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“FRESH IS NOT ENOUGH ANYMORE.”

STEVE ELLS

CHIPOTLE CO-CEO, FOUNDER, AND CHAIR

Introduction

Chipotle Mexican Grill (NYSE: CMG) has experienced great success satisfying the desire of consumers for a quick-serve restaurant that doesn't sacrifice quality for speed. Known in the food industry as a “fast-casual” restaurant, Chipotle is part of the fastest growing segment of the restaurant industry.¹ With annual revenues pushing \$2 billion and a stock price that doubled in 2010, Chipotle's steady growth and strong financial statements make it highly attractive to investors (see Exhibits 1–3). Chipotle achieves customer satisfaction while maintaining a unique vision that has committed the company to “finding the very best ingredients raised with respect for the animals, the environment, and the farmers.”² Coupled with a deceptively simple menu that allows for over 60,000 different burrito combinations, interactive ordering so customers can personalize their experience and meal, and a reasonable price—no wonder Chipotle restaurants are full of happy customers and that the company has grown to nearly 300 locations in only 17 years.

History

At an age when most of his peer group was still watching cartoons, Steve Eells was a dedicated fan of Julia Childs' cooking show on PBS. After earning a bachelors degree in art history from the University of Colorado at Boulder, Eells began his formal cooking education at the Culinary Institute of America in New York. Following his graduation in 1990 and while working in San Francisco, Eells acquired a taste for the large, made-to-order burritos found at the many taquerias in the city.³

Deciding he could shake up the traditional Mexican made-to-order burrito by adding gourmet ingredients, the dream of Chipotle Mexican Grill was born.

With an \$80,000 loan and an \$85,000 investment from his father, Eells opened the first Chipotle restaurant in Denver, Colorado in 1993. Quickly ditching the traditional back-of-the-house kitchen, Eells brought customers and staff together with an open kitchen design that increased efficiency and gave customers more control over their food orders. While the menu and food ordering process was simple, Eells put his culinary education to work to imbue his burrito meats and other ingredients with gourmet flavor and panache.⁴ Chipotle's original menu and ordering system was designed to offer only a few meal options (burritos and crispy or soft tacos), a manageable number of ingredient options (16), but thousands of flavor combinations. While its menu has remained primarily unchanged from the original, sensible additions like tortilla-free burrito bowls and salads for diet-conscious consumers keep Chipotle current with consumer trends.⁵

The original Chipotle was an instant success and Eells was able to repay his father nearly a month after opening. With a subsequent \$1.5 million investment from his father and a \$1.5 million private stock offering, Eells opened two more locations in 1995 and another five in 1996.⁶ Chipotle had found its as yet unnamed niche market between fast food and casual dining—fast-casual.

Eells quickly discovered that raising capital for expansion took him away from what he enjoyed most—the day-to-day business. Solving this problem, Eells established a board of investors. Interested in continued expansion but with limited capital, Chipotle's board sent an unsolicited business plan to the McDonald's Corporation. Following a year of negotiations, in 1998, McDonald's ventured into uncharted territory, purchasing its first minority stake in a restaurant chain. As a result of this new partnership, Eells had significant

Exhibit 1 Income Statement

Period Ending	Dec 31, 2010	Dec 31, 2009	Dec 31, 2008
Total Revenue	1,835,922	1,518,417	1,331,968
Cost of Revenue	1,143,613	965,317	1,045,041
Gross Profit	692,309	553,100	286,927
Operating Expenses			
Research Development	—	—	—
Selling General and Administrative	321,494	273,730	89,155
Non Recurring	7,767	8,401	20,963
Others	68,921	61,308	52,770
Total Operating Expenses	—	—	—
Operating Income or Loss	287,831	203,705	124,039
Income from Continuing Operations			
Total Other Income/Expenses Net	(4,797)	(5,031)	3,469
Earnings Before Interest And Taxes	289,330	204,630	127,508
Interest Expense	269	405	302
Income Before Tax	289,061	204,225	127,206
Income Tax Expense	110,080	77,380	49,004
Minority Interest	—	—	—
Net Income From Continuing Ops	178,981	126,845	78,202
Non-recurring Events			
Discontinued Operations	—	—	—
Extraordinary Items	—	—	—
Effect Of Accounting Changes	—	—	—
Other Items	—	—	—
Net Income	178,981	125,845	78,202

Source: Chipotle Mexican Grill, Inc. (CMG) Financials at Yahoo! Finance.

Exhibit 2 Balance Sheet

Period Ending	Dec 31, 2010	Dec 31, 2009	Dec 31, 2008
Assets			
Current Assets			
Cash And Cash Equivalents	224,838	219,566	88,044
Short Term Investments	124,766	50,000	99,990
Net Receivables	33,503	7,897	6,485
Inventory	7,098	5,614	4,789
Other Current Assets	16,016	14,377	11,764
Total Current Assets	406,221	297,454	211,072
Long Term Investments	—	—	—
Property Plant and Equipment	679,881	636,411	585,899
Goodwill	21,939	21,939	21,939
Intangible Assets	—	—	—
Accumulated Amortization	—	—	—
Other Assets	16,564	5,701	6,075
Deferred Long Term Asset Charges	—	—	—
Total Assets	1,121,605	961,505	824,985

Globe: © Jan Rysavy/iStockphoto.com

(Continued)

Exhibit 2 Balance Sheet (Continued)

Period Ending	Dec 31, 2010	Dec 31, 2009	Dec 31, 2008
Liabilities			
Current Liabilities			
Accounts Payable	122,933	102,057	76,706
Short/Current Long Term Debt	—	—	—
Other Current Liabilities	121	96	82
Total Current Liabilities	123,054	102,153	76,788
Long Term Debt	—	—	—
Other Liabilities	13,486	10,633	8,735
Deferred Long Term Liability Charges	174,192	145,258	116,872
Minority Interest	—	—	—
Negative Goodwill	—	—	—
Total Liabilities	310,732	258,044	202,395
Stockholders' Equity			
Misc Stocks Options Warrants	—	—	—
Redeemable Preferred Stock	—	—	—
Preferred Stock	—	—	—
Common Stock	340	335	329
Retained Earnings	456,514	277,533	150,688
Treasury Stock	(240,618)	(114,316)	(30,227)
Capital Surplus	594,331	539,880	501,993
Other Stockholder Equity	606	29	(193)
Total Stockholder Equity	810,873	703,461	622,590
Net Tangible Assets	788,934	681,522	600,651

Source: Chipotle Mexican Grill, Inc. (CMG) Financials at Yahoo! Finance.

Exhibit 3 Statement of Cash Flow

Period Ending	Dec 31, 2010	Dec 31, 2009	Dec 31, 2008
Net Income	178,981	126,845	76,202
Operating Activities, Cash Flows Provided By or Used In			
Depreciation	68,921	61,308	52,770
Adjustments To Net Income	69,792	59,169	34,181
Changes In Accounts Receivables	743	875	1,290
Changes In Liabilities	13,361	38,160	28,711
Changes In Inventories	1,481	825	(457)
Changes In Other Operating Activities	10,588	2,239	3,810
Total Cash Flow From Operating Activities	289,191	260,673	198,507
Investing Activities, Cash Flows Provided By or Used In			
Capital Expenditures	(113,215)	(117,198)	(152,101)
Investments	(76,666)	49,990	(79,990)
Other Cash flows from Investing Activities	—	—	—
Total Cash Flows From Investing Activities	(189,881)	(67,208)	(232,091)

(Continued)

Exhibit 3 Statement of Cash Flow (Continued)

Period Ending	Dec 31, 2010	Dec 31, 2009	Dec 31, 2008
Financing Activities, Cash Flows Provided By or Used In			
Dividends Paid	—	—	—
Sale Purchase of Stock	(108,952)	(72,296)	(29,756)
Net Borrowings	—	—	(76)
Other Cash Flows from Financing Activities	(96)	(82)	284
Total Cash Flows From Financing Activities	(94,522)	(61,943)	(29,548)
Effect Of Exchange Rate Changes	484	—	—
Change In Cash and Cash Equivalents	5,272	131,522	(63,132)

Source: Chipotle Mexican Grill, Inc. (CMG) Financials at Yahoo! Finance.

capital at his disposal. By 1999, Chipotle had expanded to 37 restaurants nationally and increased its revenues from \$13 million in 1997 to \$31 million in 1999.⁷ Chipotle's success eventually led McDonald's to increase its stake in the company to a majority shareholder.

