

Chipotle Mexican Grill Inc. (CMG) Memo

Name: Ryan Barr	College/School: McIntire	Year: 2 nd Year
-----------------	--------------------------	----------------------------

Important Company Financial Data

Stock Price: 360.65

P/E: 39.08

52 Week Range: 233.82 - 424.41

Trailing 12-moth EPS: \$8.60

Market Cap: 11.15B

Trailing 12-month P/E: 42.6

Beta: 0.81

EPS: 9.23

Thesis / Key Points

- After increasing 100 points from the \$240 range to near \$340 within seven months, this stock has been performing very well. But, I believe there is an ideal short opportunity once Chipotle's growth slows. David Einhorn, a famous hedge fund manager, also believes that Chipotle should be shorted. With Wall Street's high expectations, climbing food prices, high valuations and increased competition from Yum Brands' Taco Bell restaurants, Chipotle will be fighting many restraints in the near future. Nevertheless, has increased its revenue an impressive 22.8%, free cash flow by 133.6%, and book value by 17.3% annually during the past five years. However, Chipotle has had recent declines in the growth of their sales. In 2012, comparable sales slipped quarterly from 12.7% in the first quarter, 8% in the second quarter and 4.8% in the third quarter. Due to a decrease in growth, it does not appear logical to pay such a premium for Chipotle for slower growth. Additionally, some industry insiders believe that Chipotle's menu does not offer a wide enough selection to keep customers from becoming burned out on its offerings. I think this could be to blame for the company's declining comparable sales. Technically, shares have been in a strong uptrend. Therefore, I believe the best way to approach a short is to wait for the selling to commence before entering the position. This means being patient and waiting for the stock to snap support at \$315 prior to shorting.
- Chipotle has 1458 stores opened. As is the case with many concepts, the first 500 locations are fairly easy to identify and build. The ability to grow beyond that becomes increasingly difficult. I believe Chipotle's stock price assumes growth rates that are not sustainable in available quality real estate. Thus, if Chipotle does not achieve the necessary growth in locations, the stock will decline dramatically.
- In the current market, fast casual restaurants such as Chipotle are competing with quick service restaurants (i.e. Taco Bell). Recently, Molly Harnischfeger, director at the consulting firm Alix Partners stated, "Quick Service Restaurants could be better positioned to compete. QSR has rapidly upgraded its food quality and maintained a lower price point. Some have been able to redefine their brand, whether through food quality, product, design, or their sustainability agendas, what fast-casual is known for." Additionally, QSRs have the size to keep prices low, and are better equipped to handle local store marketing. QSR's are also able to better withstand oncoming cost concerns like health care and commodities. This poses a strong threat to fast casual restaurants in general, including Chipotle, since QSR restaurants are pressuring fast casual restaurants to lower their prices and increase their speed, two areas in which QSR's have the advantage.
- Recently, the Department of Justice asked for more documents in its two-year-old investigation into Chipotle's hiring practices. This investigation is looking into whether Chipotle hired illegal immigrants in their stores. After an immigration investigation began in Minnesota in 2010, Chipotle fired roughly 450 workers. The Co-CEO, Montgomery Moran stated on May 23, 2013 that it may "take a year or two before it wraps up." With this investigation looming over Chipotle, investors should be wary of investing heavily in Chipotle. President Obama has made it a priority to crack down on illegal immigrants within the US and is holding companies accountable for their workers. Not only will this hurt profits due to more lawyer costs, but there is also a strong possibility that the Department of Justice may discipline Chipotle in the future.
- Other notes: 1) As demonstrated by the company's 3Q12 results, CMG shares are subject to sharp selloffs if the company fails to meet investors' heightened expectations. 2) As is the case with any dining operation, CMG's financial results could be affected by issues related to food contamination at its restaurants or by increased public perceptions of disease risk. Finally, the company could experience disruptions and/or higher costs if necessary ingredients become unavailable in some regions.

Misperception

- In order to increase sales, Chipotle has announced a new margarita offering in 900 restaurants that includes organic agave nectar and Patron Silver tequila in a handmade drink. However, some Chipotle restaurants already offer beer and a less natural version of a margarita. This may not provide the strong growth that many investors are expecting. In addition, part of Chipotle's success has been the ease to execute their menu. This might be the first of many menu expansions that eventually dilutes the brand.
- Chipotle has long been one of the few quick-serve restaurants that offer vegetarian-friendly customization, and it's upping the ante by adding tofu to the menu. With increased food prices, adding tofu to the menu may be difficult to keep prices low for the consumers.

