

**Chipotle Mexican Grill, Inc. (NYSE: \$CMG)**

Price: \$2,055.32 (on May 11th, 2023)

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Contribution of each team member:

- Nghia Tran: Conducted research on the company's history, business model, competitive landscape, objectives, headwinds/tailwinds, growth analysis, and market positioning. (D, E)
- Ha Pham: Performed quantitative analysis, updated key assumptions, and conducted strength tests. (B1, B2, B3)
- Asad Bhatti: Prepared the executive summary, clarified the investment thesis, and conducted analysis of online chatter. (A, F)
- Joseph Daniel Selvaraaj: Conducted financial strength analysis, evaluated financial statements, and assessed cash flows. (B4, C)

The analysis was concluded on 11 May 2023.

## Executive Summary

We are interested in exploring the key business trends in the fast-casual restaurant segment. Over the last few decades, consumers have become more adventurous in trying other cuisines, and because of this, there's an increase in the adoption of international cuisines. Recent social trends, such as busier lifestyles, heavier workloads, and longer working hours, have also been boosting demand for restaurant services as consumers seek to cut down cooking time. Sustainability is another trend gaining momentum as consumers become aware of the impact of their choices on the environment. Besides, urbanization is also expected to increase, which will lead to an increase in the demand for restaurant services and convenience food. In addition, because of various factors, including the Biden Administration's ~\$1.0 trillion bill, consumer spending is predicted to grow. Finally, consumers are seeking healthier options leading to a rise in health-consciousness menu options in many restaurants and chains.

In the fast-food industry, there are some major players in the market, such as Chipotle (2.2%), Chick-Fil-A (1.8%), McDonald's (0.9%), and the rest are other restaurants (95.1%). With a hectic work schedule, customers are increasing their demand for restaurant services to have more time to focus on their work. However, as customers also become more conscious about their eating habits, they demand an alternative to traditional fast-food options. Therefore, this is decreasing the demand for traditional fast-food restaurants and making the earnings of these restaurants decrease over the past five years. On the other hand, according to Healthline, some fast-food companies are trying to shift their focus to healthy fast-food such as Chipotle, Chick-Fil-A, and McDonald's.

There are some reasons that make Chipotle appear attractive to our group. According to the Tortilla Industry Association, tortillas are now the second-most popular bread type after white bread in the United States, which shows the favorable trend of customers toward Mexican Food. Chipotle, according to our research, is the leader among Mexican restaurants, but also the entire fast-casual restaurant segment. In addition, as Americans are focusing on healthy food, Chipotle is the top company in this field as the company tries to use only organic, local ingredients, with meats from naturally raised animals. Chipotle has shown to thrive in less optimal conditions when its competition couldn't. For example, during the COVID-19 pandemic, the restaurant industry struggled to remain afloat, whereas Chipotle leveraged its digital platform orders that exceeded forecasted sales margins. Chipotle's vertically integrated supply chain allows them to efficiently source organic and fresh ingredients that rival reputable full-service restaurants that can't afford such supply chain complexities. Considering the trends in fast-food restaurants as people are having hectic schedules and want to eat something healthy and fast, we believe Chipotle is a suitable stock to keep in our portfolio.

## A. About our thesis

Our investment thesis focuses on capitalizing on key business trends within the fast-casual restaurant segment, which has experienced significant growth due to changing consumer preferences and lifestyles. The thesis revolves around four main trends: the consumer shift towards healthy and customizable options, the integration of technology and digital transformation, the emphasis on sustainability and ethical practices, and the focus on convenience and speed. To mitigate confirmation bias, our research strategy incorporates seeking diverse perspectives from industry reports, market analyses, academic research, and expert opinions. Additionally, we actively evaluate contrary evidence to challenge our assumptions, conduct primary research by analyzing the financial statements of the company, learn more about the company through surveys, interviews, and firsthand observations, and monitor industry developments to stay updated. This approach aligns with the concepts outlined in the chapters entitled Investing as a Negative Art, Shaping the Investment Thesis, How to be a Wise Investor, and The Art of Looking, which emphasize minimizing errors, critically evaluating different viewpoints, and staying informed about emerging trends.

