Chipotle Mexican Grill's (CMG) CEO Brian Niccol on Q3 2019 Results - Earnings Call Transcript

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Q3: 10-22-19 Earnings Summary

Press Release *Slides*

EPS of $3.82 beats by $0.60 | Revenue of $1.4B (14.59% Y/Y) beats by $25.3M

Earning Call Audio

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Chipotle Mexican Grill, Inc. (NYSE:CMG) Q3 2019 Earnings Conference Call October 22, 2019 4:30 PM ET

Company Participants

Ashish Kohli – Global Head-Investor Relations

Brian Niccol – Chief Executive Officer

Jack Hartung – Chief Financial Officer

Conference Call Participants

Katherine Fogertey – Goldman Sachs

David Tarantino – Baird

Sara Senatore – Bernstein

Nicole Miller – Piper Jaffray

David Palmer – Evercore

John Glass – Morgan Stanley

Jake Bartlett – SunTrust

Sharon Zackfia – William Blair

Jeffrey Bernstein – Barclays

John Ivankoe – JPMorgan

Andy Barish – Jefferies

Andrew Charles – Cowen & Company

Gregory Frankfurt – Bank of America

Peter Saleh – BTIG

Chris O'Cull – Stifel

John Tower – Wells Fargo

Operator

Good afternoon and welcome to the Chipotle Mexican Grill Third Quarter Results Conference Call. All participants will be in a listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to Ashish Kohli, Global Head of IR. Please go ahead.

Ashish Kohli

Hello, everyone, and welcome to our third quarter 2019 earnings call. By now, you should have access to our earnings press release. If not, it may be found on our Investor Relations website at ir.chipotle.com.

I will begin by reminding you that certain statements and projections made in this presentation about our future business and financial results constitute forward-looking statements, including projections about comparable restaurant sales growth, new store openings, our effective tax rate and expected G&A expenses. These statements are based on management's current business and market expectations and our actual results could differ materially from those projected in the forward-looking statement. Please see the risk factors contained in our 2018 annual report on Form 10-K and in our subsequent Form 10-Qs for a discussion of risks that may cause our actual results to vary from these forward-looking statement.

Our discussion today will include non-GAAP financial measures. A reconciliation to GAAP measures can be found via the link included on the Presentation page within the Investor Relations section of our website.

We will start today's call with prepared remarks from Brian Niccol, our Chief Executive Officer; and Jack Hartung, our Chief Financial Officer. After which, we will take your questions. Our entire executive leadership team is available during the Q&A session.

And with that, I'll turn the call over to Brian.

Brian Niccol

Thanks, Ashish, and good afternoon, everyone. We're pleased with our third quarter financial performance, which reflects further progress on our key strategic initiatives that are providing guests with a great experience and positioning the business to deliver above industry growth for many years to come. In fact, this marks the seventh consecutive quarter of accelerating comparable sales, which highlights that running great restaurants with a purpose of cultivating a better world is a compelling proposition.

For the quarter, we reported 11% comparable restaurant sales growth that included nearly 7.5% transaction growth. Restaurant level margins of 20.8%, which is 210 basis points higher than last year. Earnings per share adjusted for unusual items of $3.82, representing 77% year-over-year growth and digital sales growth of 88% year-over-year representing 18.3% of sales.

I'm often asked what's next. I believe we still have a lot of opportunity in executing our five key strategies, which are; number one, making the brand more visible and loved; number two, running successful restaurants with a strong culture that provides great food, hospitality and throughput; number three, leveraging our digital make line to grow sales and expand access; number four, engaging with our customers by launching a new loyalty program; and number five, creating a stage-gate process for innovations.

Let me give you an update on each of these starting with our stage-gate process, which is designed to test an item in a few markets on three key areas, delighting our customers, driving our financial benefit, and of course ensuring a seamless integration into our current operations. This test tends to be predictive of what happens nationally and helps increase the likelihood of success.

I'm pleased to announce that carne asada is the latest item behind Lifestyle Bowls and our Rewards program to be successfully validated through this process and all three are meeting or exceeding our expectations. Carne asada is a limited time offering that is easy to execute operationally and has a unique flavor profile. It's a tender cut of steak seasoned with fresh squeezed line and finish with hand chopped cilantro and a blend of signature spices. No wonder it's receiving terrific customer feedback.

As great as carne asada taste, it's success is amplified by all elements of our strategy coming together in unison. Specifically, digital providing more frictionless access, marketing enhancing awareness and emphasizing the deliciousness of carne asada operations, delighting our guests with great hospitality and throughput and our supply chain, ensuring we have the highest quality ingredients that meet our food with integrity standards.

I'm so proud of the collective efforts of our teams rolling out this new premium steak. Beyond carne asada, we are also testing queso blanco, salads in quesadillas. These items are in various markets where we are gaining valuable feedback. As I've stated previously, we're not going to roll out new menu items at the sacrifice of throughput nor will we add complexity to our restaurants by overemphasizing new menu choices. We will update you on our progress of all potential new menu items as they move through our stage-gate process.

Now let's talk about our marketing efforts, which have and will continue to be an important enabler of our growth. In fact, you saw this with the carne asada launch as we leverage our digital capabilities as well as a national TV campaign by teaming up with film director David Gelb. These spots are a continuation of our Behind the Foil campaign that launched earlier this year and highlight real Chipotle team members and providing an inside look at the real fresh food and skill for preparation that happens in Chipotle kitchens every day.

These efforts are designed to increase transactions and grow sales by driving culture, driving a difference and ultimately driving a purchase. In addition, we effectively utilize social media and ran several strategic promotions during the quarter to make the Chipotle brand more visible, while helping expand access. Going back to the question of what's next, we launched Chipotle Rewards in March and are just now beginning to leverage that platform.