It was after reading *The Art of Eating* by Edward Behr in 1999 that Ells' *Food with Integrity* mission came into being.⁸ Chipotle's newfound commitment to organic and sustainable ingredients began with pork in 2000 and, while the increased cost of ingredients was passed along to its customers, Chipotle's revenues continued to rise.⁹ Clearly, Chipotle's customers were willing to pay a little more for quality ingredients and seemed interested in helping Chipotle realize its vision of reducing the environmental impact of its restaurants. Encouraged, Ells didn't stop with pork: naturally raised chicken was introduced in 2002, followed by beef in 2007. Ells' *Food with Integrity* philosophy soon reached beyond its ingredients: "It is the philosophy that guides every decision we make at Chipotle." As an example, Chipotle began to focus on reducing its impact on the environment by constructing sustainable restaurants—receiving the first platinum certification in the Leadership in Energy and Environmental Design (LEED) rating system ever awarded to a restaurant at a recent store opening.¹⁰

Over time, Ells' commitment to his *Food with Integrity* philosophy led him to reevaluate Chipotle's relationship with McDonald's and, soon after the company went public in 2006, it split from McDonald's. Over the seven-year relationship, McDonald's invested \$360 million in Chipotle and, in the end, had earned \$1.5 billion.¹¹ Chipotle's public offering and split from McDonald's did not slow Chipotle's success as evidenced by a compound annual growth rate of revenue (CAGR) of 19.6 percent for 2005 through 2010.

Chipotle's international expansion began in Toronto in 2008. A London location soon followed in 2010, and Chipotle has now set its sights on Paris and Munich.¹² While international expansion may bring new challenges to Ells' *Food with Integrity* mission, Ells is optimistic explaining,

*In many ways, the food culture in Europe matches our priorities much more closely than in the US, and I think we'll be able to source beautiful ingredients from local and sustainable sources ... and establish sustainable supply chains elsewhere as we look at other European markets.*¹³

Food Fight

Chipotle continuously faces fierce competition. Chipotle's niche, which relies heavily on its unique focus on taste and organics, has helped thwart the advances of some competitors. However, having already blazed the path, sourcing and offering quality ingredients is now a relatively simple model for any competitor to copy. An increasing number of fast food and fast-casual restaurants are now using fresh and quality ingredients and marketing themselves as such. In addition, there is the simple pressure of rival chains that have the means and are moving quickly to expand both domestically and internationally.

What is Fast-Casual?

Broadly, Chipotle competes in the restaurant industry with its primary competitors in the fast-casual restaurant segment.¹⁴ As a new segment, fast-casual remains loosely defined in the industry but is generally agreed to have higher average tickets, more upscale fare, as well as better décor and atmosphere than quick-serve (fast-food) restaurants. Additionally, many argue that to be considered fast-casual, a restaurant cannot offer table or drive-through service.¹⁵

The Evolution of Fast Food—and Devolution of Full-Service

As a member of the fastest growing restaurant segment, Chipotle has no shortage of competitors. Even fast food chains—accustomed to modifying their formats with upgraded décor and new menu offerings—are beginning to compete with fast-casual restaurants.¹⁶ As fast food chains make these modifications, they have the potential to undercut Chipotle's price and create value that attracts Chipotle customers. With both full-service restaurant chains and quick-service chains entering the market,

competition is on the rise. Demonstrating this flexibility, several of Chipotle's competitors—including Qdoba and Pei Wei—are owned by companies that previously only operated restaurants in other segments.

The Evolution of Fast-Casual

New concepts also threaten to dilute the marketplace. Fast-casual is currently dominated by bakery-style restaurants like Panera Bread and ethnic formats like Chipotle. In 2010, Mexican food became the largest food category within the fast-casual segment, surpassing bakery for the first time. Even so, "Better Burgers" captured the fastest growing menu category for 2010 with 16.1 percent growth.¹⁷ While offering a different type of food, new concepts have the potential to unseat Chipotle's reign as the hip place to eat. In the attempt to glom onto some of Chipotle's success, Chipotle imitators have emerged in the market. "Many fast-casual startups describe themselves as the 'Chipotle of [fill in blank].'"¹⁸ Examples include Piada Italian Street Food, the "Chipotle of Italian" in Columbus, OH; Cava Mezza Grill, the "Chipotle of Greek" in Washington DC; and Hello Pasta, the "Chipotle of Pasta" in New York.¹⁹ Even Chipotle itself is testing the ability to imitate its own success with its new Asian food concept—ShopHouse.

An additional threat to Chipotle comes from current competitors within the fast-casual segment revamping their existing formats to more closely replicate Chipotle's offerings. For example, Baja Fresh—a fast-casual restaurant with Mexican food menu offerings—is similar to Chipotle in several ways including fresh ingredients, custom prepared food, and open kitchens. However, Baja Fresh prepares its food made-to-order on grills creating a delay of several minutes between the time a customer orders their food at the counter and the time they actually receive their food. To better compete with Chipotle, Baja Fresh is redesigning select restaurants to its new Baja Fresh Express concept with fewer menu offerings and an assembly line style ordering process similar to Chipotle. It has also invested in new

technology such as tortilla grills that reduce warming time from 2 minutes to only 25 seconds.²⁰

Within the fast-casual segment, Chipotle faces numerous local and regional competitors including many privately owned and publicly held companies. In 2010, three of Chipotle's most successful publicly held competitors were Panera Bread, Qdoba, and Pei Wei (see Exhibit 4 for a comparison of select financial data).

Panera Bread. Formed in 1998, Panera Bread is Chipotle's largest competitor with annual sales in 2010 of \$1.54 billion. Panera operates 1,453 bakery-style restaurants in 40 states, the District of Columbia, and Canada. It is comprised of both company owned restaurants (662) and franchise locations (791). Panera Bread touts a philosophy it calls "Concept Essence." Concept Essence is embodied by the quality artisan bread anchoring its menu, the warm, comfortable environment of its restaurants, and the relationships it builds with customers through passion and expertise.²¹

Panera Bread strives to deliver quality food that customers perceive as a value. Its menu includes "baked goods, made to order sandwiches on freshly baked breads, hearty, unique soups and sides, fresh, hand tossed salads, and custom roasted coffees." To provide a consistent namesake product, Panera relies on a dough production system to supply each restaurant with fresh dough daily. Additionally, it transports fresh tuna, cream cheese, and other products from distribution centers up to 500 miles to its restaurants. Panera also continuously looks to update its menu by adding new, high quality items. Examples of this in 2010 included its Cuban Chicken Panini and All Natural Steak Chili with Cornbread Crumbles.²² Panera also added steaks to its menu and Panini grills to its restaurants in 2010.

With a combination of company owned and franchised restaurants, Panera is able to rely primarily on cash generated from operations to fund new company owned locations while maximizing expansion through new franchises. Despite ready access to credit, Panera incurred no debt when funding expansion in 2010.²³

Exhibit 4 Key Competitor Data

Company	Annual Sales (in thousands)	2010 Same Store Sales Growth	Number of Restaurants	Marketing Expenses (in thousands)	States / Countries Outside US	Company Owned	Franchise
Chipotle	\$1,835,922	9.4%	1,092	25,703	39 / 2	100%	—
Panera Bread ¹	\$1,542,489	7.5%	1,453	27,400	41 / 1	46%	54%
Qdoba ²	\$ 168,424	2.8%	510	5,053 ³	44 / 0	34%	66%
Pei Wei ⁴	\$ 310,131	n/a	168	n/a	22 / 0	100%	—

¹From Panera Bread 2010 Annual Report to Stockholders.