## B. Quantitative analysis and analyzing the company's hidden liabilities and asset quality.

### Implied Growth Rate and Historical Performance:

With the corporate bond yield of 5.18% and the discount rate of 13%, the market has priced in an implied growth rate of 11.62% on an average five-year basis for Chipotle, which is relatively higher than the provided competitors, such as McDonald's Corp (8.43%), Jack in the Box Inc (0.74%), and Wendy's Co (6.34%). However, since Chipotle has a historical EBIT growth trendline of 37.94%, the implied rate seems to be a rather conservative estimate. This conservative viewpoint on the potential growth of a relatively fast-growing company opens up the discussion of whether the market is undervaluing Chipotle in relation to its historical performance. We can also consider other financial factors of the company in the table below:

	Avg 5yr	2022	2021	2020	2019	2018	2017
GM	20.60%	23.90%	22.50%	17.30%	20.50%	18.70%	16.90%
R&DM	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
EBITM	9.70%	14.00%	11.90%	6.10%	9.10%	7.20%	7.00%
NM	7.00%	10.40%	8.70%	5.90%	6.30%	3.60%	3.90%
OCFM	13.80%	15.30%	17.00%	11.10%	12.90%	12.80%	10.40%

CPXM	5.90%	5.50%	5.90%	6.20%	6.00%	5.90%	4.80%
FCFM	7.90%	9.80%	11.10%	4.90%	6.90%	6.90%	5.60%

The table shows that Chipotle has shown consistent profitability and financial strength over the past five years. The company's average gross margin is 20.60%, indicating its strong ability to generate profits from its operations. The average EBIT margin of the company is 9.70%, with a significant increase from 2020-2022, reflecting the company's efforts to enhance profitability through operational optimization. Chipotle also shows its ability to efficiently manage costs and generate profits by achieving an average net margin of 7.00% and an average operating cash flow margin of 13.80%. In addition, Chipotle also maintained a consistent capital expenditure margin of 5.90%, indicating a balanced approach to long-term investments and showing positive signs of how the company manages its operating activities. The average free cash flow margin of 7.90% also demonstrates the company's financial strength and flexibility to pursue growth opportunities or return value to shareholders. From these financial metrics, Chipotle successfully demonstrates its solid performance and ability to drive profitability and growth to investors.

#### **Bond Yields and Financial Stability:**

On the other hand, a more effective approach to predicting future earnings is to analyze the perceived riskiness of a company's bonds. The average yield of a company's bond reflects the bond market's evaluation of interest rate risk and can be used to predict the potential for default or downgrade of that company. With companies that are actively trading bonds, bond yields can be used as a benchmark for the discount rate. However, for companies undergoing rapid change, such as Chipotle, the past may not be a reliable indicator of the future. For Chipotle, as the company does not have any bonds, this could indicate that the company has a strong balance sheet and does not need external funding from bondholders.

We can also calculate the other yields for the company and compare them with the treasury yield and evaluate the sustainability of the company:

As of to May 08, 2023			
10-year treasury	3.45%	Earnings yield	1.80%
10-year corporate AAA	4.38%	Dividend yield	0.00%
10-year corporate AA	4.63%	Operating cash yield	2.29%
10-year Chipotle	0.00%	Free cash flow yield	1.46%

From the table above, Chipotle's earnings yield of 1.80% indicates that for every dollar invested in the company's stock, an investor could earn a return of 1.80% through earnings. This demonstrates that the company has the potential to generate more profit in the future. Chipotle's operating cash yield is 2.29% suggests that the company is generating positive cash flow from its operation. In addition, Chipotle's free cash flow yield is 1.46%, indicating that the company has enough cash after paying all its capital expenditures. This suggests that Chipotle has the ability to invest in growth opportunities or return value to its shareholders through dividends or share buybacks.