We currently have 7 million enrolled members and have only scratched the surface on database marketing. We are encouraged by early signs of transaction increases across all frequency bands and going forward, we'll double down on our ability to leverage this data to incent behaviors. We expect this lever to become a bigger driver over time as we gain more experience gathering customer insight, while continuing to expand our digital platform.

Reducing friction and providing more convenient access for our guests has been critical to increasing our digital system penetration over the past couple of years. This quarter, digital sales grew 88% year-over-year to $257 million and represented 18.3% of sales during the seasonally slower summer quarter for digital. And we're knocking on the door of digital becoming $1 billion business. Consistent with past quarters delivery remained a key driver of our digital growth given enhanced capabilities on our app and website as well as our expanded availability from more than 97% of our restaurants.

Importantly, digital remains highly incremental and we continue to see residual lift in delivery sales that lasts beyond any promotion. Additionally, I'm pleased to announce that we have finished installing our digital make lines in all relevant restaurants and this was completed slightly ahead of schedule and makes the system more efficient for our guests, team members and delivery partners, while driving more sales and loyalty for Chipotle. Now that we have the digital make lines installed, we are focused on ensuring that execution for this large and growing business matched that of the traditional front line.

This brings me to the evergreen topic of operational excellence. The reality is that all the growth initiatives I just mentioned are being supported by the terrific job our operations team is doing in providing a great guest experience. And we know cultivating a better world includes investing in our people. And we believe that's the right approach in creating an environment where our employees can thrive professionally as well as personally and be in a position to win not only today but also in the future.

Enhanced training and development, industry-leading employee benefits, including the recent Debt-Free Degrees program in addition to our newly expanded tuition reimbursement program and a new crew bonus that was paid out to more than 2,600 employees last quarter are just a few examples of how we continue to invest in our people to cultivate a better restaurant culture.

The result is our employees putting their best foot forward and remaining focused on our core fundamentals. This is leading to us attracting and retaining the right talent and having higher teams stability, which is allowing them to spend more time together and deliver on two important benefits. One, delicious food consistently being prepared and served every time, something our guests have definitely noticed. And number two, we're seeing a steady improvement in throughput aided by training, focus and providing our teams with an easy to use dashboard that provides greater visibility on performance.

I want to recognize our team for their efforts and hard work in delivering another outstanding quarter. I believe we are still in the early stages of our journey and we need to stay focused on our priorities and executing flawlessly to support our growth, while providing our customers with the experience they expect from Chipotle. Thank you to all our employees for all that you do. We have a unique brand and I love the passion and determination that I see during my restaurant visits as our crew members constantly strive to be better today than they were yesterday.

With that, here's Jack to walk you through the financials.

Jack Hartung

Thanks, Brian and good afternoon, everyone. We delivered outstanding financial results in the third quarter as comps and margins continued to expand further highlighting the strength of our economic model. Connecting with guests through culturally relevant marketing focused on Chipotle's great taste and real ingredients, while providing more convenient access is helping lead to greater overall demand.

Sales were $1.4 billion in the quarter, an increase of 14.6% from last year. Comp sales grew 11% in the quarter, which includes a 10 basis point reduction as a result of deferred revenue from our Rewards program. This deferral is lower than previous quarters due to a combination of an increase in free entrée redemptions as guests earned enough points and an adjustment and breakage rate assumption for chips and guacamole now that we have more history.

Moving forward, we expect quarterly deferral to range between 20 basis points and 40 basis points based on various factors including the pace of signups and promotional activity. Restaurant level margins of 20.8% expanded 210 basis points over last year and earnings per share adjusted for unusual items was $3.82, a 77% year-over-year growth. The third quarter had unusual expenses related to our transformation as well as legal reserves that negatively impacted our earnings per share by about $0.35, leading to GAAP earnings per share of $3.47.

Our comp of 11% was driven by an acceleration in transactions as nearly 7.5% of the comp came from greater guests visit. The higher average check includes a price impact of about 2% and a mixed contribution of roughly 1.5% driven predominantly by digital orders, which have a higher average check. Looking to the fourth quarter, factoring in strong sales we have seen thus far in October as well as the tougher comparison from last year, we expect Q4 comps to be in a high single digit range. This will result in our 2019 full year comp guidance being at the top end of our high single digit range.

We opened 25 new restaurants in the quarter bringing our total openings for the year to 60. And based on the early success of Chipotlanes, we shifted our real estate strategy to seek more sites that can accommodate a Chipotlane. As a result of the more than 80 restaurants currently at construction, about half of them will have a Chipotlane, which will result in a total of about 60 Chipotlanes by the end of 2019.

Given the longer construction timeline associated with Chipotlane, some of these new openings are likely to shift from Q4 into early 2020, so expect our total openings for 2019 to fall at or slightly below the low end of our 2019 range of 142 to 155 openings. For 2020 we anticipate opening between 150 and 165 new restaurants with more than half including a Chipotlane. And we expect these openings will be better balance throughout the year with around 60 openings in the first half of the year versus only 35 openings through June of this year.

Food cost for the quarter were 33.2%, a decrease of 20 basis points from last year due primarily to a menu price increase that was partially offset by higher cost of several ingredients. On a sequential basis, avocado pricing moderated as we expected. This was the result of sourcing more supply from Peru, which reduced our reliance on Mexico. For Q4 we expect ongoing moderation in avocado pricing as a result of increasing supply in the back half of the quarter, but we believe this will be largely offset by the higher cost of carne asada resulting in cost of sales remaining in the low to mid 33% range.

