

# CMG: Growing Outside the Bun

## Current Estimates

### EPS Estimates (Before SFAS 123)

FY Date	1Q	2Q	3Q	4Q	EPS	EOY P/E
2005	\$0.00	\$0.00	\$0.00	\$0.00	\$1.38 E	31.9x
2006	\$0.00 E	\$0.00 E	\$0.00 E	\$0.00 E	\$1.27 E	38.9x

\*See page 13 for estimates including SFAS 123. 2005E excludes any tax benefits.

Source: Onboard Consulting Estimates

## Highlights

- We are initiating coverage of Chipotle with a Buy rating and a \$53 price target. The result of our DCF and EVA models, as well as an analysis of its peers, suggests that the company offers upside potential to investors.
- Since its founding in Denver in 1993, the company has grown throughout the US. Most of the growth has come since its purchase by McDonald's in 1998, and from 2002 through 2005, it has grown same-store sales (SSS) and units at a double digit rate.
- Given its history, as well as its positioning within fast casual, we believe that the company can meet its expectations for SSS growth (low to mid single digits) as well as double digit unit growth in 2006 (80-90 new units) and beyond. However, we estimate that if the company enters a low-growth scenario instead, it would be valued around \$40—approximately 15% below its current price.
- Factors that would cause us to be incrementally more optimistic on the company include accelerated SSS and unit growth, leverage on fixed costs, decreased unit ramp-up time and less than expected dilution from stock options.
- The company could also face headwinds should it not meet guidance, lower its growth outlook, suffer procurement issues, or have uncertainties arise around its tax issue.
- Given these factors, we believe that the company could appreciate more than 15% over the next 12 to 15 months. At current levels, Chipotle commands a premium valuation, but one that is in-line with its high-growth peers. Thus, though there is significant risk inherent in this highly valued IPO, we believe in the company's growth estimates, as well as its potential ability to improve margins and increase growth beyond our expectations.

## Disclosures

### Reg AC, Analyst Certification

I, Kelly C. Peebles, hereby certify that all the views expressed in this review, accurately reflect my personal views about the subject Company or companies and its, or their, securities. No part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views contained in this review.

Please read additional disclosures located on page 23

Rating	
New:	Buy
Old:	None
Price Target	
New:	\$53
Old:	None

Price	\$45.48
Market Cap.	1650.1m
52wk Range	\$39.51-\$49.30
Div. Yld.	0.0%

2006E	
ROA	8.4%
ROE	9.7%
ROIC	7.5%
BV Per Share	\$14.47
Debt to Cap	0.0%

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Kelly Peebles

kp@onboardconsulting.org

404-285-7197

*Information for Decision Makers*

### Overview

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**About the company.** Chipotle operates a chain of 486 restaurants in the “fresh mex” sector of the rapidly growing fast casual market segment. The company was founded in Denver in 1993, and was purchased by McDonald’s in 1998. With McDonald’s as the financial backer and management’s mentor, Chipotle’s goal has been to supply full service restaurant food with the service of a fast food establishment.

The main theme of the stores is to serve “food with integrity”. This concept entails using high-quality ingredients and traditional cooking techniques in the preparation of their menu items. Suppliers to the company are expected to know the source of their food, with the emphasis on naturally raised meat and organic vegetables being a driver for the individuality of the concept.

Chipotle believes that the importance of training their employees to better execute and serve customers is in keeping with the vision of the company. The design of the stores with the open kitchen concept has helped promote the theme of Chipotle by influencing customers to spread the word about the food quality and service in the stores. The design and layout of the restaurant is an additional driver since no two restaurants are designed the same. Store design emphasizes the concept of space efficiency and basic materials.

Management is heavily weighted with former McDonald’s executives, as would be expected with McDonald’s currently holding a majority of the voting stock. However, many who were with the company before its purchase by MCD, including founder Steve Eells, are still with the company.

Chipotle’s “Food with integrity,” word of mouth advertising, and a solid management team should continue to drive new store openings. Additionally, the concept of a limited menu of high-quality items and superior service should continue to please patrons who closely follow the company.

**Segments, menu, marketing and store development.** Chipotle’s business is divided into 2 distinct parts: company and franchise operations.

1. **Company operations-** Company restaurant sales are the primary source of revenue for this segment. Restaurant expenses include, food, insurance, labor, utilities, rent and other real estate related costs. As sales have increased, and management has introduced more cost savings policies, margins have expanded from an operating loss to a 6.5% profit in 2005E (Figure 1).



Figure 1. Estimated margins

	2002	% Chg.	2003	% Chg.	2004	% Chg.	2005	% Chg.	2006E	% Chg.
Company Unit Margin	10.76%	NM	15.12%	NM	16.35%	123 bp	19.54%	319 bp	21.13%	159 bp
Food	33.19	(125) bp	33.41	22 bp	32.90	(51) bp	32.90	0 bp	32.90	(0) bp
Labor	32.62	(244) bp	29.94	(268) bp	29.77	(17) bp	27.81	(196) bp	27.00	(81) bp
Occupancy	9.18	24 bp	8.14	(104) bp	7.72	(42) bp	7.40	(32) bp	7.17	(23) bp
Other	14.61	(180) bp	13.86	(75) bp	13.72	(14) bp	12.74	(98) bp	12.11	(62) bp
Gross Margin	10.72	NM	15.05	NM	16.28	123 bp	19.47	319 bp	21.06	160 bp
G&A Expense	12.61	(311) bp	10.84	(177) bp	9.53	(131) bp	7.95	(158) bp	7.95	0 bp
Depreciation and Amort.	5.50	(113) bp	4.78	(72) bp	4.63	(15) bp	4.36	(28) bp	4.14	(21) bp
Preopening Costs	0.50	(121) bp	0.52	2 bp	0.47	(5) bp	0.27	(20) bp	0.25	(2) bp
Operating Margin	(8.62)	NM	(2.51)	NM	1.30	381 bp	6.51	NM	8.46	195 bp
Interest Expense (Inc.)	(0.17)	38 bp	(0.07)	10 bp	(0.00)	7 bp	(0.94)	(94) bp	(0.94)	0 bp
Pretax Margin	(8.45)	NM	(2.44)	NM	3.60	NM	7.45	386 bp	9.41	195 bp
Net Margin	(8.45)	NM	(2.44)	NM	3.60	NM	7.45	386 bp	6.07	(139) bp

Source: The company and Onboard Consulting estimates.

Part of its increased sales comes from the use of its natural ingredients, such as its free range pork. These items are promoted through its "Food with Integrity" slogan, which emphasizes "raw ingredients that you can be proud of," from the organic beans to beef that it procures. Currently, all of its stores serve free range pork, 43% serve natural chicken, and 32% serve natural beef. Though these products may cost more, it has been able to regain lost margin by taking a price increase (such as \$1 for pork and \$0.25 for chicken) when it initially offered these items.

Similarly, Chipotle has a streamlined menu and has the ability to (mathematically) produce over 65,000 items with its current ingredient set. Its menu started out in 1993 offering only burritos and tacos, and remains simple today. The company opportunistically looks to add new products without expanding its inputs. Two successful products they launched with this strategy were its burrito bowl and a salad. To prepare for the day, the staff cooks its meats and seasons its food using traditional cooking methods and every employee, including the manager, spends their first three weeks on the job learning how to perform these activities.



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Turning to store development, each restaurant is uniquely designed to its area of operation and costs about \$906,000 to build-out (Figure 2). Most units operate under operating leases, have a high sales to investment ratio of 1.3x, and a cash on cash return of about 19.2%. The highest unit growth count the company has achieved was 104 in 2004, and it only reached this level with the help of McDonald's real estate staff. In 2005 it opened 80 stores and we expect it to open 92 in 2006. In the future, we anticipate Chipotle will increase its development staff greatly with its IPO funds, so that it has room to rapidly grow its units.



**Figure 2.** Chipotle's stores are unique to their surroundings and have a high sales-to-investment ratio, but a below average ROI

(in thousands)	Cost
Land	\$26
Building	\$880
<b>Total</b>	<b>\$906</b>

Average		
	Free Standing	\$1,200
	In-line/End Cap	\$700
	Expensive Areas	\$1,300

Sales-to-investment	1.30x
Cash on Cash ROI	19.2%

Source: The company and Onboard Consulting Estimates

- Franchise operations-** The company has 8 franchised stores, which only generated less than 1% of revenue in 2005E. The franchisees of these stores also own McDonald's, and are restricted by their franchisee agreements to a 10 year term. If McDonald's no longer is a majority shareholder of CMG, then the franchisees must forfeit their McDonald's franchise, or sell their Chipotle restaurants to retain their MCD franchise. Considering that the company has stated that franchising is not an important part of its current strategy, we expect the company to take back these stores when the franchisee agreements allow them to do so.

Further, we believe that the company's core competency is not in franchising. Much like SBUX, the company's ownership of its stores allows the company total control over the implementation of the company's initiatives and should help management grow the unit base. However, as the company matures, it can use this ownership strategy to add value to shareholder's through franchising a portion of the system.