While the yields provided for Chipotle may be relatively lower compared to Treasury yields, it's essential to consider the company's growth potential. Chipotle has exhibited a robust historical growth rate of approximately 38% and has an implied growth rate of around 12%. These growth indicators can instill confidence in the potential return on investment for Chipotle in the future.

### **Stability of Margins and Operational Performance:**

We can see that despite the challenges posed by the COVID-19 pandemic, Chipotle exhibited steady growth in margin stability, with a slight dip during the peak of the crisis but a strong rebound in subsequent years. This resilience indicates Chipotle's ability to successfully navigate adverse conditions within the restaurant industry.

Additionally, key operational ratios such as asset turnover (~1.48) suggest that the company generates \$1.48 for every dollar invested in assets on average. Such proficient utilization of its assets highlights Chipotle's ability to drive revenue and maximize investment returns.

Moreover, the recent upward trend in Chipotle's Receivables T/O (26 to 29.6) suggests an enhanced ability to manage its liquidity effectively. This ratio reflects the number of times the company collects its average accounts receivable balance within a given period. The positive trend indicates that Chipotle has improved its collection processes and strengthened its financial position, thereby optimizing its cash flow management.

In addition, Chipotle's Inventory Turnover (Inventory T/O) ratio demonstrates the company's approach to inventory management. With a narrow range of 176.2 to 185.3, this ratio indicates the company's ability to ensure timely sales and replenishment strategies. By efficiently managing its inventory, Chipotle ensures that its products are readily available to meet customer demand, increasing customer satisfaction and operational effectiveness.

Overall, these factors highlight Chipotle's ability to leverage its assets, optimize liquidity, and maintain effective inventory control. By demonstrating strong performance across these critical operational ratios, Chipotle shows its ability to navigate challenges while maintaining sustainable growth and bringing more profits to its stakeholders.

	Average 5 yr	2022	2021	2020	2019	2018
Asset T/O	1.48	1.3	1.2	1.1	1.5	2.3
Receivables T/O	50.42	49.6	26	24.2	65.5	86.8
Inventory T/O	180.78	181.4	182.2	178.8	176.2	185.3

### Financial Strength and Debt Exposure:

We know that financial ratios such as the company's debt level, liquidity, and operating cash flow tell us whether a company has the resources to overcome financial distress and can provide consistent profits for an investor in the long run. Chipotle passed the strength test even during the COVID-19 pandemic, when they were able to weather the storm, and this was reflected in their improved 2021 figures across the board. What stands out from the strength tests is that Chipotle does not have any listed coverage ratios, meaning they are not using any debt to finance its operation. Chipotle's stability of operating earnings coupled with no debt exposure indicates rather good financial strength.

	Average 5 yr	2022	2021	2020	2019	2018
Interest Coverage						
Debt Coverage(ocf)	2.88	2.7	3.4	4.3	4	0
Debt Coverage (fcf)	5.22	4.2	5.8	8.7	7.4	0
Debt/Equity	1.2	1.5	1.4	1.5	1.6	0

The table above shows that Chipotle's debt coverage(ocf) over the past five years is 2.88. This ratio indicates that Chipotle's operating income can pay off its interest expenses in almost three years, highlighting the company's ability to meet its financial obligations comfortably. The debt coverage(fcf) ratio suggests that Chipotle's free cash flow is sufficient to pay off its interest expenses in about 5.22 years, proving the company's strong financial position and cash flow management. The debt/equity ratio shows that its debt level is about 1.2 times its equity, which has been relatively stable from 2018 until now. This stability indicates responsible financial management and a prudent approach to debt utilization, which can benefit Chipotle from a risk-averse investor perspective.