Labor costs for the quarter were 26.6%, a decrease of 60 basis points from last year. This decrease was driven primarily by sales leverage, partially offset by labor inflation, which continues to be in the 4% to 5% range. It also includes 20 basis point additional investment related to our restaurant level performance incentives including the crew bonus, Brian mentioned earlier. We expect Q4 labor costs to be in the high 26% range given extra initial labor expenses associated with a significant number of new restaurants being opened in this quarter as well as lower seasonal sales in the fourth quarter.

Other operating costs for the quarter were 12.8% a decrease of 90 basis points from Q3 of last year due to lower marketing and promo cost as well as sales leverage. Marketing and promo cost were 2% in the quarter, a decrease of about 50 basis points compared to Q3 of last year as we decided to shift some of our marketing investment to Q4 to support carne asada and other promotions. As a result, we expect our marketing investment to be at or slightly above 4% in Q4, which will result in the full year investment remaining right around 3% of sales.

G&A for the quarter was approximately $115 million on a GAAP basis or $105 million on a non-GAAP basis, excluding about $7.5 million for settlements of several legal matters and $2.5 million related to transformation expenses. It also includes $72 million in underlying G&A expenses, $25 million related to non-cash stock compensation, $5 million related to higher bonus accruals from our strong performance and payroll taxes on stock option exercises and $3 million related to other expenses including our All Manager Conference, which will be held in March of next year. Underlying G&A with a little lower than expected as we continue to finish rounding out our organizational structure.

We're expecting to fill open positions in Q4 and therefore, we believe our underlying G&A support will get to around $74 million to $75 million in Q4. Also, if we assume our current financial trends continue stock compensation, including performance adjustments, along with the higher bonus expenses should be right around $25 million.

Lastly, we're expecting to recognize between $2 million and $3 million for expenses in Q4, related to our upcoming All Manager Conference. And we expect the total expense to be right around $16 million, most of which will hit in Q1 of next year.

Our effective tax rate for Q3 was 17.9% on a GAAP basis and 18.3% on a non-GAAP basis. Both these rates are lower or below our full year guidance range due to the recognition of excess tax benefits on stock-based compensation during the quarter. For Q4, we expect underlying effective tax rate to be in the 26% to 29% range, though it may vary based on discrete items as well as any stock option exercises.

Our balance sheet remains strong with cash and investments totaling $844 million, as of September 30. We repurchased $39 million of our stock at an average share price of $783 during the quarter.

In closing, we're pleased with our Q3 results as our strategic growth initiatives continue to sustain strong sales momentum, which is a key driver of our economic model. We remain bullish about the future and we believe we still have plenty of runway ahead.

I just want to thank all of our restaurant team members for their contribution and their passion as they remain Chipotle's most valuable asset as we worked together to cultivate a better world.

With that, we're happy to take your questions.

Question-and-Answer Session

Operator

Thank you. We will now begin the question-and-answer session. [Operator Instructions] The first question comes from Katherine Fogertey with Goldman Sachs. Please go ahead.

Katherine Fogertey

Great, thank you. I'm just trying to get a handle around the new unit guidance. So you guys expect additions to new units to go now at the lower end of the 140 to 155. And some of those are getting pushed into next year. Does the new unit guidance then implicitly state that you guys are slowing down the pace of new restaurant adds? I'm just trying to get a handle on what are the puts and takes between unit growth here when coupled with the very strong comp momentum in the quarter? Thank you.

Brian Niccol

Yes. Thanks, Kathy. So no, the plan is actually, I think the guidance that we shared is we're going to be accelerating new units as we move into 2020. And I think, what we just wanted to share with people is, a greater blend of that will now include Chipotlane, which we've accelerated the composition of Chipotlanes in our new unit kind of growth trajectory going forward. So the good news is with 11% comp and 7.5% transactions and really strong margins, we're now going to be able to push on how we continue to expand our new units going forward.

So this is really just one of these temporary things, whereas we take advantage of an opportunity with the Chipotlane, which really I think it is a terrific outcome because it will drive our digital results as well as drive the total business, which hopefully as we've seen to date will result in even better returns going forward as we build out the new units. So no plan to slowdown, if anything, our guidance was intended to inform people we're going to be increasing. And we also wanted to be share with folks that we're going to have a greater mix now Chipotlanes.

Katherine Fogertey

Can you help us also just to remind us on the AUVs for restaurants with Chipotlanes versus those without? How we should think about how that blend might progress?

Brian Niccol

Yes. I don’t think we’re disclosing exactly what the AUVs are on this. But here’s what it is, I think we can give you some interesting facts on it, which is our digital business is roughly 50% bigger and the driver of that additional growth is our order ahead business, which as you know, it has got the best margin associated with our business going forward. So we loved the composition of the sales and we love the economics associated with new units, whether they have Chipotlanes or not. But we’re very positive on which Chipotlane brings to our new unit program and why we’re raising guidance for next year.

Katherine Fogertey

Great. Thank you.

Operator

The next question will be from David Tarantino with Baird. Please go ahead.

David Tarantino

Hi, good afternoon and congrats on another great quarter. Jack, I was wondering if you could maybe clarify what you meant around the Q4 guidance. I think you mentioned that October so far has been strong and you’re expecting maybe that to ease, as it is cycle tougher comparisons coming up. So could you maybe just elaborate on what you’re seeing in October so we have the right context for the rest of the quarter? And then Brian, you mentioned that you’re seeing some progress on throughput in the restaurants, I was just wondering if you could contextualize what that progress has been so far and how you see that playing out in 2020? Thanks.