²From JBX 2010 10-K. Other financial data from: Top 50 Special Report, QSR Magazine.

³Marketing expense estimated at 3 percent of revenue as JBX does not report advertising expenses by business segment.

⁴From P.F. Chang's Inc. 2010 10-K.

With a portion of franchisee payments dedicated to this expense, Panera Bread markets itself in a variety of ways. The focus of all Panera Bread marketing is to build brand image and strengthen relationships with its customers to drive repeat sales. As an example, in 2010, Panera launched its customer loyalty program—MyPanera—that rewards repeat customers with bonuses and gifts such as a free bakery item.²⁴

To maximize sales opportunities, Panera Bread serves breakfast, lunch, and dinner. A catering business currently in development is a key component in its growth plan. Driven by investments in its sales force and training programs, catering sales increased by 26 percent in 2010. According to President and CEO William Moreton, “We believe that continued development of our off premise solutions provides us with an opportunity for significant growth in the future.”²⁵

Qdoba Mexican Grill. With approximately half the restaurant locations of Chipotle, Qdoba Mexican Grill operates 188 company owned restaurants and 337 franchised locations throughout the US and generated \$168.4 million in revenue in 2010.²⁶ Founded in 1995, Qdoba operates as a wholly owned subsidiary of Jack in the Box Company (JBX). Similar to Chipotle, Qdoba serves traditional Mexican food prepared to the customers’ liking. Fresh guacamole, slow simmered beans, slow roasted shredded beef and pork, and flame grilled chicken and steak are all key components of a Qdoba burrito. JBX has successfully expanded Qdoba Mexican Grill into 43 states and the District of Columbia by offering hand-crafted, top-quality food prepared on open grills in front of waiting customers.²⁷ Qdoba also offers healthy and less filling options including its Mexican Lettuce Wraps that were added to the menu in 2010.²⁸ Bringing its food to locations other than its restaurants, Qdoba provides catering for groups up to 500, offering several options including fully staffed hot taco, nacho, and burrito bars.

Qdoba franchises are largely responsible for its growth. In 2010, 21 of the 36 restaurant openings were franchise owned. Franchising offers several advantages for JBX. Franchisees pay an up-front fee of \$30,000 and royalty fees that are typically five percent of gross revenues. JBX is able to use this income to offset the startup costs associated with opening a company owned restaurant. Franchisees also pay up to two percent of gross revenue to JBX in marketing fees and are required to spend a minimum of two percent on local advertising. Franchisees are eligible for rebates on portions of these fees if applied to the opening of a new restaurant, thus encouraging additional growth.²⁹ Because franchise locations do not require the same level of support as company owned restaurants, JBX enjoys lower corporate overhead than it would were all Qdoba locations company owned.

While franchise locations of all industries are sometimes perceived to lack the quality of a tightly monitored company owned store, JBX has highly developed systems to ensure consistent operations across all restaurants. For example, its “farm to fork” quality assurance program “combines employee training, testing by suppliers, documented restaurant practices, and detailed attention to product quality at every stage of the food preparation cycle.” Additionally, while only 45 percent of Qdoba restaurants utilize the JBX purchasing and supply chain systems, all restaurants are required to exclusively use JBX quality control approved suppliers.³⁰ JBX expects to open 50 to 60 new Qdoba Mexican Grill restaurants in 2011.

Pei Wei. Pei Wei, owned by P.F. Chang’s China Bistro, Inc., opened its first restaurant in 2000, and is another strong competitor in the fast-casual segment. In 2010, the 168 Pei Wei locations in 22 states produced \$310 million in revenue.³¹

P.F. Chang’s also operates full-service restaurants of the same name. Its strategy for Pei Wei is “to serve freshly prepared, wok seared, contemporary, pan-Asian cuisine in a relaxed, warm environment, with friendly, attentive counter service and take-out flexibility.” P.F. Chang’s believes that, by providing both a full-service offering as well as a fast-casual option, it gains brand loyalty.³²

In addition to its standard fare, Pei Wei includes Limited Time Offers (LTOs) on its menu three to four times per year. Pei Wei typically keeps these dishes on the menu for a 12-week cycle. Pei Wei’s LTOs keep its menu fresh by providing new dishes to customers. Examples of LTOs offered in 2010 were the Thai Mango Chicken and Japanese Chile Beef Ramen. Pei Wei also offers a limited alcohol selection that accounts for one to two percent of sales revenue each year. With take-out orders responsible for approximately 40 percent of total sales, Pei Wei offers online ordering to facilitate customers that don’t want to wait.³³

P.F. Chang’s utilizes a cooperative network of suppliers called Distribution Market Advantage to supply all its restaurant locations. For its Asian-specific ingredients, P.F. Chang’s relies on a single supplier and uses its size to negotiate reduced rates. Aside from the economies of scale it enjoys with this supplier, quality is more easily controlled with a single source.³⁴

P.F. Chang’s relies heavily on positive customer experiences to drive positive word-of-mouth for its Pei Wei locations. While it has utilized traditional media advertisement in the past, it is generally on a very limited basis. Despite launching a loyalty program for its P.F. Chang’s customers, Pei Wei customers have not yet been offered their own nor are they included in P.F. Chang’s program.

To deliver the desired experience to customers, prospective Pei Wei managers must complete a nine-week manager training program that concludes with a

certification process validating the manager candidates have achieved proficiency in both culinary and overall operational skills. Hourly employees receive a full week of training and, similar to managers, are required to pass a certification process specific to their respective positions before being allowed to serve customers.³⁵

P.F. Chang's has announced plans to open between six and eight new Pei Wei restaurants in 2011.³⁶

Chipotle's Plate...and What's on It

Chipotle targets customers seeking high-quality food ingredients from a source that is faster and/or less expensive than a full-service restaurant. Chipotle also focuses on the "customer experience" to build a strong following and develop better branding. Initiatives to develop employees and maintain a strong workforce have also contributed to Chipotle's success.

What's for Dinner?

Chipotle's *Food with Integrity* philosophy sets it apart from its competitors by creating a unique taste that is difficult to imitate. Its great tasting food develops customer loyalty, which helps to increase patronage by positive word-of-mouth. In connection with this philosophy is the dependence Chipotle has on organic farmers to supply its restaurants with the necessary ingredients. Chipotle's use of a network of farmers keeps a heavy concentration from developing on any one supplier, which helps to minimize—but not eliminate—the risk of supply outages.

Chipotle restaurants receive ingredients from 22 independently owned and operated regional distribution centers. However, Chipotle first approves all farmers the distributors use on its behalf. Distributors have little bargaining power as Chipotle selects farmers based on "quality specifications, and [distributors] purchase within pricing guidelines and protocols [Chipotle has] established with the suppliers."³⁷ Chipotle prefers to work with farms that are family owned and operated. They partner with suppliers like Niman Ranch (a network of independent ranchers),³⁸ Meister Cheese Company (local Wisconsin farmers and founders of the Animal Friendly Family Farms program),³⁹ and The Chef's Garden (a grower of artisanal produce straight "from Earth to Table").⁴⁰ Chipotle is the largest restaurant buyer of locally grown produce and the only national restaurant chain to expand its commitment to the use of local products year after year.⁴¹

Chipotle is highly dependent on the success of its suppliers because, without them, it cannot meet its *Food with Integrity* goals. When Chipotle started working with the Niman Ranch network to increase supply over a decade ago, the network had only 50 farms; as of 2010, Niman Ranch now represents over 500 farms and, not surprisingly, Chipotle is its largest customer.⁴² Even so, Chipotle continues to encounter challenges in sourcing

ingredients that meet its high standards in the quantities it requires. As a result of supplier shortages, it has not yet fully met its goals for 100 percent naturally raised meat, pasture raised dairy, antibiotic free chicken, or organic beans as,⁴³ even when Chipotle has a sustainable supplier, the supplier may experience shortages thus leaving some restaurants without key ingredients.