**Lease Obligations:**

Chipotle's lease obligations primarily consist of operating leases.. As of December 31, 2022, the total lease payments amounted to \$5.16 billion, with lease liabilities (current and long-term) of \$3.73 billion. The weighted average remaining lease term was approximately 13.8 years, indicating a relatively long-term commitment to these leases. It's important to note that the lease term includes reasonably certain renewal periods, which could extend the overall lease obligations.

**Lease Costs:**

Chipotle's lease costs, recorded primarily as occupancy costs, have been increasing over the years. In 2022, the total lease cost was \$494.94 million, compared to \$451.79 million in 2021 and \$368.19 million in 2020. This increase in lease costs suggests a growing burden on the company's financials.

**Debt:**

Chipotle reported a revolving credit facility with JPMorgan Chase Bank, which had no outstanding borrowings as of December 31, 2022. The facility provides Chipotle with the flexibility to access funds if needed. However, it's important to note that the analysis does not reveal the full extent of Chipotle's debt position, as the company's lease obligations were not considered as debt in the analysis. Once lease obligations are accounted for, the debt ratio significantly increases to approximately 47.67%, indicating a substantial financial obligation.

**Financial Coverage:**

Chipotle's operating income of \$11.60 billion in fiscal year 2022 provides a strong basis for covering its fixed charges, including operating lease payments. With average annual rental payments of approximately \$2.36 billion, Chipotle's operating income covers its fixed charges approximately 4.91 times. This indicates a healthy financial position, suggesting that Chipotle has the ability to meet its lease obligations comfortably based on its current income.

While Chipotle has been able to manage its financial obligations well so far, it is essential to consider the potential risks associated with its lease obligations. The long-term nature of the leases and the significant lease payments expose Chipotle to the risk of increasing costs and potential constraints on its financial flexibility. Changes in market conditions, business performance, or lease terms could impact the company's ability to meet its lease obligations comfortably in the future.

**Pension and post-retirement obligations:**

Chipotle Mexican Grill offers two types of employee benefit plans related to retirement: a Defined Contribution Plan (401(k) Plan) and a Deferred Compensation Plan. The 401(k) Plan allows eligible U.S.-based employees to contribute a portion of their pay on a pre-tax basis, with

Chipotle providing matching contributions. The matching contributions totaled approximately \$12,923,000, \$10,527,000, and \$8,490,000 for the years 2022, 2021, and 2020, respectively. This plan seems to be well-funded and serves as a retirement savings vehicle for employees.

The Deferred Compensation Plan is a non-qualified plan that allows participants to make tax-deferred contributions beyond the limits of the 401(k) Plan. The company matches contributions once the 401(k) contribution limits are reached. The total obligations under the Deferred Plan were \$21,140,000 and \$19,330,000 as of December 31, 2022 and 2021, respectively. These obligations are included in other liabilities on the consolidated balance sheets. It is worth noting that the Deferred Plan was fully funded as of December 31, 2021.

### **Litigations and lawsuits:**

Chipotle Mexican Grill has addressed legal matters through settlement agreements. The company paid a \$1.0 million civil penalty to New York City and will potentially compensate individuals up to approximately \$20 million for labor law violations. Chipotle has accrued a liability for these settlements and believes they won't have a significant adverse effect on their financial position. While involved in various other legal actions, the company doesn't expect these matters to materially impact their financial strength. It emphasizes the importance of adhering to labor laws and employment regulations to avoid legal consequences and reputational damage. Chipotle's purchase obligations, primarily related to food purchases, supplies, and marketing, are manageable and of short-term nature. Overall, Chipotle has recognized its legal obligations and made provisions accordingly, mitigating potential financial risks.