Jack Hartung

Yes, David on comp. We saw comps accelerate in September, when we initially rolled out carne asada, which is around September 12 or so. And then we started media around September 22. So we saw sales accelerate at the end of the quarter and then we saw those higher sales levels continue into October. The guidance that we're giving for the fourth quarter though it takes into account the strong comps as we start the quarter, but also that our strongest comp month last year was December, so going up against the tougher comparison in December. That's when we had the delivery bowls and those were very, very successful.

The other thing, I want to mention is, we only have enough supply for carne asada to last us for part of the quarter. We think we'll probably run out around the end of November, maybe into early December. And so we're being a little cautious with what happens once we run out of carne asada. But the momentum to start the quarter is great, but we got a tougher challenge as we move through the quarter.

Brian Niccol

And then, yes, to your second question, David, on throughput. The thing that I think is really exciting to see is as each quarter has gone by with the focus on this. We continue to see every region making progress on their throughput goals. So we're not all the way to where we have targeted, but we are making great progress and our throughput is better than it was last quarter and it's definitely better than it was two quarters ago. So the operational team is very focused. Scott has the guys dialed in on this and our throughput is continuing to improve quarter-to-quarter, month-to-month. So I'm very optimistic about what that's going to do for the business going forward.

David Tarantino

All right. Thank you.

Operator

The next question will come from Sara Senatore with Bernstein. Please go ahead.

Sara Senatore

A question about margins if I could, which is just about the fact that it's been a little bit volatile this year, but in the end, very good margin expansion and maybe for the full year, EBIT margin on a recurring basis, maybe as much as high 100 to 200 basis points something in that range. But I guess that implies a very high flow through margin, even on a 10% comp. So could you just deconstruct that a little bit? Especially, because you have a traffic-driven comp, there's not a lot of price in there. Is that digital mix? Are there cost savings that are coming through? And is it still the case that when we think about potential return to peak volumes, we should think about restaurant level margins that are maybe below what they would have been at previous peaks? Or are you finding opportunities again between throughput order ahead is sort of structurally offset, whatever the headwinds may have been?

Brian Niccol

Yes, Sara. The way I would think about margins is I think most of the leverage, it's from flow through. So we do get a higher, a very attractive flow through, when we have higher sales, especially when they're transaction-driven like this. We have some headwinds in there. That we have to overcome, like we do have labor inflation that 4% to 5%, that's about a 100 basis point headwind, avocados to get better in the quarter. So we had bigger headwinds from avocados in Q2 than Q3. And then moving into Q4, we've got a little bit of a challenge. The carne asada's more expensive, a cut of meat. It's a higher quality premium cut of steak. So that puts a little bit of pressure on our food costs.

But I would say that from overall margin standpoint, we're pretty much right on track. We talked about at $2.1 million volume, we should generate a margin of about 21% and we're right about there. In terms of as you move from $2.1 million to $2.2 million to $2.3 million up to if we get back to our peak volumes of $2.5 million, we're still confident that we'll be right in that same kind of margin range of like a 25%. So we think the flow through so far is pretty much right on track.

Sara Senatore

Thank you.

Operator

The next question comes from Nicole Miller of Piper Jaffray. Please go ahead.

Nicole Miller

Thank you. Good afternoon. I wanted to understand what might be the tipping point on the acquisition of customer data. I believe, you said 7 million loyalty members. So right now the comps are producing, I would imagine it's not doing much yet with that data. So maybe you could talk about what you're doing with the data, but the power of what it can be – what it can do, now that you have a 7 million base and is that enough of a base to produce results?

Brian Niccol

Yes. Thanks, Nicole. The – obviously, we're delight we've got 7 million users now in rewards program. We anticipate that's going to continue to grow. And as I mentioned in the past, we are already starting some experimentation with the various cohorts. And the good news is, when we have done some of these experiments, we've seen meaningful changes in peoples' frequency and their engagement levels with the brand.

So I think this is something that ongoing, as we roll into 2020, it starts – it's going to start being a contributor to our sales growth. Because we'll have a meaningful database with meaningful numbers of users and I think we're learning really quickly and figuring out what really does result in behavior changes that rewards people and at the same time rewards the business with incremental transactions and incremental sales. So I'm very optimistic about what this can do for us. The database marketing is showing signs of being a really meaningful growth lever going forward.

Nicole Miller

Thank you. And just a follow-up and last question, Chipotle is clearly getting stronger every day. So when you think about the development acceleration for next year, is there anything in there for international growth and if not, when and how do you leverage that international opportunity?

Brian Niccol

Yes. So the reality is exactly what you said, which is the health of the business and the operational performance gives us confidence to accelerate new units next year. And then you compound that with adding to the mix, new growth lever called Chipotlanes, which is a driver of digital sales and highly profitable sales. We're really excited about what our growth opportunity is from new unit standpoint in United States, so very excited about that. At the same time, we're continuing to work on our business in Canada, which they have made tremendous progress to date. And if they continue to deliver the financial performance that they're delivering, which is now getting close to what we're seeing in the U.S., obviously, that'll be a place down the road that we will look to accelerate new units as well.

We're still probably in the earlier innings in Europe. Because we're still learning there on what we can do with our Chipotle business. But again, the team there is making great progress as well. But still some work to be done there on both the model and how we continue to introduce Chipotle in the new markets. But I just want to emphasize, there is so much opportunity in the U.S., with the performance that we're getting out of our business. As well as frankly, the types of restaurants we can build going forward, the combination of end-caps, and now end-caps with Chipotlanes as well as the inline unit and then the freestanding restaurants that we've done to date. So we're very optimistic about where we can go with our unit growth in United States. And then obviously, down the road, we'll figure out how we pivot outside the U.S.