Chipotle Mexican Grill Inc. (CMG) Memo

VAR

Owner and Chairman of roughly 30 YUM brand stores including KFC and Taco Bell
 Board Member of the International Franchise Association
 Board Member of Rita Restaurants which operates Don Pablos restaurants a Texican-Mexican franchise
 Board Member of the second largest TGI Fridays franchisee

How It Plays Out

- CMG will continue to be best in class fast casual operator and with that obtain some acclaim
- Other fast casual competition will come along such as Pei Wei in Chinese or Pie Five in Pizza further segregating the category
- CMG's unit growth will begin to slow as suitable real estate becomes more difficult to find
- CMG will settle for less quality real estate in order to attempt to achieve the Street's growth projections. This will result in lower Average Unit Volumes and less profitability.
- The aggregation of less restaurant openings and less profitability will result in lower growth multipliers being applied to the CMG stock
- Valuation of the CMG stock will be lowered as growth is no longer as robust
- CMG stock price will retreat to \$270-\$295 resulting in a favorable short and the ability to cover

Risks / What Signs Would Indicate We Are Wrong?

- Chipotle continues to grow at a strong growth rate. In order to do this, Chipotle strategically continues to grow their brand and find strong real estate for their units.
- The Department of Justice ends its investigation within a year and finds that Chipotle complied with all rules and regulations. This would ease investors minds and as a result, the stock price would increase.
- CMG's new concept, ShopHouse, shows the ability to grow allowing for new growth model.

Signposts / Follow-Up

Comparable store sales
 New unit development
 Food Prices – Specifically Dairy and Corn Prices
 Discretionary Spending Growth
 Consensus Fast Casual Dining Comps

Company Description

Chipotle Mexican Grill, Inc. and its subsidiaries (Chipotle) operate restaurants throughout the United States, as well as two restaurants in Toronto, Canada and two in London, England. As of December 31, 2011, Chipotle operated 1,230 restaurants, which includes one ShopHouse Southeast Asian Kitchen. The Company's restaurants serve a menu of burritos, tacos, burrito bowls (a burrito without the tortilla) and salads. The Company manages its operations and restaurants based on six regions that all report into a single segment. As of December 31, 2011, the Company delivered ingredients and other supplies to its restaurants from 22 independently owned and operated regional distribution centers. Chipotle categorizes its restaurants as either end-caps (at the end of a line of retail outlets), in-lines (in a line of retail outlets), freestanding or other.

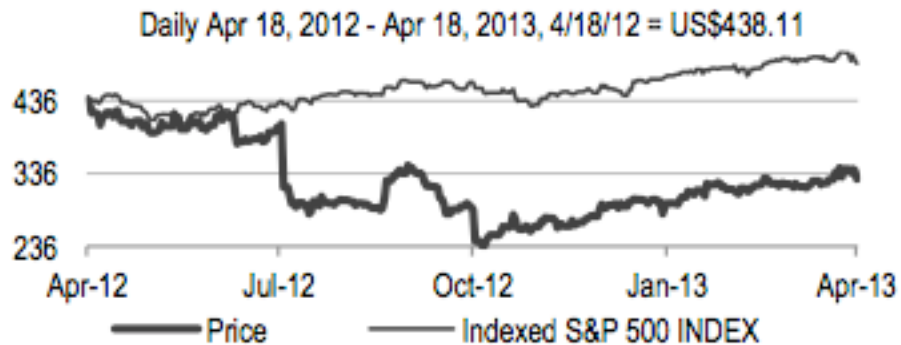
Chipotle Mexican Grill Inc. (CMG) Memo Stock Price



Opportunity to Short CMG



CMG Share Price Performance



Chipotle Mexican Grill Inc. (CMG) Memo

Quarterly Revenue Growth

3rd Quarter 2013 Estimate	16.49	
2nd Quarter 2013 Estimate	15.71	
1st Quarter 2013	13.45	
4th Quarter 2012	17.16	
3rd Quarter 2012	18.36	
2nd Quarter 2012	20.89	

EPS % Change (Year over Year, Standardized)