### **Quality of assets:**

Chipotle's assets reflect a commitment to enhancing its restaurant locations, with leasehold improvements, property, and equipment increasing from \$1,769,278 in 2021 to \$1,951,147 in 2022. The company's accrued payroll and benefits increased slightly from \$162,405 to \$170,456, while accrued liabilities decreased from \$173,052 to \$147,539, indicating effective management of liabilities. Chipotle's fair value of financial instruments, including cash, cash equivalents, and investments, remained stable and showed potential gains, with a fair value of \$1,239,344 in 2022. The company also measures certain assets at fair value on a nonrecurring basis, demonstrating a conservative approach to valuations and impairments. Overall, Chipotle's assets reflect a focus on maintaining quality infrastructure and managing liabilities effectively, while its financial instruments contribute to liquidity and potential growth opportunities.



### C. Define Good Business

	CMG	JACK	MCD	WEN
ROE	0.342	-0.341	-1.495	0.571
ROA	0.138	0.171	0.202	0.061
ROC	0.139	0.257	0.250	0.073
ROS	0.09584583	0.11191166	0.29568526	0.09513973
AE	1.18365534	0.57784866	0.44543237	0.37645266
Lev	2.9106673	-3.0548005	-10.053042	11.7489211
CapLev	2.9106673	3.25348099	1.711412	1.73436443

CMG has generated strong cash flows from operating activities over the three-year period. In 2022, CMG generated \$1,323,179 in cash from operations, reflecting a positive trend. This suggests that CMG's core business operations are generating healthy cash flows. CMG exhibits relatively high levels of capital efficiency, with a ROE of 0.342 and a ROC of 0.139. These ratios suggest that CMG effectively utilizes its financial resources, both equity and debt, to generate returns for shareholders. The company also demonstrates a strong asset efficiency (AE) ratio of 1.1837, indicating efficient utilization of its assets to generate sales. However, it is worth noting that CMG has a high leverage ratio (Lev) and capital leverage (CapLev), indicating a significant amount of debt.

In comparison, JACK faces challenges in capital efficiency. The company reports a negative ROE and a relatively low ROC. JACK's leverage ratio is highly negative, indicating a substantial amount of debt, which raises concerns about financial risk. On the other hand, MCD showcases mixed results. Although MCD reports a negative ROE, it demonstrates positive ROC and relatively high ROS, suggesting profitable operations. The company's asset efficiency is moderate, but its leverage ratio is highly negative, indicating a significant amount of debt. Investors should carefully evaluate MCD's financial position and the reasons behind the negative ROE.

WEN, similar to CMG, exhibits positive capital efficiency with a relatively high ROE. However, WEN's ROA and ROC are lower compared to CMG, indicating lower operational and

capital efficiency. The leverage ratio for WEN is significantly high, suggesting a substantial debt burden. Investors should carefully assess the impact of high leverage on WEN's financial health and overall performance.

When comparing CMG with the other companies, CMG's capital efficiency ratios outperform JACK and MCD, indicating superior utilization of financial resources and better overall performance. However, CMG's performance is comparable to WEN, which also demonstrates positive capital efficiency but with lower efficiency ratios. Both CMG and WEN should be evaluated regarding their leverage levels and the potential risks associated with high debt.

In conclusion, CMG stands out for its strong capital efficiency, showcasing effective use of financial resources and generating higher returns for shareholders. However, investors should consider the company's leverage position and ensure that the high capital efficiency is rooted in well-managed operations rather than excessive financial engineering.

#### **D. Watch the Game**

##### **Company History:**

Chipotle Mexican Grill, Inc. was founded by Steve Ells who opened up the first restaurant in Denver, Colorado in 1993. Their menu is inspired by Mexican cuisines and consists of burritos, tacos, burrito bowls, and salads that are strictly created with sustainably sourced healthy ingredients. As of the most recent 10-Q filing (FY23, Q1), Chipotle operates 3,164 restaurants in the United States and 54 internationally. In 2002, the United States Department of Agriculture (USDA) released national standards on organic production and processing that essentially brought organic food into the mainstream. Chipotle started selling naturally raised chicken as a response to this among other actions taken that laid the foundation for their mission of 'Food With Integrity'. In 2006, the company went public at \$22 per share. In 2015, they faced food safety incidents, such as the E.coli and salmonella outbreaks relating to sourcing and in-store restaurant preparation that dramatically stained the company's brand reputation. As a response, they immediately closed all of its restaurants in February 2018 and later implemented new and robust food safety protocols. In 2018, Ells was replaced as CEO by former Taco Bell CEO Brian Niccol and since then, Chipotle has recovered from the food safety incidents and have been recognized as an industry leading brand with a differentiated product offering that is executed with a sustainable business model.

