

Restaurants

**Chipotle Mexican Grill
(CMG) - BUY**

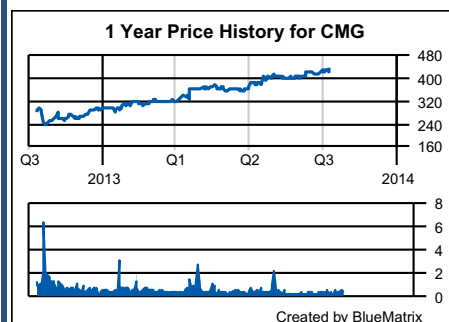
Price: **\$435.87**
Fair Value Estimate: \$525.00
52-Week Range: \$233.82-\$436.95
Market Cap (MM): \$13,455
Shr.O/S-Diluted (mm): 30.9
Average Daily Volume: 342,560

FYE: Dec 2012A 2013E 2014E
Revenue (M): \$2,731.2A \$3,180.7E \$3,662.6E

Quarterly Revenue (M):
Q1 \$640.6A \$726.8A --
Q2 \$690.9A \$816.8A --
Q3 \$700.5A \$820.2E --
Q4 \$699.2A \$816.9E --

FYE: Dec 2012A 2013E 2014E
EPS: \$8.75A \$10.55E \$13.00E
Prior EPS: \$10.17 \$12.45

Quarterly EPS:
Q1 \$1.97A \$2.35A --
Q2 \$2.56A \$2.82A --
Q3 \$2.27A \$2.80E --
Q4 \$1.95A \$2.58E --



CMG: UPGRADING TO BUY & DREAMING OF BREAKFAST BURRITOS

INVESTMENT CONCLUSION:

We rate shares of Chipotle Mexican Grill a Buy due to: (1) long-term opportunities to expand into the breakfast daypart, (2) a solid near-term same-store sales outlook, (3) the possibility that commodity costs in general could start to come down at some point in 2014-15, disproportionately helping 100% company-owned restaurant companies such as Chipotle, and (4) continued admiration for the Chipotle's "food with integrity" approach to its business. The main risk remains a relatively high valuation compared to most other restaurant stocks we cover.

KEY POINTS:

- Chipotle indicates that it currently has no plans to roll out a breakfast business nationally. And we do not doubt that is indeed the case. But, we are paid to peer into the future using our handy-dandy crystal ball, and what we see when we look inside is: delicious breakfast burritos.
- To us, by far the most compelling reason for Chipotle to test coffee for what may eventually evolve into a national rollout, is because at some point down the road it makes sense for Chipotle to test breakfast.
- Based on conversations with numerous industry sources, we raise our Q3 same-store sales forecast by +80 basis points, to +5.8%. According to Consensus Metrix, this places us as the high forecast on the sell-side. Consensus Metrix is at +4.6%.
- If commodity costs in general come down in 2014 and/or beyond, there could be sizable upside to existing long-term Street EPS expectations.
- We believe that Chipotle will continue to remain a standout concept in years to come from a customer standpoint due to this "food with integrity" approach, one benefit of which is – in our view – better-tasting food.
- Our 2013 EPS estimate rises by 38 cents, to \$10.55. Our 2014 EPS estimate rises by 55 cents, to \$13.00. We take up our fair value estimate for CMG to \$525.

KEY POINTS

We upgrade Chipotle Mexican Grill (CMG) to Buy from Neutral. Our upgrade centers on four main factors: (1) we believe the odds have meaningfully increased that Chipotle could test breakfast, perhaps eventually leading to a meaningful (national?) launch of that daypart down the road, (2) our channel-checking process suggests that the fast-casual sector's same-store sales in general remained fairly solid during Q3, suggesting Chipotle should at least meet the Q3 Consensus Metrix same-store sales figure of +4.6% when the company reports Q3 after the market close on Thursday, October 17th, (3) with prices for grains coming down, this might lead to lower commodity costs over 2014-15 (or at least less of a rise in commodity costs), which would disproportionately help restaurant companies with 100% company-owned systems such as Chipotle, and (4) continued operational excellence including great tasting food. The main risk to CMG remains valuation. We note the following:

BRIEF OVERVIEW OF ESTIMATE CHANGES

With this note, we update various estimates as follows:

- * Q3 same-store sales forecast rises by +80 basis points to a "sell-side high" +5.8%
(note: Consensus Metrix is at +4.6%)
- * Q3 EPS estimate rises by 20 cents, to \$2.80 (three cents above First Call consensus)
- * Q3 same-store sales forecast rises by +60 basis points to a "sell-side high" +6.6%
(note: Consensus Metrix is at +5.1%)
- * Q4 EPS estimate rises by 18 cents, to \$2.58 (three cents above First Call consensus)
- * Full-year 2013 EPS estimate rises by 38 cents, to \$10.55
- * Full-year 2014 EPS estimate rises by 55 cents, to \$13.00 (note: +23.2% year/year growth)
- * Fair value estimate goes up to \$525

ANY EVENTUAL ANNOUNCEMENT OF BREAKFAST COULD HELP THE STOCK

Chipotle indicates that it currently has no plans to roll out a breakfast business nationally. And we do not doubt that is indeed the case. But, **we are paid to peer into the future using our handy-dandy crystal ball, and what we see when we look inside is: delicious breakfast burritos.** (Unfortunately, the date of the receipt we see inside of our crystal ball is fuzzy... so we are making no call on when a breakfast test or meaningful breakfast rollout might happen. Might be next year. Might be ten years from now. Who knows.)

We believe the odds of a breakfast test and eventual meaningful rollout of breakfast has become more likely because Chipotle recently started testing coffee in one of its Washington D.C. units... here is what we noted in our CMG note dated September 20th:

According to the philly.eater.com website, Chipotle Mexican Grill (CMG; Neutral) has quietly started a coffee test in one of its Washington D.C. units. The coffee involved is from Philadelphia-based La Colombe, whose coffee is already featured in fine-dining restaurants such as Daniel in New York City. According to the website, Chipotle is "going to continue to flesh out the [coffee] program, adding espresso drinks, and the cold-brewed Pure Black. Once all of the wrinkles have been ironed out at the point of service and sourcing is consistent, the rest of the universe will start to see La Colombe in their local Chipotle storefronts." We also ponder over whether this could be the beginnings of a potential wider breakfast rollout for Chipotle, which at present -- to the best of our knowledge -- only opens for breakfast in two airport locations, and only serves breakfast items at one of those two sites.

For more information, please click on the following link:

<http://philly.eater.com/archives/2013/09/18/la-colombe-is-available-at-chipotle-in-dc.php>

To us, by far the most compelling reason for Chipotle to test coffee for what may eventually evolve into a national rollout, is because at some point down the road it makes sense for Chipotle to test breakfast.

CHIPOTLE MEXICAN GRILL – COFFEE AT ONE UNIT IN D.C.



Source: <http://philly.eater.com/archives/2013/09/18/la-colombe-is-available-at-chipotle-in-dc.php> (retrieved on October 10, 2013)

What might breakfast at Chipotle look like? Our current understanding is that two (and just two, to the best of our knowledge) Chipotles are open during breakfast hours – each of which are at airport locations. One of these airport units open during breakfast hours serves Chipotle’s usual menu items (i.e., no specific breakfast items available at this location). But the other Chipotle unit open during breakfast hours – in BWI airport just outside of Baltimore – does serve breakfast items. Some photos of this – posted at the dictailgate.com website on June 16, 2013 -- follow:

CHIPOTLE MEXICAN GRILL – BREAKFAST AT BWI AIRPORT PHOTO #1 OF 4



Note: photo posted at source website on June 16, 2013.

Source: <http://www.dictailgate.com/wordpress/?cat=11> (retrieved on October 10, 2013)

CHIPOTLE MEXICAN GRILL – BREAKFAST AT BWI AIRPORT PHOTO #2 OF 4



Note: photo posted at source website on June 16, 2013.

Source: <http://www.dictailgate.com/wordpress/?cat=11> (retrieved on October 10, 2013)

CHIPOTLE MEXICAN GRILL – BREAKFAST AT BWI AIRPORT PHOTO #3 OF 4



Note: photo posted at source website on June 16, 2013.

Source: <http://www.dictailgate.com/wordpress/?cat=11> (retrieved on October 10, 2013)

CHIPOTLE MEXICAN GRILL – BREAKFAST AT BWI AIRPORT PHOTO #4 OF 4



Note: photo posted at source website on June 16, 2013.