Chipotle Mexican Grill Inc

2012	33.3	
2013 Estimate	20.9	

Industry: Restaurants

2012	15.8	
2013 Estimate	0.0	
2014 Estimate	0.0	

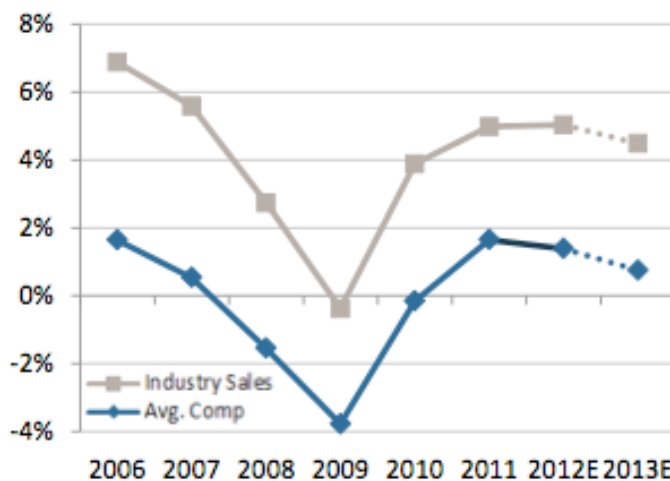
Current P/E of CMG

TFQ A	35.3	
FFQ E	33.4	
2012 E	37.2	
2013 E	31.7	

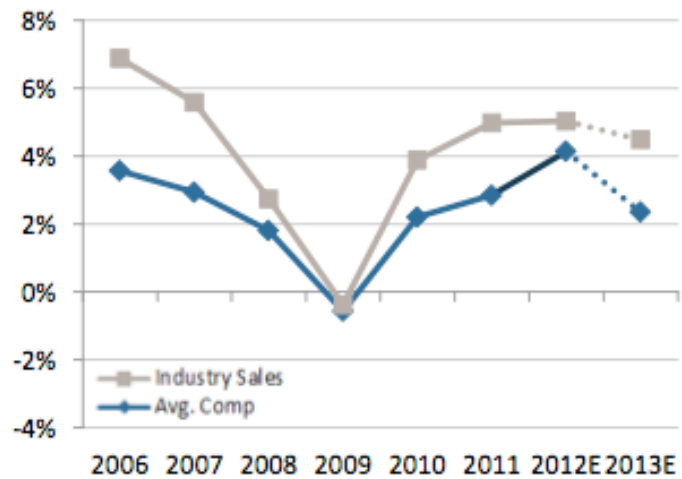
Current P/E of the Industry

TFQ A	70.0	
FFQ E	51.7	
2012 E	NA	
2013 E	NA	

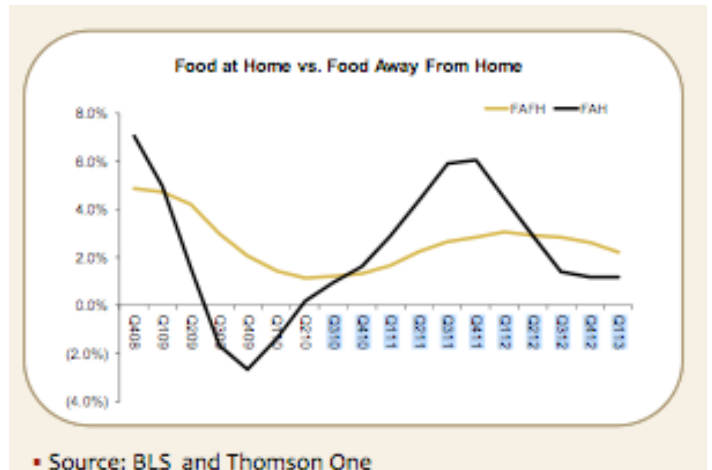
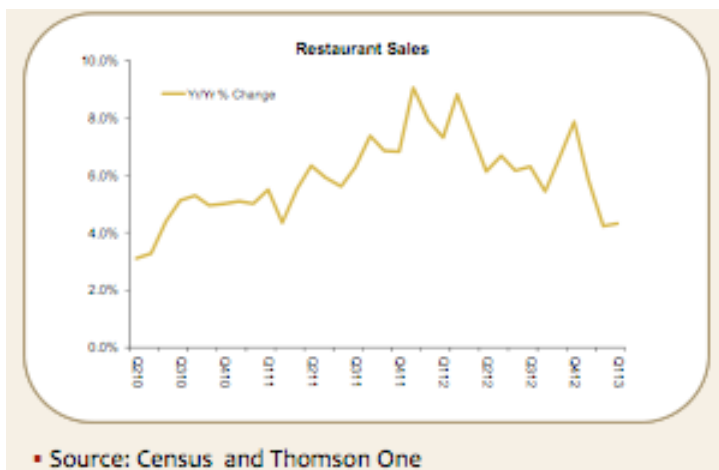
Industry vs. Avg Casual Comp Growth



Industry vs. Avg QSR Comp Growth



Source: Company data, Credit Suisse estimates, Consensus Matrix



*The Restaurant Sales Graph shows that sales in December were up 7.9% from the prior year, up 5.8% in January and were up only 4.2% and 4.3% in the last two months, respectively. The year-over-year slowdown implies consumers are slowing spending after the tax hikes.