Because it takes longer to identify and develop supplier relationships, it costs more to establish them. This results in "higher costs and other risks associated with purchasing naturally raised or sustainably grown ingredients." Additionally, because Chipotle depends on a smaller number of suppliers, it is more difficult to replace or substitute a supplier, resulting in serious interruptions to the supply chain.⁴⁴

The cost of sourcing its high quality ingredients results in a higher cost for Chipotle customers. The restaurant attempts to reduce other operating costs by using a centralized purchasing department that works with local suppliers and regional distributors to help reduce transportation costs.⁴⁵ Fortunately, having previously partnered with McDonald's, Chipotle has been able to leverage many of the supply chain management capabilities of its former owner.

Despite the challenges and costs incurred by using only suppliers who pass the test of producing naturally raised meats and organic foods, Chipotle's *Food with Integrity* has been successful and it is evident that customers are willing to pay a premium for better tasting food.

On what is unfortunately the negative side of being a highly visible proponent of environmental and ethical causes, Chipotle faces sharp criticism any time its actions appear out-of-step with social causes. For example, the company did not initially agree when People for the Ethical Treatment of Animals (PETA) called for the use of poultry suppliers using controlled atmosphere killing (CAK)—a purportedly less cruel method of slaughter whereby a bird's oxygen is slowly replaced with other gases. Arguing there were an insufficient number of suppliers using CAK to meet its needs, after heavy petitioning and a shareholder resolution, Chipotle relented and agreed to give preference to suppliers using CAK.⁴⁶ Additionally, in Florida, despite putting the proposed wage increases in escrow while attempting to determine if farm workers would in fact receive the money, Chipotle came under fire from the Coalition of Immokalee Workers for its failure to act to improve wages and conditions of Florida farm workers.⁴⁷ After months of protests and negative publicity, Chipotle completed its negotiations and paid the higher wages. As a leader in ethical business practices and self designated member of the global community, Chipotle will continue to be a target for activists should it not respond as promptly as the activists deem it should or, even worse, should it disagree with a popular—irrespective of its validity—initiative.

Who's Hungry?

The fast-casual segment draws customers in search of better quality food than fast food and “something hipper, faster, and cheaper than full service.”⁴⁸ Chipotle satisfies those customer needs by providing fresh, quick, customizable food that is prepared in front of customers while they wait.⁴⁹ The chain has a wide appeal, mainly serving adults between the ages of 18 and 49.⁵⁰ Chipotle has among the highest customer ratings in the fast-casual and fast food segments (see Exhibit 5A for 2010 Zagat ratings). The J.D. Power and Associates 2010 US Restaurant Satisfaction Study asked consumers in ten markets to rate their top choices based on price, environment, meal, and service. Chipotle placed among the top three in nine of the ten markets—more than any other fast-casual restaurant (see Exhibit 5B).⁵¹ A study in the *International Journal of Hospitality Management* showed that customer satisfaction is a good predictor of customer purchase intentions; “High levels of customer satisfaction decreases the perceived benefits of service provider switches, thereby increasing customer repurchase intentions.”⁵²

Even when the company had shared ownership with McDonald's, Chipotle always ran its business autonomously without significant involvement from its parent. As a result, many of the initial concepts that made the restaurant successful continue today. One of its founding concepts was to sell to the customer that Chipotle was a hip place to eat. In alignment with Ells' approach to food, Chipotle's restaurant design mentality was to use simple materials without significant fabrication to create something extraordinary. Chipotle designs individual restaurants to fit into their distinctive

environments. While each restaurant typically has a sleek, modern feel with plenty of exposed wood and steel, Chipotle believes this foundation creates an “appealing, eclectic atmosphere.”⁵³

Chipotle prides itself on being unique in the industry due to its *Food with Integrity* philosophy and offerings. Indeed, as a competitor analysis shows, dishes made fresh-to-order with fresh ingredients—like those from Chipotle—appeal to the fast-casual segment.⁵⁴ Chipotle believes that sustainably raised products make its food taste better, which, in turn, gives it a competitive advantage. Nevertheless, there is some uncertainty surrounding to what extent sustainable ingredients are at the forefront of its customers' minds. In an in-house ethnography study, the Chief Marketing Officer found that customers don't necessarily return to Chipotle because of

*...the fact that we spend a lot of time and effort on making all of our food as sustainably and naturally raised as possible. We all assumed that that was a big driving factor. Even people who were coming to Chipotle for a long time, they appreciate it, but it's not the reason they are coming in. They just love the way the food tastes. That was a little bit of a surprise to us.*⁵⁵

However, others believe that naturally raised ingredients set Chipotle apart and lend to its customer growth.⁵⁶ Either way, customers will continue to patronize Chipotle for the great taste and, whether intentionally or not, in doing so, lend their support to the sustainability cause. In the meantime, Chipotle remains hopeful that sales will be driven even further as customers become increasingly aware of where its food is sourced.

Exhibit 5A The 2010 Zagat Fast-Food Survey

	Top Food Large Chain (up to 5,000 locations)	Best Value	Best Grilled Chicken
1	In-N-Out Burger	McDonald's	Chick-fil-A
2	Papa Murphy's	Panera Bread	KFC
3	Chick-fil-A	Chipotle	El Pollo Loco
4	Five Guys	Taco Bell	Panera Bread
5	Chipotle	Chick-fil-A	Chipotle

Definitions	
Fast-Food Chain	National restaurant chain offering burgers, chicken, or other main-course items but no table service
Large Chain	Fast-food chain with up to 5,000 locations
Food	Quality of menu items
Best	Cited most often as being the best for a particular menu item
Top	Highest Zagat rating for food, facilities, or service among all chains in a particular category

Survey does not have a separate category between fast food and full-service, fast-casual included within fast food category.

National survey of 6,500 diners.

Source: <http://www.zagat.com>

Exhibit 5B J.D. Power and Associates 2010 US Restaurant Satisfaction Study: Top Three Quick-Service Restaurant Brands in Overall Customer Satisfaction by Market

Atlanta	1	Chick-fil-A
	2	Chipotle Mexican Grill
	3	Jason's Deli
Boston	1	Chipotle Mexican Grill
	2	Panera Bread
	3	Uno Chicago Grill
Chicago	1	Culver's
	2	Chipotle Mexican Grill (tie)
	2	Jersey Mike's Subs (tie)
Houston	1	Chick-fil-A
	2	Papa John's
	3	Jason's Deli
Los Angeles / Riverside / Ventura County, CA	1	In-N-Out Burger
	2	Chick-fil-A
	3	Chipotle Mexican Grill
Minneapolis-St. Paul	1	Papa Murphy's Take N Bake Pizza
	2	Panera Bread
	3	Chipotle Mexican Grill
New York / Northern New Jersey	1	Panera Bread
	2	Sonic America's Drive-In
	3	Chipotle Mexican Grill
Phoenix	1	In-N-Out Burger
	2	Chick-fil-A
	3	Chipotle Mexican Grill
San Francisco Bay Area, CA	1	In-N-Out Burger
	2	Chipotle Mexican Grill
	3	Baja Fresh
Washington DC	1	Chick-fil-A
	2	Chipotle Mexican Grill
	3	Panera Bread

Source: J.D. Power and Associates 2010 U.S. Restaurant Satisfaction StudySM. Charts and graphs extracted from this press release must be accompanied by a statement identifying J.D. Power and Associates as the publisher and the J.D. Power and Associates 2010 U.S. Restaurant Satisfaction StudySM as the source. Rankings are based on numerical scores, and not necessarily on statistical significance. No advertising or other promotional use can be made of the information in this release or J.D. Power and Associates study results without the express prior written consent of J.D. Power and Associates.