##### **Business Model:**

Chipotle's primary value proposition centers around their 'Food With Integrity' mission, which emphasizes serving high quality food made at reasonable prices with sustainably sourced ingredients grown with respect for the environment, animals, and the suppliers. Their annual

published sustainability report is a testament to upholding their value proposition as it details the incremental steps that are taken to constantly improve their mission. As the new generation of consumers in the fast-casual restaurant industry are wanting more healthy alternatives, Chipotle is built and committed to fulfilling this industry-defining consumer preference as they carefully use only organic, local ingredients, with meats from naturally raised animals.

Chipotle's operating model is tasked with delivering exceptional in-restaurant and digital experiences. Their condensed and simple menu allows them to streamline the food preparation process while minimizing food safety risks. To further ensure that their value proposition is being upheld by external stakeholders, they have 26 independent regional distribution centers purchased from suppliers who are carefully selected based on quality, price, and their commitment to Chipotle's 'Food with Integrity' mission. Other notable features of their operating model is their kitchens in their restaurants that are being incrementally digitized (e.g. autonomous kitchen assistant), partnerships with third-party delivery services, ongoing implementation 'Chipotlanes'; drive up windows for customer to pick up digital orders, and their digital platform that makes it convenient for customers to order on the go with features, such as unlimited customization, contactless delivery, and group ordering. All these efforts towards innovation and quality control have shown to drive their operating performance as seen in their operational stability ratios in the last five years. The outlook for Chipotle's business model seems to bode well given the supporting evidence of how they constantly plan to expand, optimize, and change certain features within their operating model to execute their strategic initiatives that will be discussed later.

### **Competitive Landscape:**

Chipotle falls under three segments in the restaurant industry: fast-casual, quick service, and casual dining. Each is highly competitive in terms of pricing, food quality, service, store location, brand appeal, etc. Each segment includes the likes of locally-owned, national, and regional chains that are expected to only increase in the future. The comparable companies that were aforementioned are known to be Chipotle's comparable companies as they offer dine-in, take-out, online, and delivery services. However, main competitors are among those who use the framework of serving quick high quality foods at reasonable prices that don't contain artificial flavors and preservatives. As aforementioned, Chipotle is expected to have a better growth trajectory relative to their comparable companies that includes entrenched companies, such as McDonald's. Their competitive positioning is quite differentiated when taking into account their own spin to fast-casual restaurant service as they promote a condensed menu catered to an industry defining consumer trend of healthy food alternatives at reasonable prices. As Chipotle have gone against the grain to achieve some degree of a first mover advantage, they have been the first to subvert the traditional fast-food service approach on a large scale that many have replicated by peers for decades.

## **Headwinds and Tailwinds:**

A major headwind for Chipotle is the increase in competition due to the very low barriers of entry, thus allowing for competitors to emerge, such as Sweetgreen that are delivering on attributes that Chipotle is known for. In addition, it is feasible for large national companies and small mom & pop shops to try to replicate Chipotle's product and operating model as fast casual restaurants have many companies attempting to grab market share. Another headwind includes downward pressure on consumer spending, which economic downturns entail. This is expected in the latter half of this year by Fed officials, and thus will affect many industries across the board including restaurants. However, Chipotle's management is optimistic that they are positioned well to hold up if this plays out.