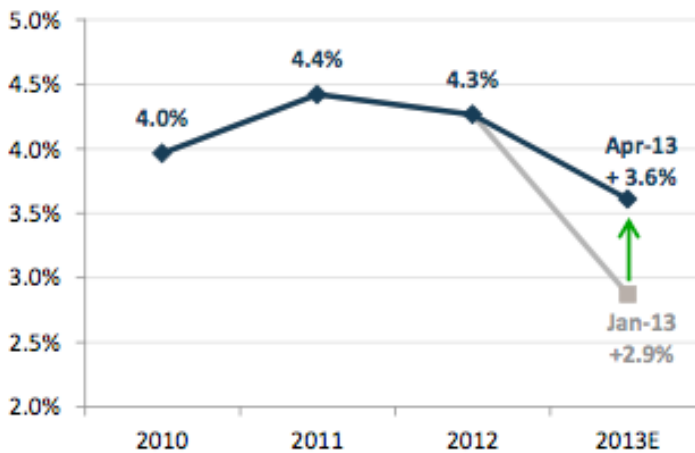
*The Food at Home vs. Food Away From Home shows that it is more economical, especially during tough economic times, for consumers to continue to eat at home rather than eat away from home.

Chipotle Mexican Grill Inc. (CMG) Memo

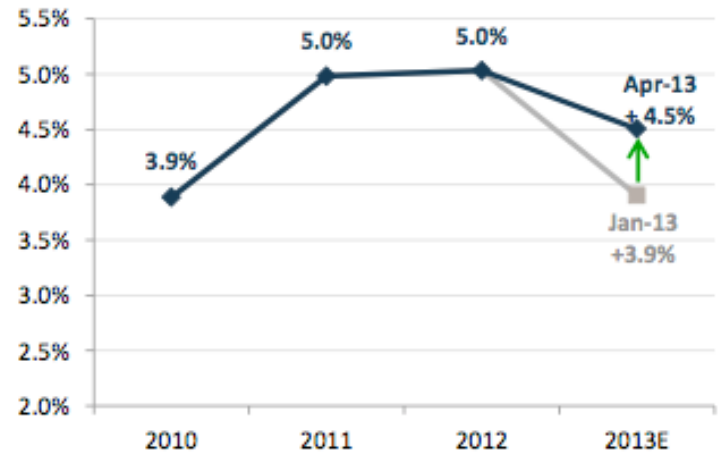
American Restaurant Association Restaurant Commodity Index



Revised Outlook for Discretionary Spending Growth



Revised Outlook for Restaurant Industry Growth



Suggestions for MII

MII has made great strides this year with continuing the analyst group program. I still see four areas for improvement:

1. I believe that it would be beneficial if the managers would give feedback to the analyst groups on the analyst updates. It is difficult at times to understand what management would like from the analyst groups. I believe the analyst program is a great way to involve more people and I believe that it has been successful in that sense, but I also believe that the analysts look up to the managers and therefore more updates/commentary on analyst updates would be appreciated.
2. I believe that MII would benefit if more individuals from investment banking/current UVA professors would come and speak to MII. I understand that MII is largely based upon students pitching, but I believe that the members, especially underclassmen, would greatly benefit from the perspective of an experienced individual on stock trading, but also to teach and inform members about the culture of Wall Street, London, Hong Kong or other financial center.
3. I believe that it would be beneficial for the managers to further describe their choices when they long/short a company. Some of the companies that are added to the portfolio come from the managers themselves and I believe that it would benefit the club for the members to understand more of the managers' thought process when they add a position to the portfolio. Although managers do mention changes in the portfolio before every meeting, I believe a further outline and reasoning of a change in an email would be helpful to the members.
4. I believe that the communication within MII could be better. For example, I think that more meetings between managers and associates would be beneficial. As an associate, I do not always understand completely what the managers would like me to focus on in my memos. Even though the thesis points within a memo may describe the overall plan for a particular position, many times, it appears that managers look at different sign-posts and indicators than the associates are looking at when covering a stock. By having meetings, associates would learn from the experience of the managers.