While Chipotle should be applauded for its efforts to source healthful foods, an important but often-considered fact remains—just because the ingredients of a meal are environmentally sound does not make the meal healthy. Even as Chipotle offers quality and sustainable ingredients, its menu options can be packed full of calories. As an example, the general rule of thumb dictates that a healthy adult should consume 1,800 to 2,000

calories—including 60 grams of fat and 2,400 milligrams of

sodium—a day. However, an average Chipotle burrito can contain 900 to 1,000 calories, 50 grams of fat, and 2,300 mg of sodium.⁵⁷ While Chipotle offers healthier options in the form of its burrito bowls and salads and allows customers to easily customize a meal depending on their health needs, it might need to consider increased disclosure of nutritional information regarding its ingredients.

Despite all the societal good and tasty reasons to eat at Chipotle, food costs for the restaurant industry have increased across the board making it increasingly difficult to further delay price hikes that could alienate customers living on dwindling budgets. In February 2011, domestic wholesale food prices were reported to have risen 3.9 percent since January 2010, with global increases of 37 percent for the same period.⁵⁸ In its 2010 Annual Report, Chipotle acknowledged that increases in critical menu items could “adversely affect [its] operating results” or force it to suspend an item from the menu temporarily, which could “negatively impact restaurant traffic and comparable restaurant sales.”⁵⁹ While Chipotle implemented price increases in the Pacific region, it had no immediate plans to pass increases to other Chipotle customers before assessing customer resistance and the size and timing of inflation in Q3 2011.⁶⁰ Analysts, however, warn that delaying price increases will result in a continued impact on margins and, more likely than not, make a more aggressive price increase necessary. Chipotle’s last significant increase in Q4 2008 “was followed by several quarters of same store traffic declines.”⁶¹ Key competitors like Panera Bread and Pei Wei have already bitten the bullet and increased menu prices in Q4 2010 to mitigate higher commodity costs.^{62,63}

Who's Serving?

Chipotle views its approach to employees as central to its success. Monty Moran, the company's co-CEO, states,

*The single best way to improve operations is to make sure that restaurant managers are the best they can be and that they have the company's full support. The restaurant manager position is more important than my job and Ells' job. It's key to how a customer experiences our food every day.*⁶⁴

In the early days of the restaurant, Chipotle operated using a standard hierarchy: staff employees reported to a restaurant manager, who reported to a regional manager, who reported to company directors, who reported to the President. However, as Chipotle promoted managers to higher positions and they left their restaurants, Chipotle discovered the flaw inherent to its structure. “We promoted our best managers, those who had the best effect on customers, the best food, the cleanest restaurants, and the best crew,” said Moran.⁶⁵ To combat this issue, Chipotle launched the “Restaurateur Program” in 2006. This program was

designed to encourage good managers to make a career of the position by developing staff and increasing store revenue. The incentives for doing so included large bonuses that allowed good managers to earn as much or more than their supervisors. As Moran put it, "It's truly entrepreneurial, and it puts the manager in a position that is as close to ownership as possible without being an owner."⁶⁶

With incentives for good managers to remain in their positions, staff turnover decreased due to consistency in the workplace and because staff development was a key driver to a manager's bonus. Moran believes that managers who are promoted from within are four times less likely to leave than those hired from outside. "We're rewarded by the fact that once they become managers, they're fiercely loyal and they know this company better than anyone else."⁶⁷

Expanding this view to the next level, Chipotle also wanted its employees to be innovative and carry an entrepreneurial mindset. Marketing Director Jim Adams is known for telling candidates interviewing for corporate positions that "the way to fit in at Chipotle is to be creative and independent."⁶⁸ Chipotle empowers its employees and shows this by entrusting them to prepare its food as a chef would in a restaurant. Employees are paid an amount higher than minimum wage and everyone has access to health care benefits. Ells believes that by allowing his employees certain freedoms and self-empowerment, morale improves, creating a positive work environment that, ultimately, has a positive effect on the customer experience.

Creating a notable impact on the culture and community of particular Chipotle locations, in recent years, the US Immigration and Customs Enforcement (ICE) shifted its focus from undocumented individuals and began instead to target employers that hire undocumented workers.⁶⁹ Restaurants in particular were admonished to reduce their use (and thus the demand for) illegal workers and encouraged to carefully examine hiring practices.⁷⁰ For Chipotle, ICE audits of its restaurants resulted in about 500 firings of illegal workers in Minnesota, Virginia, and Washington DC with investigations continuing in Los Angeles and Atlanta.⁷¹ These raids were not only embarrassing to its reputation, but also carried fines and resulted in higher costs. Because all Chipotle locations are company owned, ultimately, Chipotle is responsible for each restaurant meeting federal hiring regulations. Chipotle acknowledged the firings created a temporary increase to its labor costs as it hired and trained new employees. Chipotle also understands that, without franchisees to share the costs, it shoulders considerable more risk than many of its competitors.⁷²

Who's Selling?

Leveraging its customer loyalty, Chipotle encourages fan interaction and uses social media to connect with seasoned and prospective customers alike. Chipotle has a much larger Facebook following compared to its top rivals—1.3 million "likes" compared to 513,000 for Panera Bread, 102,000 for Pei Wei, and 92,000 for Qdoba Mexican Grill.⁷³ Chipotle fans both on and offline provide valuable word-of-mouth marketing for the company and drive the majority of first time visits to Chipotle. Media consulting firms affirm that when people hear a recommendation from a friend or stranger "they'll probably believe it since the tipster has nothing to gain. Chipotle so far has got it nailed. You have people evangelizing the brand because they love it."⁷⁴

As new restaurants open and the company works to attract new customers, a common marketing tactic is to offer free burritos to neighboring businesses and residents.⁷⁵ Although expensive, Chipotle believes the brand awareness created outweighs the cost involved. According to Adams, "When you take this idea that your best marketing tool is the restaurant and the experience customers have in it, then the object is, of course, to drive people in so they can experience it."⁷⁶

Chipotle also participates in charity fundraisers to help build the brand. In fact, the company has a dedicated group of marketing personnel specifically charged with working with charities, schools, and other organizations to set up events thus driving more customers into its restaurants. While learning about Chipotle's unique approach to high-quality ingredients from sustainable resources is an incentive to some, customer positive word-of-mouth continues to be Chipotle's best form of free advertising. Marketing Director Adams notes that the company spends less than 2 percent of revenues on advertising, while its competitors spend between 3 and 5 percent.⁷⁷

Keeping It in the Family

Chipotle owns and operates all of its restaurants and has determined it will not sell franchises. Because management places such a strong emphasis on the importance of the restaurant manager, it has determined that having a direct say in who is managing individual restaurants is to its advantage.

With Chipotle's plan to expand both domestically and internationally, the company faces both organizational and cultural challenges. Organizationally, Chipotle is a simple structure with a single corporate office in Denver overseeing all of its restaurants. This creates issues with management and effective communication, as well as understanding local and cultural differences as they open new locations.

Domestically, Chipotle will be challenged to continue to find “A” locations given its vast geographic footprint. In 2010, there were 1,092 Chipotle restaurants in the US.⁷⁸ Chipotle operates in 39 states, with California, Ohio, Texas, Colorado, and Illinois being the largest markets (Exhibit 6). The company plans to expand significantly over the next three years, including the opening of 135 to 145 stores in 2011.⁷⁹ With the majority of openings in 2011 scheduled to occur in the second half of the year, the inconsistent pace could result in reduced oversight of construction projects, which could result in higher than expected costs. Additionally, in current markets, new stores could cannibalize sales from existing stores. Finally, approximately 30 percent of the new stores will be opened using its A-Model format.⁸⁰ This model has a smaller footprint and initially produced a slightly lower volume than the traditional Chipotle format.⁸¹

International expansion poses its own unique brand challenges. The primary issue with expanding into new and unfamiliar territory is the risk of the product not being accepted by local consumers. Consumer tastes and discretionary spending habits are different from those in the US: international customers may not understand or even appreciate Chipotle’s *Food with*

Integrity philosophy due to their country’s unique cultural or economic circumstances. At the end of 2010, Chipotle had only three international locations (one in the UK and two in Canada).⁸² Chipotle’s management expertise in the US may lead it to make international business decisions that, while appropriate in the US, may not be acceptable overseas. In addition, the company may not be equipped from an information systems or structural standpoint to support international operations properly.

