1) EPS Est 12 week change	-59.44%	-92.84%	-15.68%	-213.51%	-35.81%	-28.94%
(Q1) EPS Est Mthly Chg	-130.57%	-63.60%	-13.12%	-110.76%	-18.45%	-2.62%

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	F
Growth Score	B
Momentum Score	B
VGM Score	D

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.

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