Nicole Miller

Thank you.

Operator

The next question will be from David Palmer of Evercore. Please go ahead.

David Palmer

Thanks. Good evening. Question on labor, I think your labor hours per unit went up more like high-single digits this quarter versus mid-single digits in the first half of the year. I know you can tell me if I'm right on that, but if it did ramp up, why? And more broadly, even beyond this quarter, how do you view that leverage point going forward? Is that second make line, for example, fully staffed and ready to go? And should we see similar levels of labor leverage? Or is there more to be had or even less because you're not up to where you need to be? Thanks.

Jack Hartung

Yes, David. I would say, the labor leverage hit exactly where it should be. I'm not sure, how you're doing your calculation. We had additional transactions of 7.5%. We grow our labor hours at a lesser percent than sales, quite a bit lesser percent. So when you say high-single-digit, that's not what we actually added. We would have added something quite a bit less than 7.5% in terms of the hours. And if you breakdown the labor leverage, we had labor leverage of about 60 basis points in the quarter and that's despite the fact that we had about 100 basis points of inflation challenge that we had to deal with. So we really labor – leveraged the labor line by about 160 basis points and that's really right on the target.

Now going forward with digital, we do think there's an opportunity with digital for us to get even more efficient. We're in the early innings there. Chipotlane, we've only got 20 Chipotlane restaurants right now, but we're going to have 60 by the end of the year. And we'll learn more about how we staff the Chipotlanes and how we can really get as much as efficiency that we know is possible, out of moving more of the sales towards that second make line. So, so far we're really pleased with where labor is, but we do think that there's additional efficiencies as the second make line grows.

David Palmer

I guess my second point was really about, in that second make line, are those staffed and are you effectively at a low capacity utilization on that second make line currently and therefore that incremental margin is going to be outstanding, perhaps even better than the first line? Or is that something that you're not, where you need to be in terms of staffing when that mix gets up to where some of your better digital make line stores are staffed? Thanks.

Brian Niccol

Yes. David, I got your question. It's a good question. In our very busiest digital restaurant, those things are fully staffed and I think there's additional leverage to be had. There are areas of the country and there are individual stores where the digital business is not at that same 18%. We do have challenges in making sure we've got the right staffing throughout the day and every single day.

So there are opportunities for us to staff those restaurants, so that the business will build, but I will tell you in terms of the levers that you're getting at with the restaurants that are already at 18%, 20%, 25% digital, those restaurants are staffed. And as we add more sales to the second make line, you're going to see greater sales leverage in those stores.

David Palmer

Great. Thank you.

Operator

The next question will be from John Glass of Morgan Stanley. Please go ahead.

John Glass

Hi, thanks very much. Just on digital sales, I understand there's some seasonality, but I was still surprised to see sequentially about the same percentage of sales as digital. So maybe what gives you confidence that you aren't hitting some sort of ceiling in that, the consumer doesn't want to transact more than they are in digital channels. And can you talk specifically about how delivery has performed in this quarter relative to prior quarters?

Brian Niccol

Yes, sure. So what we've seen is the seasonality was more around the delivery aspect of the business, in our digital business because we continue to see growth in our order ahead business. And so, what we've also seen is we've come out of kind of the summer months where the seasonality was is, that strength in continued on with the order ahead business and then consistent with what we've seen in the past, the seasonality played out in the delivery side of the business.

So we're definitely confident that we are far from the ceiling. And then we've got other indications where when we've added additional access like the Chipotlane, you get well beyond 20%. So that's what gives us confidence that we're far from the ceiling on this.

John Glass

Okay, that's helpful. And then just on carne asada, is this – was this intended to be an LTO or what – why are you running out of product and is it just temporary or is it, you're just going to pause this in-and-out? I thought it was more like, you were going to try attempting to build sort of permanent new sales items, not LTOs?

Brian Niccol

Yes. This was intended to be a seasonal offering where we would bring it in-and-out. There are other items like queso blanco, we're assuming it the success for the stage-gate-process, that'll be more permanent. But yes, this one initially was intended to be more of a product represent some news and we may use it again depending on how the whole experience plays out.

The early feedback we've seen from our customers and our crew members is, they definitely would like us to do this again. So, we'll figure out exactly the right pacing and sequencing and whether or not it's something we want to have permanently in the business or if we continue to use it more as like a seasonal item.

John Glass

Got it. Okay. Thank you.

Brian Niccol

Yes.

Operator

The next question comes from Jake Bartlett of SunTrust. Please go ahead.

Jake Bartlett

Great. Thanks for taking the question. I just want to ask a follow-up on the carne asada, my kind of chats or just even my experience in the stores was that the carne asada was selling significantly more than the regular steak. And so I assumed that, that was driving a decent amount of checks. So within that the context of that, of those statements, could you talk about how October has been impacted by the carne asada? And maybe what we could expect to kind of fall-off with the carne asada's removal.

Brian Niccol

Okay. Yes, sure. So, we have gotten great response to the carne asada initiative. We're really excited to see that the stage-gate-process was predictive of what we've seen nationally. So we're really delighted about that. We're seeing it drive both check-in transactions, which is also another thing we're very excited about. And what we're seeing is, it's sourcing new users as well as having people that have been users of the Chipotle business to try a new occasion. So we're seeing frequency compression and we're seeing new users coming in.

What we'll obviously want to continue to understand, which we've got some understanding on is, what happens to all those new users that came in now that they've experienced the Chipotle business and historically, Chipotle has been very sticky beyond just one product, it's the whole value proposition that get people excited about Chipotle. The idea of Food With Integrity, the idea of customization, the idea of speed, and then obviously putting that all together at a really reasonable price, it's something that's very sticky for the Chipotle business. So we think this is much bigger than just the product. It's more about introducing people to the Chipotle experience ongoing.