A tailwind includes the continued demand for online pick-up and delivery service that allow customers to place an order on the go at their convenience. Chipotle's strong digital platform as seen with their app and website gave them a major competitive advantage during the COVID-19 pandemic as customers had no other safe option, but to order contactless delivery. It has shown no signs of dramatically slowing down post-pandemic as their digital sales remained quite strong YoY in 2022 as it made up ~39.4% of their food and beverage revenue. Another tailwind is the proliferation of plant-based diets among consumers. Chipotle has taken steps to cater to this trend by experimenting with vegetarian and vegan menu options that have been well received, which further expands their customer base.

## **E. Meet the Managers**

Chipotle's Chairman and CEO, Brian Niccol (49), wrote a letter to the shareholders detailing the company's strategic priorities, which are concentrated towards delivering their value proposition of 'Food With Integrity'. One of their strategic priorities consisted of using technology and innovation to drive growth and productivity at their restaurants and support centers. Niccol addresses the recent investments in technology, such as an autonomous kitchen assistant that would improve efficiency and minimize human errors. Another strategic priority consisted of sustaining world class leadership by developing and retaining diverse talent at every level. In response, Niccol addresses the company's commitment to invest in competitive wages for their employees along with industry-leading benefits and career progression opportunities. In addition, one of their strategic priorities consisted of more restaurant openings to improve their accessibility as their long-term goal was 7,000 restaurants. Niccol addresses this by saying they opened up 236 restaurants in 2022 and that the development growth rate is accelerating in Canadian and European Markets. Our takeaway from this is that Niccol seems to be strictly results-oriented as he's seen in the shareholder letter addressing the company's continued progress on each strategic priority that ultimately contributes towards their value proposition.

Key individuals in the management include: (1) Chairman and CEO, Brian Niccol, (2) CFAO, Jack Hartung, (3) CTO, Curt Garner, (4) CMO, Chris Brandt, and (5) CRO, Scott Boartwright. Each individual has considerable experience in the restaurant industry from corporate leadership positions at different companies including Starbucks, Wendy's, Yum! Brands, and Arby's. Niccol has a proven track record in previous roles including being the CEO at Taco Bell for three years and holding various leadership roles at Yum! Brands for nearly 10 years, bringing to the table experience in public company oversight and corporate governance. When reviewing the individual performance factor section of the most recent proxy statement reflecting the 2022 fiscal year, each of the named executives produced measurable results that were instrumental to the company's success for that year. The management team acknowledged their strong performance in 2022 as their customer engagements normalized to pre-pandemic levels while digital sales stayed strong. They believed the company had made good progress on their strategic growth plan for 2022 and are well positioned to continue this moving forward. The insights from the thought leadership are consistent with regulatory filings, which both are conveying a strong level of clarity for shareholders to digest. Management has continued to deliver once again (see FY23 Q1 financial results) as Chipotle appears to be on track to meet their strategic goals that were detailed in the letter to shareholders.

Executive compensation is primarily variable, meaning Chipotle promotes a performance-driven compensation structure. In the 2022 fiscal year, Niccol's compensation was 93% variable and fellow executive officers average a total of 86% variable. Long-term incentive plans, which rewards employees for meeting shareholder creation goals, represents 80% of Niccol's compensation and 74% of fellow executive officers. The structure for Chipotle's annual incentive plan is proportionally weighted on three performance factors: company performance (70%), individual performance (20%), qualitative ESG (10%). It is also worth noting that Niccol's base salary has not changed since the 2020 fiscal year. These are examples of Chipotle's emphasis on company performance that demands their executives to play their part at a high level to align with the bigger picture goals. These are shareholder-friendly signs and further gives us confidence in management to continue to deliver on their long-term goals set out for the company. Moreover, the listed individuals on the management team show credible professional experiences and no signs of red flags that could potentially throw off the company's brand reputation. The management team in the earnings calls are very transparent with the few areas that need improvement and respond with actionable insights to rectify.

