Street Takeaways - Chipotle Mexican Grill reaffirms FY17 comps of +HSD vs FactSet +10.3%
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- **<u>Overview:</u>**
  - Shares are off (7.3%) following Chipotle's release of an 8K in which they reiterated their FY17 comps of high single digits vs FactSet's +10.3% expectations. Management also expanded on guidance for Q2 in that they continue to expect food costs to be ~34.2% of sales with marketing/promotion costs to be up ~20-30bps vs Q1 to 3.6-3.7% of sales, resulting in operating costs to be at or slightly higher than reported for Q1
  - We tracked lowered estimates to Q2 and FY17 following the guidance update as it appears to firms that Chipotle has run into some increased costs associated with higher food costs, particularly reflecting stubbornly high avocado prices, high ad spend from their national marketing campaign, and higher IT security spend in relation to the massive credit card security breach in March/April. While one firm suggested the higher food costs were already discussed on Q1's earnings update, however may have been misinterpreted due to the language used and saw the guidance clearing up that confusion.
  - While near term estimates have come in, analysts were largely constructive on comp trends as a few firms suggest their checks imply traffic trends are improving and this update serves as a modicum of reassurance that some of the negative news items of late are not impacting comps, specifically the impact of the security breach. That said, sentiment remains mixed and largely neutral with the majority of firms, 57%, Hold-equivalent rated while 29% are Buy rated and 14% are sell rated. The recovery in traffic trends continues to remain the major factor in notes we tracked with some suggesting they expected the recovery to be further along now after 18 months while more constructive firms we tracked believes it's a matter of when not if.
- **<u>Analyst Commentary:</u>**
  - **BTIG** analyst Peter Saleh
    - Suggests the guidance update reduces their Q2 and full year estimates on higher food costs and thereby 100bps increased operating costs; Q2 to $2.12 from $2.44 with FY17 to $8.38 from $8.79.
    - Adds that the guidance update doesn't change their thoughts on sales trends and while only modestly changes their overall EPS outlook, it does result in a wider gap to CMG's $10.00 EPS goal which they believe indicates the economic recovery remains further away.
    - Remains Neutral on shares as they think the sales and unit economic recovery ought to be further along 18 month after the initial food safety incidents; continues to believe the mid-single digit increase in total traffic seen last quarter suggests a lackluster sales recovery, especially on the coasts.
  - **Goldman Sachs** analyst Karen Holthouse - <u>raises price target</u>
    - Thinks there was some initial confusion on the Q1 call as they believe the initial guidance ties to language that was previously misinterpreted given management indicated avocados would add 40bps to COGS and in CMG's reiterating of 34.2% COGS for Q2, that equals 40bps plus Q1 COGS of 33.8%.
    - While OpEx higher than Street expected came in lower than their estimate of 14.8%; adjusts their estimates by less than 1% and believes the report may be viewed mildly negatively as it suggests OpEx and COGS running higher than consensus.
    - Remains Neutral rated and raises their price target to $440 from $430 driven by updated estimates and while the stretch goal of $10/share in EPS in FY17 was not addressed, they do not believe the update suggests the goal is viewed as less likely.
  - **Maxim Group** analyst Stephen Anderson
    - Reduces their Q2 EPS estimate to $2.62 from $2.87 following the update alluding to higher costs incurred during the quarter; also highlights the uptick in SG&A spending to reflect increased IT security spending tied to the data breach in April as well as the national multimedia campaign; lowers FY17 EPS to $9.37 from $9.62.
    - Full year comp estimate of +11.3% unchanged as they model another double-digit quarter for Q2, though believes the Easter shift and the data breach hurt traffic somewhat; still expects a mix of accelerated traffic and full-priced sales to help deliver same store results of +11.5% vs Street's +10.2%.

        - Maintains their Hold rating and $440 price target as they still prefer to wait for a deeper pullback before recommending CMG shares.
    - **Piper Jaffray** analyst Nicole Miller Regan
        - For the year, their top and bottom lines remain largely unchanged and continue to bake in a sequential easing of comp trends as y/y comparisons become relatively more difficult.
        - Their latest checks suggest trends are headed in the right direction and they reiterate their confidence in CMG's long brand recovery efforts and continue to believe meaningful leverage as the recovery is a function of when and not if trends improve; new tv ads have helped drive awareness and highlights new bunuelos dessert item being received favorably.
        - Maintains their $530 price target and Overweight rating and remains patient in owning the shares.
    - **Telsey Advisory Group** analyst Bob Derrington
        - Revises their estimates lower following the 8K release as their Q2 restaurant cash flow margin goes to 19.1% from 19.9% and EPS to $2.30 from $2.55; trims FY17 to $8.58 from $9.00, though retains their FY18 $11.00 EPS estimate.
        - Suggests the SSS update adds a modicum of reassurance that the massive credit card breach hasn't had a sustained, material negative impact on traffic trends and also runs counter to a late May negative story on LikeFolio/June Philadelphia drug raid having a negative impact on trends.
        - While they are encouraged by CMG's prospects for further margin improvement to come, they believe that's already reflected in the company's recent valuation and reiterates their Market Perform rating and $440 price target.

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