**Competition Overview.** Chipotle operates in the fast casual segment of dining. Stores in this segment often prepare the food in front of the customer and use less packaged ingredients. Check averages from \$7 to \$10 and other companies in their sector of fast casual (called fresh mex) include Rubio's, Del Taco, Qdoba, and Moe's Southwestern Grill. Some of the qualities that distinguish Chipotle from its competition are its "food with integrity", bilingual employees, and differentiated restaurants that create a space for people to meet. In terms of system-wide sales in the Mexican segment, Chipotle is the largest fast casual player and only trails Taco Bell for the overall title in QSR Magazine's Annual Ranking (Figure 3). In the future, we believe that Chipotle will extend its lead over the closest competition due to taking share from casual dining (due to its lower price point, but similar offering) and poor execution among its closest peers (Del Taco was recently bought, Baja Fresh was written down by Wendy's, and Taco John's unit growth ~1.7%). However, we expect Qdoba and Moe's to be Chipotle's greatest competition going forward- as they both continue to expand their unit base, offerings and sales.

**Figure 3.** QSR Magazine's Top 50 Chains for 2005

"We expect Qdoba and Moe's to be Chipotle's greatest competition going forward"

QSR 50	Chain	2004 Systemwide Sales (\$M)
5	Taco Bell	\$5,700.0
34	Chipotle	\$480.0
35	Del Taco	\$472.0
47	Baja Fresh Mexican	\$305.0
55	Taco John's	\$234.1

Source: QSR Magazine

## Valuation

We valued the company through our EVA and DCF models, as well as looking at comparative multiples. Based on these analyses, we value the company at \$53 per share based on the average of these results.

**1) Examining our DCF and EVA models.** Our Discounted Cash Flow (DCF) model yields a share price of \$43, and our Economic Value Added (EVA) model yields a value of \$63.

To get to these values, we modeled assumptions based on historical trends, as well as management's outlook. We believe our estimates represent a realistic case based on our assumptions, which include:



- **Continued growth in SSS and units.** The company has guided towards expanding SSS by in the low to mid single digits, and increasing its store base by 80-90 units in 2006. We believe in managements near-term outlook given it opened at least 75 stores in the past three years, and SSS during that time period grew at a double digit rate. Looking ahead, we have modeled 15% unit growth (consistent with management's 2005 to 2006 guidance for growth) and a declining SSS rate that starts out at 6.0% in 2006.
- **The company will not buy shares to offset dilution and not issue a dividend.** As part of its pre-IPO status, stock options were awarded to various people in management, as well as to its employee stock ownership plan. We estimate that approximately 900K exercisable shares were outstanding at its IPO, and 153K additional shares will be exercisable in 2006. In addition, the company registered an additional 2.4m shares to issue under stock incentive plans and arrangements. Thus, our model incorporates this data, and assumes that 300k shares a year will run-off. We also expect the company to restrict future awards, and, consistent with a growth company, use cash to grow the business instead of buy-back stock.
- **G&A expenses will grow at a consistent rate.** Another vestige from its former parent is the back office infrastructure. Currently, the company has a multi-year service contract with MCD to maintain these services. The cost of this contract is approximately \$10m-\$11m, and we believe that this price reflects the historical trends the company has booked to G&A. Given this situation, we expect the company to gradually move towards developing its own back office.

Along with these moves, we expect the company to expand G&A spending to increase staff in key areas such as Development and Marketing. We note that the company has increased marketing expenses about 24.6% a year since 2001, and believe that it will shift from its word of mouth strategy to a more conventional advertising to the markets it has built out. Turning to development, we believe that it is currently restricted from growing units beyond 90 or so units a year due to staff limitations. Though the company built 104 units in 2004, it leveraged the site development capabilities of MCD's staff. This growth is 24 more than its own staff could develop in 2005, and 31 more than 2003's 73 unit development. To further support for our idea, the chains CEO mentioned in its road show that "We'll only add restaurants as fast as we can find terrific real estate and top-performing managers" (Reuters).



"G&A expense seems to lag unit growth by a year for rapid growers"

In an effort to quantify the G&A growth we could expect, we looked at the differences between a slower unit grower (MCD) and a fast one (Starbucks when it was at a similar position as Chipotle is now) (Figure 4). The results illustrate that there is a quantifiable effect- the faster unit growers seem to have a reactionary G&A expense growth that lags its unit growth by a year. This effect mirrors Chipotle's results (we believe that the company restricted G&A growth in 2005 ahead of its IPO) and compares to McDonald's that don't have this kind of observable pattern. As a result, we incorporated this kind of growth pattern into our model and will watch to see if it happens.

**Figure 4.** G&A expense seems to lag unit growth by a year for rapid growth companies

**McDonald's**

	2000	2001	2002	2003
SSS	1.0%	0.1%	(1.5%)	6.2%
Unit Growth	23.2%	9.5%	7.4%	(0.5%)
Growth in New Units	10.7%	(13.7%)	(2.1%)	(7.9%)
G&A Expense Growth	7.4%	4.7%	3.1%	7.0%
Sales Growth	1.1%	1.1%	2.2%	10.7%

**Starbucks**

	1995	1996	1997	1998
SSS	9.0%	7.0%	5.0%	5.0%
Unit Growth	38.8%	47.7%	36.8%	28.2%
Growth in New Units	(14.6%)	8.8%	(10.9%)	(8.6%)
G&A Expense Growth	43.4%	30.1%	53.4%	35.8%
Sales Growth	62.0%	49.0%	38.8%	32.4%

**Chipotle**

	2002	2003	2004	2005E
SSS	17.0%	24.4%	13.3%	8.7%
Unit Growth	33.5%	34.2%	35.5%	19.6%
Growth in New Units	(21.9%)	0.7%	1.3%	(14.0%)
G&A Expense Growth	24.7%	32.5%	31.1%	10.7%
Sales Growth	55.3%	54.0%	49.2%	32.7%

Source: The companies and Onboard Consulting Estimates

- **Other areas of interest:**
  - **The company will remain profitable.** In the past, the company incurred a significant tax asset from the losses it experienced. Despite these losses, the company has posted positive Operating Income by our model since 2004. Given the clean post-IPO tax slate, we expect Chipotle to remain profitable and build a deferred tax liability.



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- **The company will reverse its sale leaseback transactions.** In 2005, Chipotle completed 4 sale lease back transactions. They were not accounted for as a sale lease-back due to the nature of the transaction, but the company did book a liability of about \$2.4m. Given the cash infusion from the IPO, we expect the company to use cash to reverse these transactions in the near future.
- **The company will not incur serious damages from the theft of credit card data in 2004.** Chipotle booked a one time loss reserve in 2004 to cover the potential loss exposure to the breach of its vendor's credit card data. Through 2005, we estimate that the company used about \$2.5m of the \$4m reserve. Considering the nature of the data, we would have expected a larger loss if the data was misused by this point in time. As such, we believe that the company has set aside enough at this time to cover these losses.
- **Seasonality means lower sales in 1<sup>st</sup> Qtr and 4<sup>th</sup> Qtr, as well as more back-half store openings.** The company's business is adversely effected by people's tendency to stay in during the holidays and during the cold weather. Similarly, the company tends to open more stores in the back-half of the year. This schedule means that the 4<sup>th</sup> quarter also has higher pre-opening expenses and more inefficient stores (due to new store openings).
- **Goodwill.** Expect that one type of the company's tax benefit (SRLY- separate return limitation year) will net out at the time of deconsolidation and goodwill will remain constant (versus the current situation where profits net the SRLY's against goodwill)
- **McDonald's will continue to be a majority stakeholder.** Given the potential price appreciation (as well as the negative contractual consequences that Chipotle would face) we believe that McDonald's will maintain its majority holding position in CMG.
- **Franchise stores will be taken back when their agreements expire.**
- **Tax rate.** Assume a 38% tax rate, which is consistent with historical trends.

*But what about the tax asset?* In the prospectus (page 40), the company noted that post-IPO, it will receive cash for its net tax position. This situation arises because McDonald's will own less than 80% of the company, so it will now file its taxes as a separate entity (be deconsolidated). Given this situation, the company will not longer consider its operating losses for tax purposes and receive cash for its net tax position by the end of 2007. At the end of the third quarter 2005, we estimate that the net benefit the company accrued was \$38.6m. We expect that the company was profitable until its IPO date, and believe that its tax asset was further decreased to an estimated level of \$34.6m. As such, we have modeled a net cash inflow of \$14.8m in 2006 and \$19.8m in 2007.



*Why so many shares available?* In its offering, the company gave the underwriters an over-allotment option, which we assume they will exercise (Figure 5). In addition, the company issued a form S-8, in which it offered 2.4m shares to its stock incentive plans. Our estimate of 37m shares outstanding incorporates all of these values, as well as an additional 0.9m shares that were issued in the past, and are either optionable, vested or granted (and assumed to be vested). This count aside, remember that McDonald's retained about 24m shares (with 10 votes per share) in the company, and the share count in our model is slightly lower due to our option vesting schedule.

**Figure 5.** Calculating the estimated share count

	Est. Shares Outstanding
At IPO	33,675,987
S-8 Registration	2,425,000
Options (Est. Avail.)	899,506
<b>Total</b>	<b>37,000,493</b>

Source: The company and Onboard Consulting Estimates

*Where is the cash from the IPO going?* The company plans on using the majority of the funds from its offering to pay for expanding its operations. It predicts that these funds, along with OCF, will last at least 24 months, and will fund its capital expenditures in 2006 (~\$95m) and 2007. Other items marked for funds include the repayment of its revolver with MCD (~\$4.6m) and corporate expenses.