Jake Bartlett

Got it. And I don't know if Jack would you want to just share what it's kind of done to how much it's been helping the October sales in mix. But also just building on that question, if it's sounds like its successful in driving check and driving traffic and kind of hitting everything you want it to, why not keep it around or do it more permanently? Is it a matter of the throughput or is it a matter of the supply being a little more difficult? What would be the reason why not to keep on offering it?

Jack Hartung

Yes, so look, the main driver is, we were not willing to compromise on our Food With Integrity principles on the supply over this program. And so going into it, we knew the supply available would take us through November to early December.

And, something we're going to work on going forward, given the response we've seen is, okay, how do we work on the supply of steak in that particular cut to be consistent with our Food With Integrity principles to give us the flexibility to do it beyond just the seasonal program. But I don't think we can answer your specific question that you're looking for on exactly how is it playing out in the product mix and the comp. Obviously it's playing a positive role.

Jake Bartlett

Got it.

Jack Hartung

That's where I would leave it.

Jake Bartlett

Okay. I appreciate it.

Jack Hartung

Sure.

Operator

The next question is from Sharon Zackfia with William Blair. Please go ahead.

Sharon Zackfia

Hi, good afternoon. I am wanted to follow up on the Chipotlanes and as well on the carne asada. So on Chipotlanes, could you – Jack give us any idea on kind of what the incremental cost is when you add the Chipotlanes to locations and maybe what the unit economics are that we should think about for 2020 associated with those new openings?

And then on carne asada, any quantification around what it did to COGS either in the September quarter or what we should expect in the fourth quarter?

Jack Hartung

Yes, Sharon on the investment, the investments about an extra $75,000 to add Chipotlanes, that would be for like an end-cap building. It’s the same $75,000 on a free standard, but a free standard just cost more than an end-cap. So our emphasis so far has been on getting the vast majority of our sites should be on the end-cap. We’re trying to get as many end-caps with Chipotlanes as possible, that’s why we’ve been able to pretty quickly pivot so that we can have more than half of our portfolio. Now we’ll have the Chipotlanes. So it’s a relatively modest investment.

Too early to say on the sales what the difference is between Chipotlanes and non-Chipotlanes, Sharon, we’ve got 20 of these that spread throughout the country. I’ll tell you they’re opening up nicely. We’re very pleased with the results. I just wouldn’t want to put a number on whether it’s performing at or above from a sales standpoint, but the fact that it’s 50% above on digital it’s a very strong starting point.

We know that when you can operate Chipotlanes with less friction, meaning it’s easier to order, it’s easy to stop-in and pick up Chipotlane without even getting out of your car. That tends to cause our customer to want to get your Chipotlanes even more often. So our optimism, even though it’s very early is very strong and the economics with even a modest increase in sales at that kind of an incremental investment is going to be very attractive.

Sharon Zackfia

And then on carne asada, if you could help quantify the impact on your COGS for the third and fourth quarters.

Jack Hartung

Yes, it's going to be about it – it's very small in the third quarter, Sharon, because it was only in for a few weeks, but it's going to be in the ballpark of 50 basis points. And so – that's what we mentioned in our guidance that our food costs in Q4 is going to stay about the same, maybe a tick or two higher. Even though avocados are going to cause less in the fourth quarter, that's going to be offset by carne asada and we're guessing right now, again, we're trying to predict what the rest of the quarter is going to look like when we'll run out. But it looks like it's probably going to be right around 50 basis point impact in the quarter.

Sharon Zackfia

That's helpful. Thank you.

Operator

The next question will be from Jeffrey Bernstein of Barclays. Please go ahead.

Jeffrey Bernstein

Great. Thank you very much. Two questions, just one following up on the, I guess menu relation. Brian, it sounds like the carne asada success, I'm wondering how you literally would define success in terms of maybe what mix you've achieved thus far or what you think is the target level and maybe any color on the case of DSL. In case, you talked about what potential hurdles there would be to overcome in the stage-gate-process before we might see any or all of those? And then I have one follow-up.

Brian Niccol

Yes, look on a carne asada, I mean what we did in this stage-gate-process was, we wanted to make sure we had a product that consumers wanted. We wanted to make sure we had a product that our operators could execute. And then obviously we wanted to make sure it made sense financially.

And the way we derive that financial benefit is through check and transactions. The good news is carne asada has done terrific on the traffic driving as well as the check driving. And then our operators, to their credit have done job in executing and the feedback we're getting from consumers, both new users and existing consumers, is they love the product. So by all accounts, we're delighted with what carne asada is doing for the business.

And as you fast forward to other initiatives, our intention is we want to derive all those types of benefits when we're launching a product. So, queso blanco, same expectations, needs to be something our crews can execute with excellence, consistent with our Food With Integrity principles. It's got to be something the consumer is going to say they love it and they want to try it again. And then obviously it's got to play a role in the financial model so that it's continuing to move Chipotle forward.

And that's the reason why we test these things. And, some will play a bigger role in traffic driving than others and that's why you got to have a pipeline of different products to play a different role in the business. So I'm really excited about what the pipeline looks like and very delighted really about carne asada going through this whole process and then everybody executing with excellence. That's how we end up with a successful initiative.

Jeffrey Bernstein

Got it. And can you just for color, maybe Jack on the marketing stand, I think you said 4% in the fourth quarter, which would lead the full year at 3%. I'm just wondering how you measure the return on that and whether we should think about 2020 being more in the 4% range or whether there's a reason why you prefer to keep it up that lower 3% level?