The Cooks in the Kitchen

“It’s not often that graduates of the Culinary Institute of America set out to make the burrito into a culinary experience.”⁸³ His father was proud that Ells was well on his way to becoming a chef when working at Stars in San Francisco. So, when Ells borrowed money from him just three years out of school at the age of 28 to open the first Chipotle in Denver, most of Ells’ friends, family, and acquaintances were skeptical. Ells remembered, “Everyone told me that [Chipotle] was a bad name to use, because no one knew what it was or could pronounce it. And now everyone knows what it is.”⁸⁴ Ells attended Boulder High School, the University of Colorado at Boulder, and the Culinary Institute of America in Hyde Park, New York, graduating in 1990. Ells continues to be Chipotle’s visionary leader and currently serves as co-CEO and Chairman of the Board.⁸⁵

Alongside Ells as Chipotle’s business leader is co-CEO Montgomery F. (Monty) Moran. As the former CEO of the Denver law firm Messner & Reeves, LLC and general counsel of Chipotle, Moran was appointed to co-CEO in 2009 after serving as President and COO of Chipotle since March 2005. His experience as general counsel and COO of the business positions him for success in his current role. Moran holds a bachelors degree in communications from the University of Colorado and a J.D. from Pepperdine University.⁸⁶

Also key to the future success of the company is Chief Development Officer since February 2010, Robert Blessing. Blessing opened the first Chipotle in the Northeast region after coming to Chipotle in 1999 as a regional director. From 2005 to 2008, Blessing’s role expanded to include the entire Northeast and Central regions. As Chipotle’s Restaurant Support Officer from 2008 to 2010, he provided field support for marketing and oversaw five regional directors and purchasing. Prior to Chipotle, Blessing held executive leadership roles at Vie de France Retail and Restaurant Bakery, Franchise Management Corporation (an Arby’s franchisee), and Thompson Hospitality (a contract food service company).⁸⁷

Exhibit 6 Chipotle Restaurant Locations

As of December 31, 2010, Chipotle operated 1,084 restaurants			
Alabama	3	Nevada	11
Arizona	41	New Hampshire	2
California	165	New Jersey	17
Colorado	71	New York	50
Connecticut	3	North Carolina	12
Delaware	1	Ohio	123
District of Columbia	8	Oklahoma	6
Florida	58	Oregon	12
Georgia	13	Pennsylvania	24
Illinois	78	Rhode Island	3
Indiana	14	South Carolina	2
Iowa	2	Tennessee	5
Kansas	17	Texas	93
Kentucky	8	Utah	4
Maine	1	Virginia	52
Maryland	40	Washington	12
Massachusetts	23	Wisconsin	12
Michigan	12	Wyoming	1
Minnesota	51	United Kingdom	1
Missouri	24	Canada	2
Nebraska	7		

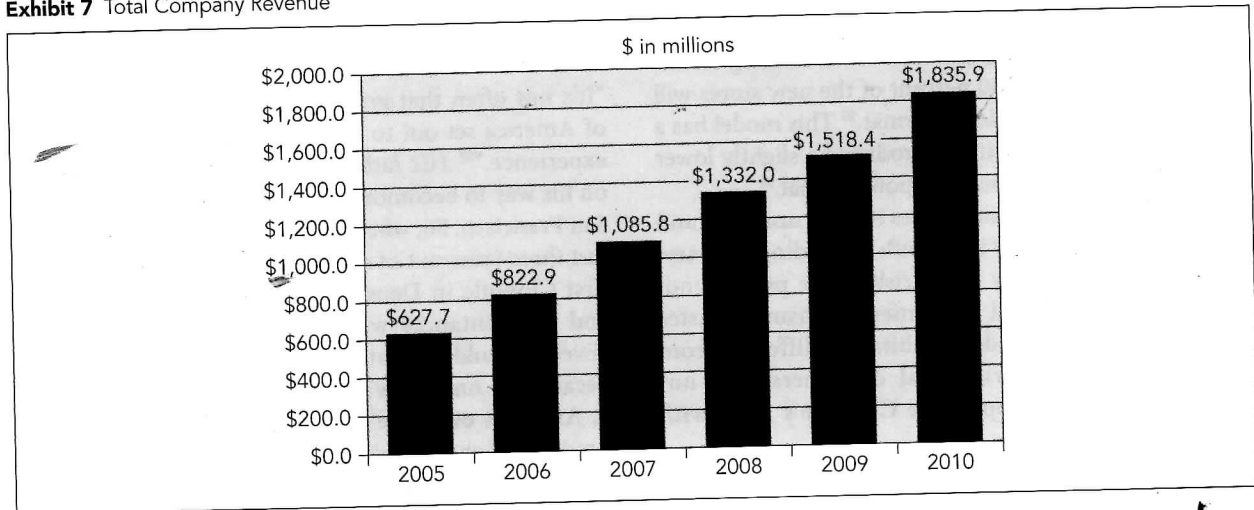
Source: 2010 Chipotle Annual Report & Proxy Statement.

Cilantro, Lime, and Other Shades of Green

Chipotle has achieved unprecedented financial results over the past six years (see Exhibit 7 for total company revenue growth) due in large part to both rapid new store expansion and same store sales (SSS) growth. CAGR over this period was 19.6 percent with Chipotle building new stores at an average rate of 126 per year. Chipotle

was able to drive SSS at existing units by, among other things, building brand awareness, promoting *Food with Integrity*, maintaining a simplistic approach to its menu, and embracing social media. At the unit level, economics remain highly attractive. Chipotle earns restaurant level revenue of \$1.84 million and cash flow of \$0.49 million (26.7 percent of revenues). Approximate investment cost per unit is \$0.80 million, which results in an ROI of 61.8 percent (see Exhibit 8).⁸⁸

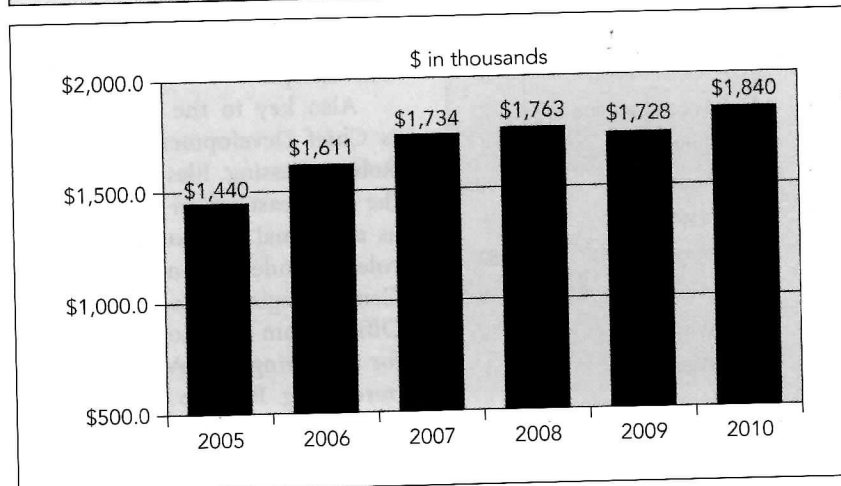
Exhibit 7 Total Company Revenue



Source: Chipotle Mexican Grill, Raymond James 32nd Annual Institutional Investors Conference, March 8, 2011 (PDF presentation).