"Since Chipotle has no price history, we have to rely on an alternative method to estimate beta"

**A further look at our calculations.** We calculated our DCF and EVA values using a WACC of 7.6% and terminal growth rate of 3.0%. We derived these values based on the assumption that:

- The historical market return is 11%, and the 10 year treasury yield is currently 4.7%.
- The company would pay approximately 0.6% over the 10 year treasury yield for new debt. This number comes from the difference in yield between treasuries and AA rated bonds, as we assume that its majority shareholder, McDonald's, would back the payment on the bonds.
- Terminal multiple analysis cannot be used unless we assume that Chipotle can be valued relative to another group of firms. Given the high growth model and lack of a track record against the market, we felt more comfortable comparing the company against itself. So, we calculated a terminal value at year T+1, and incorporated the estimated ROIC, our WACC, and an estimated 3% terminal growth rate.
- *Estimating Beta.* Since Chipotle has no price history, we have to rely on an alternative method to estimate beta. Our estimation process involved comparing beta across firms that have similar market capitalization (Figure 6). This process required four steps:



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1. Calculate the average beta and debt to equity ratio from the sample group. Our beta's were the result of a 72 month analysis comparing each company to the S&P 500, and are adjusted
  2. Calculate the unlevered beta for the group. We assumed a 35% tax rate and implicitly assumed that Chipotle's debt to equity ratio would be the group's average of 32%
  3. Estimate the levered beta for the company. Here, we assumed that the company's target debt to equity ratio would be equivalent to Starbucks. Our assumption lies in the fact that they have similar business models (high growth, company ownership of stores) and that Chipotle has a similar debt structure (little).
- As a result of these calculations, our beta was 0.56.

**Figure 6. Calculating Beta**

	Beta	Debt to Cap
Ruby Tuesday, Inc. (RI)	0.50	71%
Chipotle Mexican Grill, Inc. (CMG)		
Jack in the Box Inc. (JBX)	0.55	53%
CEC Entertainment Inc. (CEC)	0.66	33%
PF Chang's China Bistro Inc. (PFCB)	0.81	3%
RARE Hospitality International (RARE)	0.66	4%
Papa John's International Inc. (PZZA)	0.59	28%
IHOP Corporation (IHP)	0.80	29%

**Average 0.65      32%**  
*Calculated for CMG 0.54      5%*

**Levered Beta 0.56**

*Source: Capital IQ and Onboard Consulting Estimates*

*What happens if growth isn't what its projected?* From the prospectus and management's outlook, much growth is embedded into the outlook. Given this case, we performed a scenario analysis (Figure 7) on top line revenues with our model assuming that:

- The company will only grow units at a constant rate of 80 per year- the same count they grew in 2005
- Flat same-store sales in 2006 and 2% growth into the future- including in the terminal multiple, and costs will grow at the same rate as we have projected in our model

The result of this analysis is that the average of the DCF and EVA analysis is \$40- or about 15% downside from the company's current level.

**Figure 7. A snapshot of our low-growth scenario**

(Dollars in millions)	2006E	% Chg.	2007E	% Chg.	2008E	% Chg.	2009E	% Chg.	2010E	% Chg.	2011E	% Chg.
Total Revenues	\$751.1	20.3%	\$886.0	18.0%	\$1,029.3	16.2%	\$1,181.5	14.8%	\$1,343.0	13.7%	\$1,514.3	12.8%
Restaurant Operating Profit	158.0	30.1%	193.3	22.3%	235.0	21.6%	283.4	20.6%	339.0	19.6%	402.5	18.7%
Operating Income	63.6	56.4%	85.7	34.8%	117.0	36.6%	154.7	32.2%	199.8	29.1%	252.6	26.5%
EPS from Continuing Ops.	\$1.25	-9.5%	\$1.51	21.2%	\$2.04	34.7%	\$2.66	30.6%	\$3.41	28.3%	\$4.31	26.2%
Operating Margin	8.46%	195 bp	9.67%	121 bp	11.37%	170 bp	13.09%	172 bp	14.88%	178 bp	16.68%	181 bp
EOP Store Count	569	16.4%	649	14.1%	729	12.3%	809	11.0%	889	9.9%	969	9.0%

*Source: The company and Onboard Consulting Estimates*



Isn't EVA inaccurate for growth companies? We have read in academia how EVA may not be a good indicator of investment quality for companies with significant infrastructure investments, and/or long gestation periods. However, we believe that Chipotle doesn't suffer from this downside, as it has several years of high unit growth behind it and the ramp-up period for new stores continues to decrease.

**2) Multiple and peer analysis.** Comparing the company to its peers, as well as companies with similar market capitalizations, we believe that the company is fairly valued to other high growth peers. Its current price to earnings (using 2006E EPS) ratio of 35.7x is above its peer group average of 28.7x, but in-line with its other high growth peers (Figure 8). To us, this event suggests that that the company may be overvalued to its peers, but is fairly valued to other high growers. Applying this multiple to next year's estimated earnings of \$1.74, we get a stock price of \$62.20, or an estimated 36.8% upside from current levels. This number is greater than its peer's average, as well as the groups average as a whole of 20.4%. To us, these numbers suggests that the company is commanding a premium value to the group, has above average upside, and is fairly valued to its peers.

**Figure 8.** Based on other companies, we think Chipotle has above average upside

	Current Price	CY Earnings	Current P/E	1 year Fwd EPS E	Price If Current P/E Applied To Fwd EPS	% Upside Current levels
<b>Peers</b>						
Chipotle	\$45.48	\$1.27	35.7x	\$1.74	\$62.20	36.8%
Panera	\$70.65	\$1.94	36.4x	\$2.40	\$87.40	23.7%
PF Chang's	\$47.77	\$1.42	33.6x	\$1.74	\$58.54	22.5%
Sbux*	\$35.58	\$0.74	48.1x	\$0.91	\$43.75	23.0%
<b>Co's with Similar Mkt. Cap.</b>						
Jack in the Box	\$39.82	\$2.56	15.6x	\$2.82	\$43.86	10.2%
CEC Entertainment	\$31.94	\$1.98	16.1x	\$2.30	\$37.10	16.2%
Texas Roadhouse	\$15.29	\$0.46	33.2x	\$0.57	\$18.95	23.9%
Papa John's International	\$30.18	\$1.44	21.0x	\$1.58	\$33.11	9.7%
RARE Hospitality	\$31.13	\$1.66	18.8x	\$1.96	\$36.76	18.1%
<b>Average</b>		<b>\$1.50</b>	<b>28.7x</b>			<b>20.4%</b>

CMG to avg.

24.4%

16.3%

\*Forward 4Q's used instead of CY2006

Source: Wall Street Journal, Capital IQ, Onboard Consulting Estimates

Looking into other valuation metrics, the company's 1 year forward P/E is above (20.9%) the group as a whole, yet again, is in-line with its peers. Similarly, its price to earnings growth is less than 1, indicating that the company may be undervalued, especially when looking at the group as a whole (Figure 9). The company also has a 0.9% FCF yield, which is slightly below our sample's average of 2.3%, and trades at a much higher price to free cash flow multiple than the group's average of 46.8x. We attribute this result to the high amount capex from the Chipotle's growing operations. On this basis, the result would indicate that the company is overvalued.



**Figure 9.** Compared to its high growth peers, we think CMG is fairly valued at this time

	<b>1 yr. Fwd. P/E</b>	<b>EV/EBITDA</b>	<b>(5 Year Est.) PEG</b>	<b>FCF Yield</b>	<b>P/FCF (TTM)</b>
Chipotle	26.1x	18.7x	0.94x	0.9%	98.4x
Panera	29.4x	18.7x	1.65x	1.7%	59.4x
PF Chang's	27.5x	12.3x	1.49x	1.2%	85.9x
Jack in the Box	14.1x	6.7x	1.64x	1.9%	0.0x
CEC Entertainment	13.9x	6.7x	1.38x	4.8%	23.0x
Texas Roadhouse	26.8x	17.2x	1.51x	-0.3%	NM
Papa John's International	19.1x	10.0x	2.06x	6.5%	7.6x
RARE Hospitality	15.9x	8.9x	1.08x	1.8%	53.3x
<b>Average</b>	<b>21.6x</b>	<b>12.4x</b>	<b>1.47x</b>	<b>2.3%</b>	<b>46.8x</b>
<b>CMG to avg.</b>	<b>20.9%</b>	<b>50.7%</b>	<b>-35.8%</b>	<b>-1.38%</b>	<b>110.2%</b>

Source: Capital IQ, Wall Street Journal and Onboard Consulting Estimates

**3) Cash flow ROI (CFROI).** Cash flow return on investment is an approximation of the average real internal rate of return earned by a firm on all its operating assets. In short, it's a valuation tool that's applied to the total assets overtime to get a discounted cash flow and arrive at a current value for a company. As we have seen, Chipotle's ROI isn't great, but its only been around for a few years of growth similar to what we expect to see in the future. So, we chose to use this method for a different purpose- to see how well management is improving its investment.