## **F. Key Elements of the Bull and the Bear Cases**

Currently, Chipotle has chatter revolving around the need for better throughput, which is the speed at which Chipotle serves its customers. Currently, it is a problem that is widely known by Chipotle's customer base. The poor throughput can be caused by replacing the options for different ingredients that go into the food. This challenge not only causes Chipotle to lose customers but also affects customer perception. Therefore, Chipotle plans on combating this problem by creating a double-sided grill that can cook meat on both sides of the grill. With this, Chipotle will be able to deliver the same fresh meat that they previously had, but they're now able to replace ingredients a lot faster and keep the line moving faster.

Like other companies, Chipotle has many Bulls and Bears that are allowing Chipotle to continuously move forward and grow as a company, but it also has some problems that need to be addressed. The plus side for Chipotle is that they continue to have a strong brand and extreme customer loyalty. Supporters of Chipotle argue that the company has a well-established brand and a dedicated customer base. Its focus on offering fresh, organic ingredients and customizable menus has earned it a loyal following. Chipotle's sustainable practices and commitment to food integrity resonate with health-conscious consumers, fostering brand loyalty and driving repeat business.

Another plus side for Chipotle is its strong revenue growth, with impressive revenue growth in recent years. Its expansion strategy, menu innovation, and emphasis on digital initiatives have boosted sales. In addition, by integrating technology for mobile ordering, delivery services, and loyalty programs, Chipotle has enhanced convenience for its customers and capitalized on the increasing demand for online food ordering. The company has also shown that they have the ability to battle incidents within the company. Following food safety incidents, Chipotle undertook significant efforts to address the issues and regain consumer trust. The company implemented stringent food safety protocols and increased transparency in its supply chain. Supporters argue that Chipotle's successful turnaround is evidence of its ability to overcome challenges and emerge stronger, creating opportunities for long-term growth. The bear for Chipotle is that they continue to be a part of a competitive market, and although they are a big part of that market clearly, it is a market that is continuously changing. Furthermore, Chipotle has to combat rising costs. Critics point to the potential for margin pressures due to rising costs of labor, food ingredients, and delivery services. Chipotle's commitment to sourcing high-quality ingredients and implementing sustainable practices may result in increased costs that could impact profitability. Additionally, higher labor costs and the need for ongoing investments in technology infrastructure could squeeze margins.

## **End of the paper**

We see Chipotle as having a differentiated product offering with a highly attractive value proposition. Given our inability to refute our investment thesis with thorough quantitative analysis (yield-stability-strength) and qualitative analysis, we can safely say that Chipotle has shown good business economic characteristics and fundamentals. They have distinguished themselves from their competitors that have a more replicable product offering and less nutritious approach to fast-food.

Regarding the investment thesis at the current price, we have carefully considered the quantitative and qualitative factors. While the analysis presented some challenges, we have not refuted or disconfirmed the investment thesis at the current price. If there are significant changes in the market conditions, competitive landscape, or financial performance of Chipotle Mexican Grill, Inc., we would revisit our analysis. As an investor, we believe it is crucial to regularly reassess the investment thesis to adapt to evolving circumstances.

We will reevaluate our analysis of the company if its stock price falls below a threshold slightly lower than the current price of \$2,055.32. By allowing for a margin of error, we aim to ensure that any potential fluctuations or uncertainties in the market are considered before revisiting our assessment of the company's investment prospects.

Looking forward, we will keep an eye on several key factors. These include monitoring the company's ability to sustain its business model, navigate industry headwinds, and effectively execute its growth strategies. We will closely monitor financial indicators such as cash flows from operations, revenue growth, and profitability of the company. Additionally, we will pay attention to any updates from the management team, industry trends, and shifts in customer preferences that may impact Chipotle Mexican Grill's performance.

In conclusion, while the current analysis does not refute the investment thesis, ongoing monitoring and periodic reassessment are necessary. As with any investment, it is important to remain informed, adaptable, and responsive to changes in the company's performance and the broader market environment.