Exhibit 8 Average Unit Volume / Unit Economic Model

	\$ in thousands
Average trailing 12-month sales	\$1,840
Restaurant level cash flow	\$ 491
Restaurant level operating margin %	26.7%
Approximate investment cost	\$ 795
ROI %	61.8%



Source: Chipotle Mexican Grill, Raymond James 32nd Annual Institutional Investors Conference, March 8, 2011 (PDF presentation).

As a whole, Chipotle generated \$179 million of net income on revenues of \$1,836 million for fiscal year 2010. Its three international stores contributed only nominally to the overall performance of the company. Revenues increased 20.9 percent as a result of 129 new store openings during the year and a 9.4 percent increase in SSS.⁸⁹ The increase in SSS was mainly the result of an uptick in traffic, as opposed to increases in average ticket sales. Chipotle's SSS have significantly outpaced the industry over the last six years (see Exhibit 9 for historical SSS and traffic trends by industry segment). The company's stock was rewarded for 2010 results with notably better performance relative to broader markets. Chipotle stock gained 141 percent (vs. 13 percent for the S&P).⁹⁰

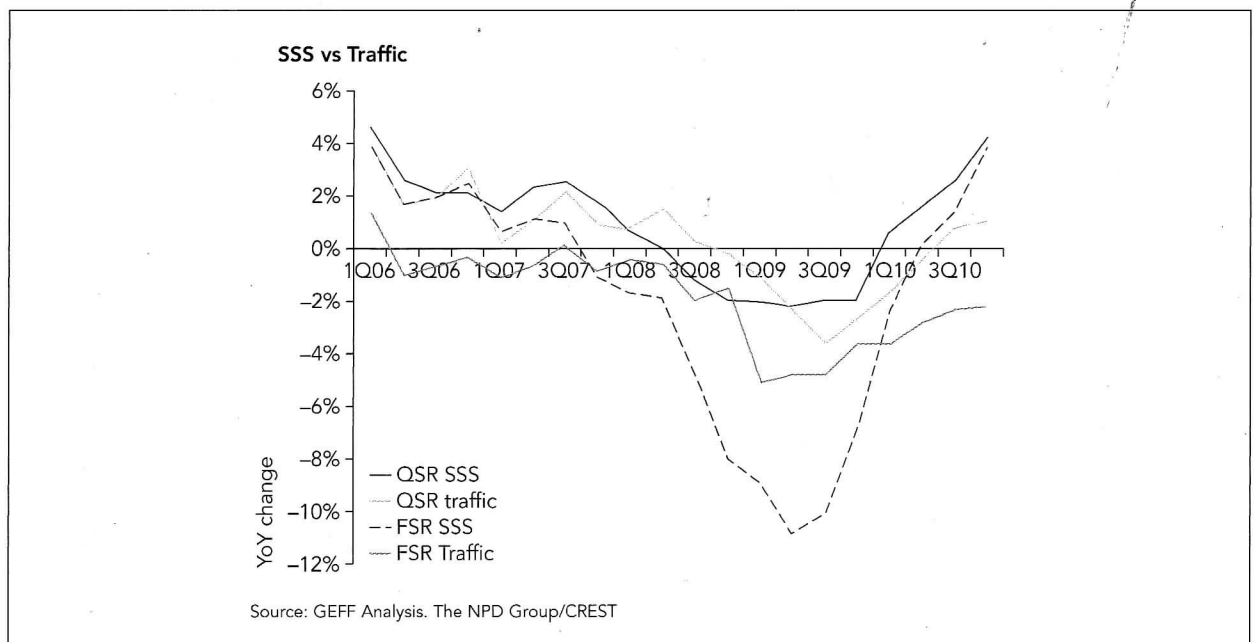
First quarter 2011 results built off a strong 2010. Total company revenue was up 24.3 percent, SSS increased 12.4 percent, and net income gained 22.7 percent. Similar to fiscal year 2010, the SSS increase was driven primarily from traffic since pricing increased only 0.7 percent. Twelve new restaurants opened during this period.⁹¹ As for the balance of its profit and loss statement, Chipotle maintained its focus on prime costs, otherwise known as cost of goods sold and labor. Prime costs are traditionally the two biggest operating expenses

incurred by restaurant chains and, for fast-casual restaurants, typically consume 60 percent of revenues or more (see Exhibit 10). Chipotle's prime costs in first quarter 2011 were 100 basis points higher than fourth quarter 2010, of which 60 basis points were attributable to higher tomato and produce costs. Chipotle continuously monitors food and beverage costs—not surprising considering recent commodity pressures resulting from higher fuel prices, droughts, etc. (see Exhibit 11). Commodity costs are even more relevant for the company given its *Food with Integrity* mission that inherently limits the number of available suppliers. Other costs experiencing pressure in the first quarter 2011 were labor (due to the previously mentioned immigration raids) and operating costs as a result of increased promotional and marketing expenses.⁹²

Yet, relative to its competition, Chipotle continues to outperform. Panera Bread is considered by many as a leader in the fast-casual segment of the restaurant industry. As compared to Panera, Chipotle has 2.5 times the market capitalization, close to 1.5 times the EBITDA, and almost 2.0 times EV/EBITDA (see Exhibit 12). Both companies have very strong balance sheets with no bank debt. Chipotle recently notified Bank of America it was cancelling its revolving line of credit because of

Exhibit 9 Same-Store Sales and Traffic

Historically, SSS at QSRs are more consistent than FSR SSS, particularly for sandwich and chicken chains. During the downturn, QSRs (including snack and fast casual) experienced six quarters (3Q08-4Q09) of SSS decline, while FSRs (including fine dining) declined for 10 consecutive quarters (4Q07-1Q10). Both QSRs and FSRs are on similar recovery trajectories, rising 4.1% and 3.8%, respectively, in 4Q10.



Note: Fast-casual restaurant chains such as Chipotle are captured within the segment QSR, or quick-serve restaurants.

Source: GE Capital, Franchise Finance 2011 Chain Restaurant Industry Review.