The results of our study (Figure 10) illustrate that the company has improved its CFROI over the past couple of years. In fact, this progress can be traced to the faster growth of its estimated CF than its outlays on additional and cash investments. In other words, it is expanding its estimated cash intake with less assets. In the future we look to use this approach to track managements progress in improving its ROIC.

**Figure 10.** Chipotle has been increasing its CFROI

	<b>2004</b>	<b>2005</b>	<b>2006E</b>
<b>IRR</b>	-7.3%	-3.9%	-3.2%
<b>Gross Cash Investments</b>	\$ 666.8	\$ 822.2	\$ 832.6
<b>Sum of CF</b>	\$ 504.9	\$ 713.4	\$ 747.9

Source: The company and Onboard Consulting Estimates

**What about Stock Option expensing?** According to the recent FASB ruling (SFAS No. 123) companies are required to report stock based compensation if the value of the company's stock price exceeds the exercise price as of the grant date. Our report excludes stock option expensing in the analysis for comparability purposes. However an examination of the company's stock compensation policy would make us adjust our estimates in the following manner (Figure 11):



**Figure 11.** EPS Estimates if stock options were expensed according to SFAS 123

	2002	2003	2004	2005E	2006E
Diluted EPS	\$ (1.32)	\$(0.50)	\$ 0.82	\$ 2.02	\$ 1.27
Options Expense	\$ (0.01)	\$(0.03)	\$(0.02)	\$ (0.01)	\$(0.03)
Proforma EPS	\$ (1.33)	\$(0.52)	\$ 0.80	\$ 2.01	\$ 1.24

Source: The company and Onboard Consulting Estimates

### Reasons that would cause us to change our thesis

**Though the company is trading at a premium to its group, there's still the ability for further appreciation.** We believe that our estimates could be conservative if the following, or other events, were to occur:

- Same-store sales exceed expectations.** From 2002 to 2005E, the company averaged an estimated 15.6% growth in SSS, and its lowest 2-year comparison is 2006E's 14.7% (Figure 12). This number includes our estimated positive 8.7% result in 2005, and is above management's guidance for low to mid single digit SSS growth in 2006. Given these facts, we are sticking to management's belief and have modeled a positive 6.0% in 2006. However, we believe that a 2002 study indicating that 55% of Chipotle customers frequent its chain at least 4 times a month may portend an increasing SSS growth. So, if this trend and history holds, this number may be revised upward closer towards 2005's estimated level, as the company enters new markets and stores continue to ramp up faster.

**Figure 12.** One and Two year SSS

	2001E	2002	2003	2004	2005E	2006E
SSS	15.0%	17.0%	24.4%	13.3%	8.7%	6.0%
2 Year Rate (T+(T-1))		32.0%	41.4%	37.7%	22.0%	14.7%

Source: The company and Onboard Consulting Estimates

- Unit growth accelerates.** The company has guided towards opening 80-90 units in 2006, and we estimate that they will open 92 units, as some openings may have run over into this year. At this level, the company would be growing openings 15.0% year over year. Our model maintains this rate of open-



## CMG: Growing Outside the Bun

15.0% year over year. Our model maintains this rate of openings in 2007, and when we expect the company to open 106 units. However, the company now has the capital needed to expand significantly, and has experienced 104 unit openings in 2004. If the company can leverage the knowledge it gained in working with MCD's real-estate staff in 2004, it may be able to expand faster than we expect. Given that ramp-up times are decreasing and AUV's are increasing, increased unit openings could boost EPS greatly. We estimate that every additional opening in 2007 boosts our EPS estimate by \$0.01.

- **Management is able to meet or exceed its goals.** Since the company is new, much focus will be placed on management's outlook and forecast. We believe in their outlook as expressed in the company's prospectus, but if management can meet or beat expectations, then their word will have more credence on the Street. Along with credibility, if management can set forth an increasingly positive, yet realistic, goal for the company every quarter, then we believe that the company could gain traction with investors.
- **The company improves its openings.** Historically, the company's new stores tend to underperform mature stores for about 24 months. Over time, this shortfall has decreased, as management builds out existing markets (where customers are familiar with the brand), gains more knowledge about real estate selection, and leverages national advertising. Given our expectation of increased capital allocated to marketing and real estate, the company has the ability to improve ramp up time. To us, this gain could be substantial, as we estimate that new stores still lag existing stores by about 9.5% after 12 months. This gap translates into about \$140,000 per new restaurant in 2006, or a total of about \$12.7m in sales (or about \$0.35 in top line 2006E). Our model conservatively estimates the gap will close an additional 15bps in 2006 (versus an estimated decrease of 350bps in 2005E). So, any additional improvement has the potential to cause us to raise our estimates.
- **The company decides to buy back stock to cover options exercised.** Our model expects that the company will not repurchase any stock in the future. However, given the cash flows that we have modeled, management could use these funds to buy back stock and offset the dilution from exercised



options. Though the company is a growth story, this purchase would effectively be an investment in themselves, which may be more lucrative than investing in risk free assets.

- **The company is better able to leverage its costs.** Given the scale of its enterprise, moves to leverage its cost structure would enable the company to increase EPS faster than we expect. On the cost side, the company chooses to serve “food with integrity”. To meet its needs, it has suppliers purchase more natural and humane products. Though the cost of serving these products is more expensive, we believe that it has enough market power to extract lower prices and purchase consistent quantities and avoid shortages of key goods. To us, this story could unfold like SBUX, where the company purchased beans at fair prices and eventually expanded down the supply chain to ensure a consistent supply of goods.

Similarly, if it can find ways to utilize its existing capital base to increase sales, it will gain leverage. For example, it has begun testing internet ordering, and could expand into other sales activities, such as to-go catering.

***What are some of the pitfalls the company could face?*** Though the company is growing right now, potential issues could lower our expectations and estimates, such as:

- **Managerial risk from high growth.** One of the greatest risks we foresee is trying to maintain profitability and efficiencies with such high unit growth. Up to now, management has been able to grow the company and reach a level of profitability. However, rapid unit expansion requires a different managerial style- from the top to the bottom levels of management. If the company cannot adjust to this demand as we expect it will, then the company may not be able to grow at our estimated rate and our EPS estimates could be lowered.
- **The company’s tax situation changes.** As part of its IPO, the company is expected to be deconsolidated from MCD’s tax return. Part of a pre-existing arrangement calls for the company’s existing tax assets to be netted against its tax liabilities, and any remaining value (netted against equity) to be paid in cash by the fourth quarter of 2007. As of 9/30/2005, the net benefit owed was \$38.6m, and we estimate that by the time of the IPO, this benefit would be about \$34.6m. In our model, we have the company receiving back this benefit in time-weighted parts in 2006 and 2007.

Given the uncertainties surrounding 4Q05 and 1Q06’s results, along with the complexities of tax law, we believe that our es-



-timate could be flawed. We also believe that MCD could withhold any benefit that the company would receive until it is due in late 2007. These uncertainties cause us to remain on guard with our valuation until more clarity is provided.

- **Store growth or same-store sales fall short.** The company's goal is for low to mid single digit SSS growth, and to open at least 80 new stores in 2006. If either of these expectations were to fall short, the company's earnings could be reduced.
- **Stock dilution is greater than expected.** We estimate that the company has about 900k shares of potentially vested stock outstanding, and estimate a dilution of 2.4m shares (from its S-8 registration) in 2006 and 300,000 shares a year until all options expire or vest. We also believe that the company may not buy any shares back to offset this dilution. Should our estimates or assumptions be wrong, our forecast could be revised.
- **McDonald's decides a new course for the company or no longer provides services to the company.** As the majority shareholder, MCD has the ability to directly influence the direction of the company. In the past, they have ceded control in the decision making process to management. However, if they decide to change the direction of the company, there is not enough other voting power to veto a change. Similarly, certain covenants are enacted should MCD fall below a certain level of ownership, and these clauses could hurt the company. Finally, many of Chipotle's back office services are still being provided by MCD under contract. Should Chipotle fail to transition from MCD's services, it could adversely effect the company.
- **Outstrip its supply chain.** As part of the company's focus on "food with integrity", it chooses to purchase natural and humane ingredients when possible. These items tend to cost more and have a smaller supply than alternative food sources. Given this situation, the company may face price and/or supply pressures should external events happen or if the company outgrows its suppliers. Similarly, 13 of the 16 distribution centers it operates are owned by McDonald's. If a situation arises where the company is restricted from using these facilities, it may face adverse conditions.
- **IPO uncertainty.** The company currently has a high amount of growth embedded in its stock price, as evident by its above group P/E of 35.7x 2006E EPS. Should the company fail to meet investors expectations, the price of the company could fall to an uncertain level. This risk is exacerbated by the fact it is an IPO and has no trading history. Finally, several academic studies have found that IPO's tend to underperform the market for a period of time. Though there is no consensus on the reasons behind this event, it does add further risk to the company's stock.