Jack Hartung

No, I mean Jeff we have no plans to do that, that could change as the year unfolds. But right now we think 3% about the right level, right now we think we're getting a great return. You know the marketing team, every single campaign they look at what's happening in terms of transaction, what the return is and so far we've been getting a great return on our dollar. So right now we think 3% is the right level. If we – should change in the future, we'll communicate that.

Jeffrey Bernstein

Thank you.

Operator

The next question will be from John Ivankoe with JPMorgan. Please go ahead.

John Ivankoe

Great. Thank you. I was hoping to get an update on some of the supply chain initiatives that we've been talking about in 2019. If there's an update in terms of how much money was saved in the third quarter, if there's an outlook for the fourth quarter and what the visibility is for some of the supply chain work on fiscal 2020 to start contribute more meaningfully the margins overall.

Jack Hartung

Yes. John, we've saved another few million dollars during the quarter, but it was offset by other things including, some of the carne asada pressure that we saw in the last three weeks of the month. But listen, the team's been doing a lot of great work and we think that we'll see more savings in 2020.

Too early to predict what those are going to be. I mean, a lot of these things will take time because you're talking about long-term relationship with suppliers, but I expect we'll be able to talk next year about even more savings from the efforts of the supply chain team.

John Ivankoe

Thank you.

Operator

The next question is from Andy Barish with Jefferies. Please go ahead.

Andy Barish

Yes. Wondering on kind of looking out, obviously, the second half margin progress, which we thought wasn't quite going to be a strong as the first half may act otherwise, but I wonder if you look out to 2020 and kind of give us a sense of the puts and takes, I assume, pricing is going to remain around 2%. Any early thoughts on kind of the protein basket just as we try to gauge some of the margin levers for next year as we sit here today?

Jack Hartung

Yes, Andy, we're not seeing anything out of the ordinary right now. It's too early to get a precise prediction, but it looks like beef generally to the extent that we can get the supply of food with integrity cuts that Brian mentioned, it looks like that should be pretty stable. We don't see anything out of the new ordinary in chicken. We see what's happening with pork supplies throughout the world. Our supplies are separate from that and so we haven't seen any impact there.

So right now we're kind of crossing our fingers and hope that everything continues to look stable. We're also hoping for a benign or maybe even a positive benefit from avocados next year is going to be the alternate year where we should see a more plentiful harvest. And so right now, knock on wood, cross fingers, all that kind of stuff. It looks like a pretty stable cost of goods sales environment for next year.

Andy Barish

And do you anticipate menu price kind of staying in this 2%-ish area?

Jack Hartung

You know, we're studying that right now. Andy, if we did anything, it definitely would be in that kind of 2% range, but no decisions have been made.

Andy Barish

Thank you.

Operator

The next question is from Andrew Charles with Cowen & Company. Please go ahead.

Andrew Charles

Great, thanks guys. On Chipotlanes, what percent of the existing 2,500 non-Chipotlane locations have the capacity or the ability to add a Chipotlane versus the amount that are structural enable and just also just curious about your appetite to retrofit these locations as you go through 2020 and beyond?

Brian Niccol

Yes, sure. So there on our current estate there really aren't that many options out there for us to retrofit into the Chipotlane only because we don't have that many end caps historically. Chipotle really was in line unit execution. So we're just limited with the real estate that we have and then you've got to have the end cap in the right location in order to do a retrofit. With that said, where the opportunity exist, we've done one, and not surprising, we saw positive result given for what Jack said earlier, when you get people more access with less friction, the order ahead business continues to take steps forward. So limited opportunity in retrofit but lots of opportunity going forward as we build new restaurants.

Andrew Charles

That's helpful. And I know you're reluctant to give numbers in details on Chipotlane, but when you talk about year-to-cash on cash returns for new store of around 40%. Is it right to think that Chipotlane is higher than that just given this is a winning prototype for future development?

Jack Hartung

I mean, it's early but, yes, we would expect to Chipotlanes are going to be a higher return than the average portfolio.

Andrew Charles

Thanks, guys.

Operator

Next question will be from Gregory Frankfurt with Bank of America. Please go ahead.

Gregory Frankfurt

Maybe just going back on to Andrew's question, in terms of the operating model for Chipotlanes going forward, I guess, right now, you can only order ahead as you pull up to a Chipotlane. what's the likelihood that you shift this model to more of a traditional drive through operating structure at some point down the line? I guess what's going to I guess prevent you from making that shift at some point? Thanks.

Brian Niccol

Well, nothing would prevent us from making the shift. We just don't believe it's the right shift. So what we've seen is giving people the access through ordering ahead, so that they don't have to get other car is a nice unlock for the Chipotle business so that we don't have to provide the additional complexity of running a traditional drive through.

Frankly, I think this is the future of how people will want to interact with restaurant companies because this is arguably faster than any other way possible to get your food. You order ahead and you don't have to get out of your car and our model is already fast now. Now, we've made it fast assuming that we get out of your car, come into the restaurant, grab your food and go. So we don't see any reason to make that pivot going forward.

Gregory Frankfurt

Got it. Can you maybe talk about the experience so far in terms of balancing consumers kind of timing when they show up at the restaurant with kind of when the food is ready, and if they show up early, and how you manage through that and kind of how you would expect to manage that as you go forward? Thank you very much.

Brian Niccol

Sure. So you have – with our smart pickup times, you do select a time for when your food is going to be ready and then you show up with it. If you show up early, we usually have people just pull forward and tell them they can come into the restaurant at their time or there are times where we will bring the food out to them where they pull forward. The good news is what we've seen is after the restaurant opens and two or three weeks in, people get into a pretty good rhythm where they shop on time and once they realize this is how the Chipotlane works and we've gotten really great consumer acceptance and the right type of behavior going forward. So that's not been a problem to-date and it's really just a matter of people adopting the new approach to how you get your food in your car.