Exhibit 10 Components of the Restaurant Dollar

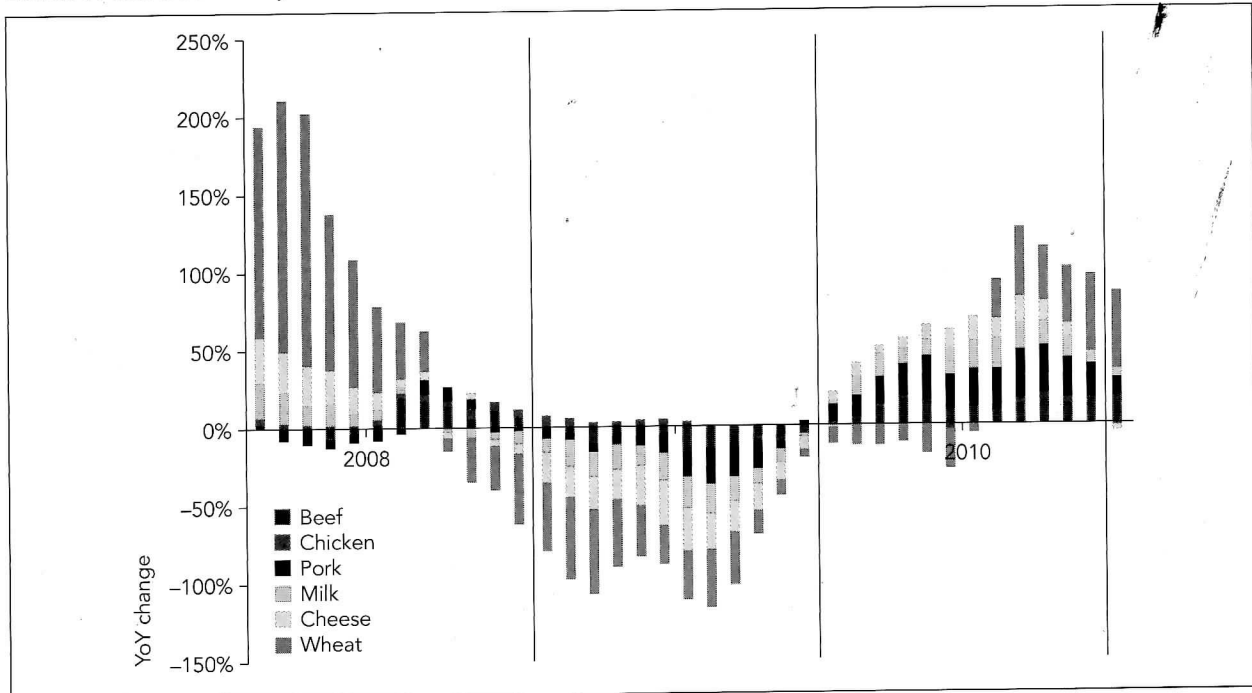
	QSR			FSR ¹		
	2008	2009	2010	2008	2009	2010
PPI – food mfg	9.6%	-2.5%	3.5%	9.6%	-2.5%	3.5%
Employment cost index	3.6	2.2	1.7	4.0	3.2	3.7
Food & beverage spend (% of sales)	30.4	31.9	31.9 ²	33.1	31.8	31.8 ²
Labor spend (% of sales)	28.6	29.4	29.4 ²	33.5	33.2	33.2 ²
Occupancy, operating & o/head spend (% of sales)	29.2	29.9	29.9 ²	27.7	30.6	30.6 ²
% of net income before tax	9.7	5.9	5.9 ²	3.6	3.5	3.5 ²
Menu price increase to maintain margin:						
Food costs	2.9	-0.8	1.1	3.2	-0.8	-0.8
Labor costs	1.0	0.7	0.5	1.3	1.1	1.2
Total menu price increase to maintain margin	4.0%	-0.1%	1.6%	4.6%	0.3%	0.4%
Menu price increase (CPI FAFH FSR)	—	—	—	4.0	2.8	1.3
Menu price increase (CPI FAFH QSR)	4.9	4.2	0.9	—	—	—
Available for occ, operating & o/head costs: or improvement of income before tax	0.9%	4.3%	-0.7%	-0.5%	2.5%	0.9%

¹Avg check \$15-\$24.99

²Preliminary calculations based on NRA/Deloitte 2010 Restaurant Industry Operations Report. Source: BLS, Deloitte, NRA.

Note: fast-casual restaurant chains such as Chipotle are captured within the segment QSR, or quick-serve restaurants.

Source: GE Capital, Franchise Finance 2011 Chain Restaurant Industry Review.

Exhibit 11 Select Commodity Prices

Source: GE Capital, Franchise Finance 2011 Chain Restaurant Industry Review.

non-usage. The restaurant chain will continue to fund new store development with cash on hand and cash flow from operations.

Chipotle also faces the issue of decelerating SSS growth in 2011 and beyond. SSS directly affects overall

sales growth and will continue to be a critical factor affecting profit growth—a strong evaluation metric for investors.⁹³ Given the state of the economy in general and the restaurant industry in particular, Chipotle's SSS performance has been unprecedented. In the long

Exhibit 12 Restaurant Valuation EV/EBITDA

(as of the close on 04/20/11)													
	Rating ⁽¹⁾	Price	Share O/S	Market Cap	Total Debt	Cash & Equivalents	Enterprise Value	Calendar EBITDA			EV/Calendar EBITDA		
								2010	2011E	2012E	2010	2011E	2012E
Quick-Service													
DPZ	N	\$ 18.38	62.1	1,141	1,452	133	2,460	252	263	268	9.8X	9.4X	9.2X
JACK	U	\$ 20.80	52.9	1,100	373	17	1,457	261	217	247	5.6	6.7	5.9
MCD	B	\$ 78.40	1,068.3	83,794	11,505	2,387	92,912	8,756	9,423	9,919	10.6	9.9	9.4
SONC	U	\$ 9.23	61.9	571	538	38	1,071	125	125	128	8.6	8.6	8.4
WEN	N	\$ 4.75	418.4	1,987	1,572	514	3,046	397	406	449	7.7	7.5	6.8
YUM	B	\$ 51.55	488.0	25,156	3,588	1,426	27,318	2,410	2,749	3,050	11.3	9.9	9.0
Average											8.9X	8.7X	8.1X
Casual Dining													
CAKE	B	\$ 30.60	60.6	1,853	52	82	1,824	200	214	232	9.1X	3.5X	7.9X
EAT	U	\$ 25.52	92.1	2,351	536	114	2,772	343	362	382	8.1	7.7	7.3
DRI	B	\$ 48.46	140.0	6,784	1,603	90	8,298	1,007	1,103	1,206	8.2	7.5	6.9
PFCB	U	\$ 46.30	23.0	1,065	3	71	997	143	150	164	7.0	6.7	6.1
RRGB	U	\$ 28.06	15.7	441	159	18	581	75	81	94	7.7	7.2	6.2
RT	N	\$ 11.00	652	718	291	8	1,000	144	144	152	6.9	6.9	6.6
Average											7.9X	7.4X	6.8X
Family Dining													
CBRL	B	\$ 51.00	23.9	1,220	577	63	1,734	235	248	270	7.4X	7.0X	6.4X
Specialty													
CMG	N	\$288.10	31.7	9,133	4	350	8,788	363	417	491	24.2X	21.1X	17.9X
PNRA	N	\$123.38	30.1	3,713	0	229	3,483	254	295	322	13.7	11.8	10.8
SBUX	N	\$ 36.89	766.7	26,284	549	2,051	26,782	2,111	2,262	2,603	12.7	11.8	10.3
Average											16.9X	14.9X	13.0X

Source: FactSet Research Systems Inc.; Reuters; Thomson Financial; BofA Merrill Lynch Global Research estimates (1) Ratings: B=Buy N=Neutral U=Underperform

Source: GE Capital, Franchise Finance 2011 Chain Restaurant Industry Review.

term however, Chipotle's current growth rate is not sustainable.

Top management's guidance for profitability is mid-single digit SSS growth for the full 2011 fiscal year.⁹⁴ Assuming Chipotle does not alter its prices in the short term, declining traffic rates would result in a lower level of comp sales increases or even flat sales. If Chipotle's overall traffic rates decline, analysts will likely point to one or a combination of four main causes: 1) an aging store base, 2) decreased marketing expenditures, 3) increased competition in the quick-serve, fast-casual, and/or casual dining segments, and/or 4) sales cannibalization due to new store openings.

Looking forward, the market will keep a close eye on SSS, specifically the rate at which it may decelerate in 2011 and beyond. Just as important, Wall Street will be focused on how 2010 store openings season after their honeymoon periods end as well as how 2011 store openings perform. Also, maintaining or increasing

margins will be important, especially cost of goods sold and labor line items.

Next on the Menu...

With the high level of growth Chipotle has realized thus far, there are many challenges related to organizational structure and personnel that could affect Chipotle maintaining or improving its performance as the company continues to expand. Chipotle's approach of embracing environmental consciousness—rather unique to chains in the restaurant industry—causes additional challenges for Chipotle and its supply chain, distribution operations, and plans for growth. Nevertheless, to date, the loyalty of and word-of-mouth marketing provided by its customers have helped Chipotle's revenues grow thus keeping shareholders happy and funding Chipotle's environmental agendas.

Steve Ells and the Chipotle team are dedicated to the company and its vision for the future. In Ells' discussion

of first quarter 2011 results with staff and shareholders, he reinforced the company's commitment.

I remain confident that our performance is rooted in our long-term vision to change the way people think about and eat fast food... This focused approach makes us unique in the restaurant industry, and continues to differentiate Chipotle in significant ways.⁹⁵

It is clear that Ells feels the path Chipotle is on has made possible its high market share and continued growth. So far, Chipotle has maintained the success of its current locations and, based on this model, has significant growth plans for additional locations. With its potential for additional financial and market share growth, how the company reacts to and handles these opportunities will determine its future.

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