## Chipotle - Annual Earnings Model

(Dollars in millions except per-share data. Fiscal year ends Dec)

	52 weeks		52 weeks		52 weeks		53 weeks		52 weeks		2006E		2007E		2008E	
	2001	% Chg.	2002	% Chg.	2003	% Chg.	2004	% Chg.	2005	% Chg.	2006E	% Chg.	2007E	% Chg.	2008E	
<b>Revenue Detail</b>																
Company Restaurant Sales	131.3	93.8%	203.9	55.3%	314.0	54.0%	468.6	49.2%	621.8	32.7%	764.5	22.9%	935.0	22.3%	1,138.9	
Franchise Revenues	0.3		0.8	182.0%	1.5	98.3%	2.1	43.5%	2.4	11.4%	2.4	0.0%	2.4	(0.1%)	2.3	
<b>Total Revenues</b>	<b>131.6</b>	<b>94.2%</b>	<b>204.6</b>	<b>55.5%</b>	<b>315.5</b>	<b>54.2%</b>	<b>470.7</b>	<b>49.2%</b>	<b>624.2</b>	<b>32.6%</b>	<b>766.8</b>	<b>22.8%</b>	<b>937.4</b>	<b>22.2%</b>	<b>1,141.2</b>	<b>0.0</b>
Food, Beverage and Packaging Costs	45.2	89.1%	67.7	49.6%	104.9	55.0%	154.1	46.9%	204.6	32.7%	251.5	22.9%	309.2	22.9%	378.2	
Labor Costs	46.0	89.0%	66.5	44.4%	94.0	41.4%	139.5	48.4%	172.9	24.0%	206.4	19.4%	243.4	17.9%	285.6	
Occupancy Costs	11.7	101.6%	18.7	59.4%	25.6	36.6%	36.2	41.5%	46.0	27.2%	54.8	19.1%	63.8	16.4%	74.5	
Other Operating Costs	21.6	103.1%	29.8	38.2%	43.5	46.1%	64.3	47.7%	79.2	23.2%	92.6	16.9%	107.4	16.0%	123.7	
<b>Restaurant Operating Profit</b>	<b>7.0</b>	<b>131.7%</b>	<b>21.9</b>	NM	<b>47.5</b>	<b>116.4%</b>	<b>76.6</b>	<b>61.4%</b>	<b>121.5</b>	<b>58.6%</b>	<b>161.5</b>	<b>32.9%</b>	<b>213.6</b>	<b>32.2%</b>	<b>279.3</b>	
General and Administrative	20.7	31.4%	25.8	24.7%	34.2	32.5%	44.8	31.1%	49.6	10.7%	61.0	22.8%	72.1	18.2%	79.9	
Depreciation and Amortization	8.7	75.1%	11.3	29.0%	15.1	34.0%	21.8	44.5%	27.2	24.7%	31.8	16.8%	37.8	19.1%	44.9	
Preopening Costs	2.2	(20.1%)	1.0	(54.5%)	1.6	59.6%	2.2	34.4%	1.7	(24.1%)	1.9	15.0%	2.2	15.0%	2.5	
Loss on Disposal of Assets	0.1		1.5		4.5		1.7		2.4		2.0		2.1	5.0%	2.2	
<b>Operating Income</b>	<b>(24.7)</b>	<b>20.2%</b>	<b>(17.6)</b>	<b>(28.7%)</b>	<b>(7.9)</b>	<b>(55.0%)</b>	<b>6.1</b>	<b>(177.0%)</b>	<b>40.6</b>	NM	<b>64.9</b>	<b>59.7%</b>	<b>99.4</b>	<b>53.2%</b>	<b>149.7</b>	
Interest Expense (Income)	(0.7)	(29.1%)	(0.3)		(0.2)		(0.0)		(5.9)	NM	(7.2)	22.8%	(4.2)	(41.8%)	(5.1)	
Other Income (Expense), Net	0.0		0.0		0.0		10.8		0.0		0.0		0.0		0.0	
<b>Pre-tax Income</b>	<b>(24.0)</b>	<b>22.8%</b>	<b>(17.3)</b>	<b>(28.0%)</b>	<b>(7.7)</b>	<b>(55.4%)</b>	<b>16.9</b>	NM	<b>46.5</b>	<b>174.7%</b>	<b>72.1</b>	<b>55.0%</b>	<b>103.6</b>	<b>43.6%</b>	<b>154.8</b>	
Income Taxes (Benefit)	0.0		0.0		0.0		0.0		0.0		25.6	#DIV/0!	39.4	53.8%	58.8	
<b>Net Operating Income</b>	<b>(\$24.0)</b>	<b>22.8%</b>	<b>(\$17.3)</b>	<b>(28.0%)</b>	<b>(\$7.7)</b>	<b>(55.4%)</b>	<b>\$16.9</b>	NM	<b>\$46.5</b>	<b>174.7%</b>	<b>\$46.5</b>	<b>(0.0%)</b>	<b>\$64.2</b>	<b>38.0%</b>	<b>\$96.0</b>	
Non-recurring (Gain)			\$0.0		\$0.0		(\$4.0)		(\$21.5)		\$0.0					
<b>Net Income, Reported</b>	<b>(\$24.0)</b>	<b>22.8%</b>	<b>(\$17.3)</b>	<b>(28.0%)</b>	<b>(\$7.7)</b>	<b>(55.4%)</b>	<b>\$20.9</b>	NM	<b>\$68.1</b>	NM	<b>\$46.5</b>	<b>(31.6%)</b>	<b>\$64.2</b>	<b>38.0%</b>	<b>\$96.0</b>	<b>104%</b>
<b>Earnings Per Share</b>																
Continuing Operations	(\$2.60)	(34.3%)	(\$1.32)	(49.2%)	(\$0.50)	(62.4%)	\$0.66	NM	\$1.38	107.8%	\$1.27	(7.7%)	\$1.74	36.9%	\$2.58	
Nonrecurring Gain (Loss)	\$0.00		\$0.00		\$0.00		\$0.16		\$0.64							
<b>Reported (Diluted)</b>	<b>(\$2.60)</b>	<b>(34.3%)</b>	<b>(\$1.32)</b>	<b>(49.2%)</b>	<b>(\$0.50)</b>	<b>(62.4%)</b>	<b>\$0.82</b>	NM	<b>\$2.02</b>	<b>146.0%</b>	<b>\$1.27</b>	<b>(36.9%)</b>	<b>\$1.74</b>	<b>36.9%</b>	<b>\$2.58</b>	
Diluted Shares (Mil.)	9.2	87.0%	13.1	41.9%	15.6	18.7%	25.5	64.0%	33.7	32.1%	36.6	8.4%	36.9	0.8%	37.2	
<b>Margin Analysis (as a percent of sales, except tax rate)</b>																
Company Unit Margin	5.34%	NM	10.76%	NM	15.12%	NM	16.35%	123 bp	19.54%	319 bp	21.13%	159 bp	22.84%	171 bp	24.52%	
Food	34.44	NM	33.19	(125) bp	33.41	22 bp	32.90	(51) bp	32.90	0 bp	32.90	(0) bp	32.98	8 bp	33.14	
Labor	35.06	NM	32.62	(244) bp	29.94	(268) bp	29.77	(17) bp	27.81	(196) bp	27.00	(81) bp	25.97	(103) bp	25.02	
Occupancy	8.94	NM	9.18	24 bp	8.14	(104) bp	7.72	(42) bp	7.40	(32) bp	7.17	(23) bp	6.81	(36) bp	6.53	
Other	16.41	NM	14.61	(180) bp	13.86	(75) bp	13.72	(14) bp	12.74	(98) bp	12.11	(62) bp	11.49	(62) bp	10.87	
Gross Margin	5.33	NM	10.72	NM	15.05	NM	16.28	123 bp	19.47	319 bp	21.06	160 bp	22.78	172 bp	24.47	
General & Administrative Expense	15.72	NM	12.61	(311) bp	10.84	(177) bp	9.53	(131) bp	7.95	(158) bp	7.95	0 bp	7.69	(26) bp	7.00	
Depreciation and Amortization	6.63	NM	5.50	(113) bp	4.78	(72) bp	4.63	(15) bp	4.36	(28) bp	4.14	(21) bp	4.04	(11) bp	3.94	
Preopening Costs	1.71	171 bp	0.50	(121) bp	0.52	2 bp	0.47	(5) bp	0.27	(20) bp	0.25	(2) bp	0.71	46 bp	0.67	
Operating Margin	(18.79)	NM	(8.62)	NM	(2.51)	NM	1.30	381 bp	6.51	NM	8.46	195 bp	10.60	214 bp	13.12	
Interest Expense (Income)	(0.55)	(55) bp	(0.17)	38 bp	(0.07)	10 bp	(0.00)	7 bp	(0.94)	(94) bp	(0.94)	0 bp	(0.00)	94 bp	(0.00)	
Pretax Margin	(18.24)	NM	(8.45)	NM	(2.44)	NM	3.60	NM	7.45	386 bp	9.41	195 bp	11.05	165 bp	13.56	
Net Margin	(18.24)	NM	(8.45)	NM	(2.44)	NM	3.60	NM	7.45	386 bp	6.07	(139) bp	6.85	78 bp	8.41	
Tax Rate	0.00	0 bp	0.00	0 bp	0.00	0 bp	0.00	0 bp	0.00	0 bp	35.49	NM	38.00	251 bp	38.00	

03/05/06

Source: The company and Onboard Consulting estimates.