Gregory Frankfurt

Helpful perspective. Thank you.

Brian Niccol

Yes.

Operator

The next question comes from Peter Saleh with BTIG. Please go ahead.

Peter Saleh

Great, thanks. With 7 million loyalty members now, can you talk a little bit about the composition of the customer. Are they new users or they lapsed customers and just maybe a little bit more detail. Are these loyalty customers, are they spending more, are they coming in more frequently? Any details around that would be helpful. Thanks.

Brian Niccol

Yes, of course. So this is a question I love to answer because the thing that's been great about the program to-date is it's definitely got bigger representation of new and light/medium users, and what we're seeing is when we do communicate with them with certain incentives, we see behavioral changes that are very positive and so we're seeing all the things you would want to see in a rewards program from a standpoint of the composition of those that are in the rewards program and then the behaviors associated with those that are within the program. So a lot of new light and medium users, and then we're seeing really nice behavior associated with all those various cohorts.

Peter Saleh

Great. Thank you very much.

Operator

The next question will be from Chris O'Cull with Stifel. Please go ahead.

Chris O'Cull

Yes. Thanks. Brian, given the supply of Carne Asada, it is going to run out late November, what are the plans to continue driving usage from guests that came in for the product. I mean, I'm just wondering if we should expect a new product news before the end of the year? And then I had a follow-up.

Brian Niccol

Yes. Our plan is those that come in with Carne Asada, they get a great Chipotle experience that is going to result in them wanting to come back even with Carne Asada is not on the menu. And we're obviously focused on continuing to drive that message throughout the whole quarter. So we probably have already seen it on television; we are running ads that both talk about Chipotle as the brand and the total restaurant company as well as driving Carne Asada.

So – and what we've seen is the response has been positive to both messages. So people are very much in tune with the idea of food with integrity, real culinary, real ingredients, cooking done right in front of them, as well as some new product menu news around Carne Asada. And the good news is Chris and the marketing team, they've got a strong plan to finish the year that goes well beyond just products.

Chris O'Cull

Okay, that's fair. And then, Brian, would you talk about how the company to determine the appropriate number of unit openings for 2020 and what you would need to see to accelerate the number of openings?

Brian Niccol

Yes, look, the good news is, there are plenty of sites and the economics would support going faster and doing more. What we wanted to really make sure is we've got the people and capability in place and I think we're seeing more and more confidence as our stability has gone up, and as we've opened new restaurants, they continue to open really well. So we're going to continue to build a really strong pipeline, which we have for next year, and if the opportunity presents itself to go a little faster, obviously we'll.

But I think I've been pretty consistent with this one, which is the key for us to continue to have great unit growth is to have great unit economics. And I think that's what we're demonstrating is tremendous unit economics. So I'm not surprising as the unit economics continue to improve. There is more and more sites that are available for us and then now we've just added another lever called the Chipotlane, which I think is going to open even more sites for us in the future.

So we've been very purposeful to be – I think very measured in how we go about ramping up our new unit development. But I think there is plenty of opportunity for us to grow from where we are today and what we probably will do in 2020.

Chris O'Cull

Great. Thanks.

Operator

And our last question today will come from John Tower with Wells Fargo. Please go ahead.

John Tower

Taking the question, just going back to the digital piece of the business, with digital and specifically order ahead mix moving higher as a percentage of your sales, does this potentially open up more opportunities on the menu over time? I'm thinking specifically about your Quesadillas and how, at least when you're testing now requires about a 30-second cook time with new kitchen equipment.

So in a traditional store that might gum up throughput, but if you're doing Chipotlanes where you've got a greater mix of order ahead, obviously that seems to tie in better in that type of a store. So does it potentially open up more opportunities for your menu?

Brian Niccol

Look, I think it's great about the digital business and the digital make line is it does present the opportunity for us to look at opportunities that historically we may not have been able to look at, because I think you can use that make line in various ways, whether it's fulfilling directly digital orders or helping alleviate the front line. So it's definitely something we're continuing to contemplate because it just presents a tremendous opportunity for us. We've got now additional capacity with really great economics associated with that additional capacity.

We before was not be thinking about how we can drive, why can't we drive that harder and that's what the team focused on is how do we drive that harder because we like the results every time that business growth. So – and I wouldn't just have it be the idea of just product. I think there's other ways to drive people into that digital business and then ultimately leverage that digital make line.

John Tower

Thank you.

Operator

Ladies and gentlemen, this concludes our question-and-answer session. I'd like to turn the conference back over to Brian Niccol for any closing remarks.

A - Brian Niccol

Okay, thank you. And thanks for all the questions and thanks for joining us today. Obviously, where I started this conversation is, I'm tremendously proud of the Chipotle team, all of our team members in the field. You don't deliver 7.5% transaction growth and an 11% comp unless you've got an organization that is all rolling together and I think the culture is tremendously strong, both in the support centers and in the restaurants, and I think what we've demonstrated with Carne Asada is we also now have a muscle where we can do new product innovation, as well as driving the digital system. And I'm also really delighted about the unlock that I think Chipotlanes is going to present for us from our new unit opportunities going forward.

So a lot of growth opportunities in front of Chipotle, a tremendous quarter I think that the team delivered most recently and couldn't be prouder of where we are, but I'm also really excited about where we're going. So thank you for joining us and we'll talk soon. Take care.

Operator

The conference has now concluded. Thank you for attending today’s presentation. You may now disconnect.