Chipotle - Annual Store Growth Analysis

(Fiscal year ends Dec)

	2001	% Chg.	2002	% Chg.	2003	% Chg.	2004	% Chg.	2005	% Chg.	2006E	% Chg.	2007E	% Chg.	2008E	% Chg.
<b>Unit Economics</b>																
Average Unit Volumes	935	(6.7%)	1,056	13.0%	1,274	20.6%	1,361	6.8%	1,406	3.3%	1,452	3.3%	1,501	3.3%	1,525	1.7%
SSS Growth	15.0%	0.0%	17.0%	13.3%	24.4%	43.5%	13.3%	-45.5%	8.7%	-34.6%	6.0%	-31.0%	4.1%	-31.0%	2.9%	(31.0%)
Total Sales (est)	131,331		203,892	55.3%	314,027	54.0%	468,579	49.2%	621,830	32.7%	764,463	22.9%	935,035	22.3%	1,138,882	21.8%
Sales Per Unit (annualized)	742	13.9%	898	21.1%	1,054	17.3%	1,180	12.0%	1,272	7.7%	1,316	3.5%	1,361	3.5%	1,409	3.5%
Sales per unit to AUVs	(20.62%)		(14.94%)		(17.29%)		(13.28%)		(9.56%)		(9.41%)		(9.27%)		(7.65%)	
<b>Units</b>																
Beginning	104		177	70.2%	227	28.2%	298	31.3%	397	33.2%	489	23.2%	581	18.8%	687	18.2%
Additions	73		57	-21.9%	76	33.3%	104	36.8%	80	-23.1%	92	15.0%	106	15.0%	122	15.0%
Closures	0		2		3	50.0%	0		0		0		0		0	
Net Additions	73		55	-24.7%	73	32.7%	104	42.5%	80	-23.1%	92	15.0%	106	15.0%	122	15.0%
Acquisitions/Other	0		(5)		(2)	-60.0%	(5)	150.0%	0		0		0		0	
End of period count (Co Only)	177		227	28.2%	298	31.3%	397	33.2%	489	23.2%	581	18.8%	687	18.2%	808	17.7%
# Franchised	0		5		7		8		8		8		8		8	

Source: The company and Onboard Consulting estimates



### Chipotle - Consolidated Cash Flow Statement

(Dollars in millions. Fiscal year ends Dec)

	2002	% Chg.	2003	% Chg.	2004	% Chg.	2005	% Chg.	2006E	% Chg.	2007E	% Chg.	2008E
<b>Operating activities</b>													
<b>Net Income</b>	<b>(\$17.3)</b>		<b>(\$7.7)</b>		<b>\$20.9</b>	NM	<b>\$68.1</b>	NM	<b>\$46.5</b>	(31.6%)	<b>\$64.2</b>	38.0%	<b>\$96.0</b>
Depreciation and Amortization	\$11.3	29.0%	\$15.1	34.0%	\$21.8	44.5%	\$28.5	30.9%	\$35.7	25.1%	\$44.4	24.3%	\$54.8
Reorganization Charges									\$0.0		\$0.0		\$0.0
Deferred Income Taxes	\$3.5		\$8.0	124.8%	\$11.5	44.1%	\$0.4	(96.3%)	(\$0.3)	(172.6%)	(\$0.2)	(46.1%)	(\$0.1)
Change in Valuation Allowance (or cash back from equity)	\$6.9		\$2.9		(\$2.6)		(\$20.3)		\$14.8		\$19.8		
Contribution to ESOP									0.0		0.0		0.0
Stock Based Compensation					\$0.2		\$1.5	NM	\$11.4	NM	\$16.5	45.3%	\$6.4
<b>Changes in operating assets and liabilities (working capital)</b>	<b>10.8</b>		<b>10.2</b>	(5.4%)	<b>9.1</b>	(11.4%)	<b>6.4</b>	(28.9%)	<b>(7.2)</b>		<b>1.8</b>	(125.3%)	<b>2.9</b>
Accounts receivable	(0.0)		(1.9)	NM	(0.7)	(64.3%)	(0.8)	18.2%	(0.8)	(6.9%)	(0.9)	19.6%	(1.1)
Inventories	(0.2)		(0.4)	123.2%	(0.8)	82.4%	(0.4)	(45.8%)	(0.6)	43.8%	(0.7)	19.6%	(0.9)
Prepaid expenses	(0.4)		(1.1)	195.3%	(1.1)	1.9%	(0.4)	(67.6%)	1.6	NM	(1.6)	(194.3%)	(2.5)
Accounts payable	2.1		5.0	143.6%	(2.3)	(146.5%)	0.9	(138.0%)	(2.5)	NM	(3.0)	19.6%	(3.6)
Deferred Rent	3.3		5.6	70.6%	7.3	29.1%	11.0	51.7%	(5.0)	(145.6%)	6.8	NM	11.8
Other accrued expenses	6.0		3.0	(50.1%)	6.7	124.2%	(3.9)	(157.5%)	0.1	(102.2%)	1.2	NM	(0.8)
Other, Net	1.2		4.5	NM	2.5	(45.0%)	(0.5)	(120.1%)	0.5	(200.0%)	0.0		0.0
<b>Net Cash From Operating Activities</b>	<b>16.4</b>		<b>33.0</b>	101.8%	<b>63.4</b>	91.8%	<b>84.1</b>	32.8%	<b>101.5</b>	20.7%	<b>146.6</b>	44.4%	<b>160.1</b>
<b>Investing activities</b>													
Purchase of PPE	(\$48.6)		(\$86.1)	77.2%	(\$95.6)	11.0%	(\$73.6)	(23.1%)	(\$84.6)	15.0%	(\$97.3)	15.0%	(\$111.9)
Increase in Notes Receivable							0.0		0.0		0.0		0.0
Purchase of securities, net							0		(75)	#DIV/0!	(15)	(80.0%)	(18)
<b>Net Cash from Investing Activities</b>	<b>(48.6)</b>		<b>(86.1)</b>		<b>(95.6)</b>		<b>(73.6)</b>	(23.1%)	<b>(159.6)</b>	117.0%	<b>(112.3)</b>	(29.6%)	<b>(129.9)</b>
<i>Calc Est Capex</i>			<i>\$68,856</i>		<i>\$94,224</i>		<i>\$72,480</i>		<i>\$83,352</i>				
<b>Financing activities</b>													
Long-term Borrowings							0.0		0.0		0.0		0.0
Proceeds from sale and leaseback arrangements									0.0		0.0		0.0
Repayment of long-term debt							(6.1)		0.0	(100.0%)	0.0		0.0
Landlord Financing Proceeds					0.0		2.4		(0.1)	(102.1%)	(2.3)	NM	0.0
Dividends paid							0.0		0.0		0.0		0.0
Purchase of Treasury Stock							0.0		0.0		0.0		0.0
Proceeds from stock options exercised							1.2		37.3	NM	54.2	45.3%	21.1
Proceeds from stock issued	54.8		38.0		64.9		0.0		124.0				
Other	(12.2)		26.1		(9.0)		2.7		2.3		2.0		1.7
<b>Net Cash from Financing Activities</b>	<b>42.6</b>		<b>64.0</b>		<b>55.9</b>		<b>0.2</b>	(99.6%)	<b>163.6</b>	NM	<b>53.8</b>	(67.1%)	<b>22.8</b>
<b>Total net cash flow</b>													
Increase (Decrease) in Cash and Cash Equivalents	\$10.4		\$11.0		\$23.7		\$10.8	(54.4%)	\$105.5	NM	\$88.1	(16.5%)	\$53.0
Cash and Cash Equivalents at Beginning of Period	0.0		0.0		0.0		2.0	#DIV/0!	12.8	NM	118.2	NM	206.4
<b>Cash and Cash Equivalents at End of Period</b>	<b>\$0.0</b>		<b>\$0.0</b>		<b>\$0.0</b>		<b>\$12.8</b>	#DIV/0!	<b>\$118.2</b>	NM	<b>\$206.4</b>	74.5%	<b>\$259.4</b>

3/5/2006

Source: The company and Onboard Consulting estimates.



Chipotle - Consolidated Balance Sheet

(Dollars in millions. Fiscal year ends Dec)

Assets	2002	% Chg.	2003	% Chg.	2004	% Chg.	2005E	% Chg.	2006E	% Chg.	2007E	% Chg.	2008E	% Chg.	2009E	% Chg.
<b>Current Assets</b>																
Cash and cash equivalents			\$0.5		\$0.4		\$12.8	NM	\$118.2	NM	\$206.4	74.5%	\$259.4	25.7%	\$351.2	35.4%
Marketable Securities									75.0		90.0	79.5%	108.0	59.0%	129.6	30.6%
Receivables, net			2.6		2.5		3.3	32.7%	4.1	22.9%	5.0	22.3%	6.1	21.8%	7.3	21.4%
Notes Receivable					0.7		0.0		0.0		0.0		0.0		0.0	
Inventories			1.5		2.3		2.7	19.0%	3.3	22.9%	4.0	22.3%	4.9	21.8%	6.0	21.4%
Prepaid expenses			3.8		4.9		5.2	7.3%	3.6	(31.6%)	5.1	43.6%	7.6	49.4%	10.9	42.7%
<b>Total current assets</b>	<b>20.2</b>	<b>86.9%</b>	<b>8.3</b>	<b>(58.8%)</b>	<b>10.7</b>	<b>28.6%</b>	<b>23.9</b>	<b>123.6%</b>	<b>204.2</b>	<b>NM</b>	<b>310.5</b>	<b>52.1%</b>	<b>386.0</b>	<b>24.3%</b>	<b>505.0</b>	<b>30.8%</b>
Long-term receivables																
Property and equipment, net			211.9		325.3	53.5%	452.1	39.0%	394.3	(12.8%)	472.1	19.7%	608.6	28.9%	780.5	28.3%
Goodwill			26.2		26.2		17.7	(32.4%)	9.2	(47.9%)	4.9	(47.5%)	4.9	0.0%	4.9	0.0%
Deferred income tax asset							2.6		0.0		0.0		0.0		0.0	
Other assets			2.6		2.8		2.8	(0.5%)	3.5	22.8%	4.2	22.2%	5.1	21.7%	6.2	21.3%
<b>Total assets</b>	<b>194.2</b>	<b>32.63%</b>	<b>249.0</b>	<b>28.24%</b>	<b>365.1</b>	<b>46.60%</b>	<b>499.2</b>	<b>36.74%</b>	<b>611.1</b>	<b>22.41%</b>	<b>791.7</b>	<b>29.55%</b>	<b>1,004.6</b>	<b>26.89%</b>	<b>1,296.6</b>	<b>29.07%</b>
<b>Liabilities and Shareholders' Equity</b>																
<b>Current Liabilities</b>																
Current Portion of LTD			14.2		6.1		6.1	(1.2%)	0.0	(100.0%)	0.0	#DIV/0!	0.0	#DIV/0!	0.0	#DIV/0!
Accounts payable			10.0		11.8		10.9	(7.5%)	13.4	22.8%	16.4	22.2%	19.9	21.7%	24.2	21.3%
Accrued employee compensation and benefits			8.0		7.3		10.9	49.0%	8.7	(19.7%)	9.0	2.7%	9.5	6.2%	9.1	(4.7%)
Other accrued expenses			6.0		13.4		9.6	(28.7%)	9.7	0.9%	10.9	12.7%	10.0	(7.8%)	10.2	1.5%
Deferred income taxes			0.0		0.0		0.0		1.1	#DIV/0!	1.5	43.6%	2.3	49.4%	3.3	42.7%
Landlord Financing			0.0		0.0		0.1		2.3	NM	0.0		0.0		0.0	
Short-term obligations			0.0		0.0		0.0		0.0		0.0		0.0		0.0	
<b>Total current liabilities</b>	<b>20.8</b>	<b>39.5%</b>	<b>38.2</b>	<b>83.8%</b>	<b>38.7</b>	<b>1.1%</b>	<b>37.5</b>	<b>(3.1%)</b>	<b>35.2</b>	<b>(6.0%)</b>	<b>37.8</b>	<b>7.3%</b>	<b>41.8</b>	<b>10.7%</b>	<b>46.7</b>	<b>11.8%</b>
Long-term obligations																
Deferred income taxes							0.0		46.1		66.3	43.6%	99.0	49.4%	141.2	42.7%
Capital lease obligations																
Deferred Rent			19.2		28.2	46.7%	39.2	39.0%	34.2	(12.8%)	41.0	19.7%	52.8	28.9%	67.7	28.3%
Deferred Landlord Financing							2.3		0.0		0.0		0.0		0.0	
Other liabilities			0.0		0.2		0.5	166.3%	0.6	22.8%	0.8	22.2%	0.9	21.7%	1.1	21.3%
<b>Total Liabilities</b>	<b>32.9</b>	<b>45.0%</b>	<b>57.5</b>	<b>74.6%</b>	<b>67.1</b>	<b>16.7%</b>	<b>79.6</b>	<b>18.6%</b>	<b>82.0</b>	<b>3.0%</b>	<b>104.8</b>	<b>27.9%</b>	<b>141.7</b>	<b>35.2%</b>	<b>189.1</b>	<b>33.4%</b>
<b>Shareholders' equity</b>																
<b>Total Shareholders' Equity</b>	<b>161.3</b>	<b>30.4%</b>	<b>191.5</b>	<b>18.8%</b>	<b>298.0</b>	<b>55.6%</b>	<b>419.6</b>	<b>40.8%</b>	<b>529.1</b>	<b>26.1%</b>	<b>686.9</b>	<b>29.8%</b>	<b>862.8</b>	<b>25.6%</b>	<b>1,107.4</b>	<b>28.4%</b>
<b>Total Liabilities and Shareholders' Equity</b>	<b>194.2</b>	<b>32.63%</b>	<b>249.0</b>	<b>28.24%</b>	<b>365.1</b>	<b>46.60%</b>	<b>499.2</b>	<b>36.74%</b>	<b>611.1</b>	<b>22.40%</b>	<b>791.7</b>	<b>29.56%</b>	<b>1,004.6</b>	<b>26.89%</b>	<b>1,296.6</b>	<b>29.07%</b>

3/5/2006

Source: Company reports and Onboard Consulting estimates.



## Chipotle - Ratio Analysis

(Dollars in millions, except per-share data. Fiscal year ends Dec)

	2003	2004	2005	2006E	2007E	2008E
<b>Liquidity Measures</b>						
Current ratio (CA/CL)	0.22x	0.28x	0.64x	5.80x	8.22x	9.23x
Quick ratio (CA - inventory/ CL)	0.18x	0.22x	0.57x	5.70x	8.11x	9.12x
Cash ratio (cash/CL)	0.01x	0.01x	0.34x	3.36x	5.46x	6.20x
<b>Financial Leverage Measures</b>						
Debt/capitalization	6.9%	2.0%	1.4%	0.0%	0.0%	0.0%
Adj. debt/adj. capitalization (1)	50.6%	46.7%	43.5%	41.6%	39.3%	37.8%
Adj. debt/EBITDAR	6.6x	4.4x	3.0x	2.6x	2.3x	2.0x
Interest coverage (EBIT/interest)	(35.90)	305.30x	6.90x	8.97x	23.60x	29.62x
Fixed expense coverage (1/3 rent)	(0.06)	1.58x	2.83x	3.53x	5.22x	6.43x
<b>Asset Utilization Measures</b>						
Asset turnover (sales/assets) (2)	1.42x	1.53x	1.44x	1.38x	1.34x	1.27x
X Net margin (net income/sales)	(2.44%)	3.60%	7.45%	6.07%	6.85%	8.41%
= Return on assets (ROA)	-3.5%	5.5%	10.8%	8.4%	9.2%	10.7%
X Financial leverage (assets/equity)	1.30x	1.23x	1.19x	1.16x	1.15x	1.16x
= Return on equity (ROE)	-4.5%	6.8%	12.8%	9.7%	10.6%	12.4%
<b>Return on invested capital (ROIC,3)</b>	<b>1.9%</b>	<b>7.4%</b>	<b>11.2%</b>	<b>7.5%</b>	<b>7.2%</b>	<b>7.7%</b>
<b>Turnover and other metrics</b>						
Receivable turnover (sales/average receiv	242.2x	184.8x	215.5x	208.2x	207.6x	207.1x
Receivable days on hand	1.5	2.0	1.7	1.8	1.8	1.8
Advertising as percent of company sales	2.0%	1.9%	1.6%	1.4%	1.3%	1.2%
<b>Per-Share Measures</b>						
Earnings - continuing	(\$0.50)	\$0.82	\$2.02	\$1.27	\$1.74	\$2.58
EBIT	(\$0.51)	\$0.24	\$1.21	\$1.78	\$2.70	\$4.03
EBITDA	\$0.46	\$1.09	\$2.01	\$2.64	\$3.72	\$5.24
Book value	\$12.31	\$11.68	\$12.44	\$14.47	\$18.64	\$23.22
Cash (end of period)	\$0.00	\$0.00	\$0.38	\$3.23	\$5.60	\$6.98
Free cash flow (FCF)	(\$4.21)	(\$1.81)	\$0.34	\$0.52	\$1.51	\$1.52
<b>Valuation Metrics (Year End)</b>						
FCF yield	NM	NM	0.77%	1.12%	3.01%	2.73%
Dividend yield	NM	NM	0.00%	0.00%	0.00%	0.00%
Price to earnings (PE) ratio	NM	NM	31.9x	38.9x	32.0x	24.3x
PE to earnings growth (PEG) ratio	NM	NM	5.44x	0.94x	0.71x	0.62x
1yr Forward P/E Est	NM	NM	34.6x	28.4x	21.6x	17.1x
<b>Enterprise value/EBITDA</b>	<b>NM</b>	<b>NM</b>	<b>21.78x</b>	<b>17.50x</b>	<b>13.45x</b>	<b>10.63x</b>
<b>Adjusted enterprise value/EBITDA</b>	<b>NM</b>	<b>NM</b>	<b>26.45x</b>	<b>21.39x</b>	<b>16.70x</b>	<b>13.32x</b>

(1) Adjusted debt equals total debt plus 8 times rental expense.

(2) Reflects the average account on the balance sheet (beginning + ending/2).

(3) ROIC equals net operating income plus after tax rent and interest expenses divided by average total adjusted capital.

Source: The company and Onboard Consulting estimates.



**Chipotle DCF Model**

(Dollars in millions, except per-share data.)

	2002	2003	2004	2005	2006E	2007E	2008E	2009E	2010E	2011E
Total Revenues	\$204.65	\$315.52	\$470.72	\$624.22	\$766.85	\$937.42	\$1,141.22	\$1,141.22	\$1,384.65	\$1,675.25
Food, Beverage and Packaging Cost:	67.7	104.9	154.1	204.6	251.5	309.2	378.2	378.2	460.6	559.1
Labor Costs	66.5	94.0	139.5	172.9	206.4	243.4	285.6	285.6	333.6	388.2
Occupancy Costs	18.7	25.6	36.2	46.0	54.8	63.8	74.5	74.5	87.0	101.4
Other Operating Costs	29.8	43.5	64.3	79.2	92.6	107.4	123.7	123.7	141.6	160.9
<b>Restaurant Operating Profit</b>	<b>\$21.94</b>	<b>\$47.48</b>	<b>\$76.62</b>	<b>\$121.52</b>	<b>\$161.52</b>	<b>\$213.57</b>	<b>\$279.27</b>	<b>\$279.27</b>	<b>\$361.93</b>	<b>\$465.75</b>
General and Administrative	25.8	34.2	44.8	49.6	61.0	72.1	79.9	79.9	88.4	97.7
Depreciation and Amortization	11.3	15.1	21.8	27.2	31.8	37.8	44.9	44.9	53.5	63.2
Preopening Costs	1.0	1.6	2.2	1.7	1.9	2.2	2.5	2.5	2.9	3.3
Loss on Disposal of Assets	1.5	4.5	1.7	2.4	2.0	2.1	2.2	2.2	2.3	2.4
<b>Operating Income</b>	<b>-\$17.63</b>	<b>-\$7.94</b>	<b>\$6.11</b>	<b>\$40.64</b>	<b>\$64.89</b>	<b>\$99.38</b>	<b>\$149.72</b>	<b>\$149.72</b>	<b>\$214.77</b>	<b>\$299.06</b>
Op Lease Interest (Implied @ 30%)	4.9	6.8	9.6	11.9	14.1	16.7	19.6	23.0	27.0	31.4
Change in Deferred Taxes	3.5	8.0	11.5	0.4	-0.3	-0.2	-0.1	-0.1	0.0	0.1
Increase of Bad Debt Reserve										
<b>EBITDA</b>	<b>-\$9.17</b>	<b>\$6.86</b>	<b>\$27.15</b>	<b>\$52.94</b>	<b>\$78.70</b>	<b>\$115.91</b>	<b>\$169.24</b>	<b>\$172.64</b>	<b>\$241.67</b>	<b>\$330.56</b>

Addback	Income Tax Expense	0.0	0.0	0.0	0.0	25.6	39.4	58.8	83.9	116.4	158.0
	R Savings	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	Lease Savings	6.2	8.6	12.1	15.0	17.9	21.1	24.9	29.2	34.1	39.8
	Change in Deferred Taxes	3.5	8.0	11.5	0.4	-0.3	-0.2	-0.1	-0.1	0.0	0.1
	<b>Cash Taxes</b>	<b>\$9.78</b>	<b>\$16.61</b>	<b>\$23.59</b>	<b>\$15.47</b>	<b>\$43.17</b>	<b>\$60.34</b>	<b>\$83.57</b>	<b>\$112.98</b>	<b>\$150.50</b>	<b>\$197.93</b>

Depreciation and Amortization	11.3	15.1	21.8	28.5	35.7	44.4	54.8	67.5	82.8	101.2
Change in Working Capital	10.8	10.2	9.1	6.4	-7.2	1.8	2.9	5.2	7.3	9.6
CapEx	-48.6	-86.1	-95.6	-73.6	-84.6	-97.3	-111.9	-128.6	-147.9	-170.1
<b>FCF</b>	<b>-\$45.48</b>	<b>-\$70.55</b>	<b>-\$61.20</b>	<b>-\$1.10</b>	<b>-\$20.52</b>	<b>\$4.47</b>	<b>\$31.60</b>	<b>\$3.74</b>	<b>\$33.34</b>	<b>\$73.33</b>
<b>PV CF</b>					<b>-\$20.52</b>	<b>\$4.16</b>	<b>\$27.30</b>	<b>\$3.00</b>	<b>\$24.89</b>	<b>\$50.87</b>

**Chipotle Economic Profit Moe**

(Equals PV of projected profit+Invested Capital)

(Dollars in millions, except per-share data.)

Per Share Value

	2002	2003	2004	2005	2006E	2007E	2008E	2009E	2010E	2011E	WACC	
Net working Capital	(\$0.59)	(\$29.90)	(\$27.95)	(\$13.52)	\$168.94	\$272.70	\$344.18	\$458.26	\$609.80	\$810.57	10 yr Treasury	4.7%
Net PP&E	0.0	211.9	325.3	452.1	394.3	472.1	608.6	780.5	1,002.4	1,286.2	Bond Spread	0.6%
Deferred Tax Lia (expect to increase in future)	0.0	0.0	0.0	0.0	0.0	47.2	67.8	101.3	144.5	200.4	Tax rate	42.6%
Other Assets	0.0	28.8	29.1	20.6	12.7	9.1	10.0	11.1	12.4	14.0	Cost of debt	3.0%
Non-recurring Charges	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	Adj. Debt/Cap	41.6%
LIFO Reserve	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	Beta	0.56
Bad Debt Reserve		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	Risk premium	6.3%
PV of Op Leases	16.4	22.7	31.9	39.6	47.1	55.6	65.5	76.8	89.8	104.8	Market Risk	11.0%
<b>Invested Capital</b>	<b>\$15.82</b>	<b>\$233.52</b>	<b>\$358.26</b>	<b>\$498.75</b>	<b>\$622.94</b>	<b>\$856.69</b>	<b>\$1,096.01</b>	<b>\$1,427.94</b>	<b>\$1,858.96</b>	<b>\$2,415.98</b>	Treasury	4.7%
<b>Economic Profit</b>	<b>-\$18.94</b>	<b>-\$9.75</b>	<b>\$3.56</b>	<b>\$37.47</b>	<b>\$35.53</b>	<b>\$55.57</b>	<b>\$85.67</b>	<b>\$59.66</b>	<b>\$91.17</b>	<b>\$132.63</b>	Cost of equity	10.8%
											<b>WACC</b>	<b>7.6%</b>

<b>Net Invested Capital</b>					-11.7	-9.4	2.5	-48.7	-49.9	-50.7	<b>Stock Price</b>	<b>\$45.48</b>
<b>PV</b>					-11.7	-8.8	2.2	-39.1	-37.2	-35.1		

EV Summary	
PV of Operations	<b>\$1,878*</b>
Equity	<b>\$623</b>
Net Debt (Adj.)	<b>\$190</b> (Includes capitalized operating leases)
<b>Enterprise Value</b>	<b>\$2,311</b>

**\$63 Per Share**

Source: The company and Onboard Consulting estimates

### Disclosures

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#### Reg AC, Analyst Certification

I, Kelly C. Peebles, hereby certify that all the views expressed in this review, accurately reflect my personal views about the subject Company or companies and its, or their, securities. No part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views contained in this review.

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Company	3.3.2006	Initiation Price	12-month Target Price
IHOP Corporation (IHOP)	\$51.25	\$47.35	\$46
Chipotle (CMG)	\$45.48	\$45.48	\$53

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Ranking	Definition
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Distribution of Rankings Breakdown

	Buy	Neutral	Sell
<b>Companies</b>	50 %	50%	0%

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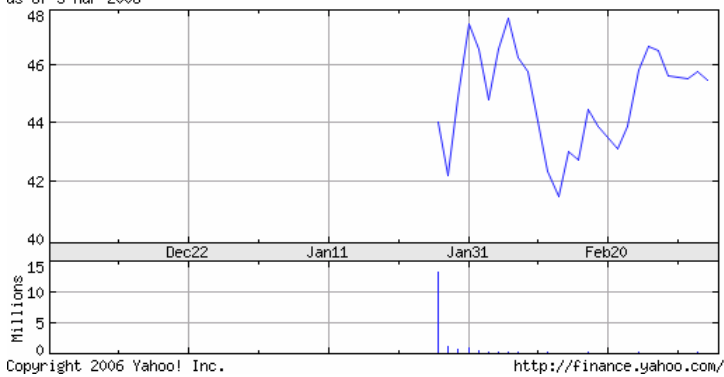
**IHP**



Initiation 12-26-2005	"Hold" 12-26-2005			
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## CMG

CHIPOTLE MEXICAN GRILL INC  
as of 3-Mar-2006



Initiation 3-3-2006	"Buy" 3-3-2006			
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For more information, contact  
us at:

[info@onboardconsulting.org](mailto:info@onboardconsulting.org)

Contact Information:

Kelly Peebles

[kp@onboardconsulting.org](mailto:kp@onboardconsulting.org)

404-285-7197