Source: <http://www.dictailgate.com/wordpress/?cat=11> (retrieved on October 10, 2013)

The source of the previous four photographs – the dictailgate.com website – comments: “... take a look at the limited line-up on the second incarnation of Chipotle Airport Breakfast... Right off the bat you will see that the options are two-fold: **Vegetable and Chorizo Frittata**. This is a far different offering from the full spread of original meats and additional breakfast items we saw at Dulles. The two Frittata styles are cubed and placed in the serving trays behind the beans where you would normally see grilled veggies and barbacoa. I went with the Chorizo bowl and added the only other breakfast specific topping: **Ranchero salsa**.”

Incidentally, the Wikipedia definition for frittata is “an egg-based dish similar to an omelette or crustless quiche, enriched with additional ingredients such as meats, cheeses, vegetables, or pasta.” (Source: <http://en.wikipedia.org/wiki/Frittata>)

RAISING Q3 SAME-STORE SALES FORECAST TO SELL-SIDE HIGH +5.8%

Based on conversations with numerous industry sources, we raise our Q3 same-store sales forecast by +80 basis points, to +5.8%. According to Consensus Metrix, this places us as the high forecast on the sell-side. Consensus Metrix is at +4.6% with 20 different sell-side estimates comprising this figure.

Our updated +5.8% forecast for Q3 comps looks achievable -- but admittedly is no slam dunk. If Chipotle’s Q3 same-store sales do fall somewhat light of our updated projection, we still believe upgrading the stock is the right thing to do today, for all of the other reasons outlined in this note. That said, there appears to be a decent chance of beating Q3 consensus. Our sources suggest to us that the fast-casual segment in general enjoyed a slightly better August than July, and a slightly better September than August. And, fast-casual remains – with the possible exception of fine dining, which is relatively less driven by consumer spending, and relatively more driven by expense-account business – the top performing major sector of the U.S. chain restaurant industry in terms of quarterly same-store sales, according to our industry sources.

Chipotle Mexican Grill is the nation’s second-largest fast-casual chain, with over \$2.7 billion in annual U.S. systemwide sales, trailing only **Panera Bread (PNRA; Not Rated)** and its \$3.7 billion in U.S. systemwide sales. It stands to reason that if the fast-casual category is holding in relatively well, the odds favor that Chipotle Mexican Grill is at least holding in well, too.

CHIPOTLE MEXICAN GRILL -- SAME-STORE SALES, 1998-2014E

	Q1	Q2	Q3	Q4	FY
2014E	2.0%	2.0%	2.0%	2.0%	2.0%
2013E	1.0%A	5.5%A	5.8%	6.6%	4.7%
2012	12.7%	8.0%	4.8%	3.8%	7.3%
2011	12.4%	10.0%	11.3%	11.1%	11.2%
2010	4.3%	8.7%	11.4%	12.6%	9.4%
2009	2.2%	1.7%	2.7%	2.0%	2.2%
2008	10.2%	7.1%	3.1%	3.5%	5.8%
2007	8.3%	11.6%	12.4%	10.6%	10.8%
2006	19.7%	14.5%	11.6%	10.1%	13.7%
2005	4.1%	9.6%	11.5%	14.3%	10.2%
2004	23.2%	13.2%	8.9%	10.4%	13.3%
2003	25.3%	24.6%	24.7%	23.4%	24.4%
2002	16.8%	18.8%	15.5%	17.0%	17.0%
2001					22.5%
2000					16.4%
1999					27.1%
1998					14.9%

A Actual. E Estimate. Source: Company reports and Janney Capital Markets

CHIPOTLE MEXICAN GRILL -- JANNEY'S FULL SAME-STORE SALES TRACK RECORD

Quarter	Janney Forecast	Chipotle Actual	Difference
Q4 2013	6.6%**	???	???
Q3 2013	5.8%**	???	???
Q2 2013	3.5%	5.5%	2.0%
Q1 2013	1.5%	1.0%	-0.5%
Q4 2012	4.0%	3.8%	-0.2%
Q3 2012	5.0%	4.8%	-0.2%
Q2 2012	10.0%	8.0%	-2.0%
Q1 2012	11.5%	12.7%	1.2%
Q4 2011	10.5%	11.1%	0.6%
Q3 2011	11.6%**	11.3%	-0.3%
Q2 2011	10.5%	10.0%	-0.5%
Q1 2011	11.5%**	12.4%	0.9%
Q4 2010	10.0%	12.6%	2.6%
Q3 2010	9.1%	11.4%	2.3%

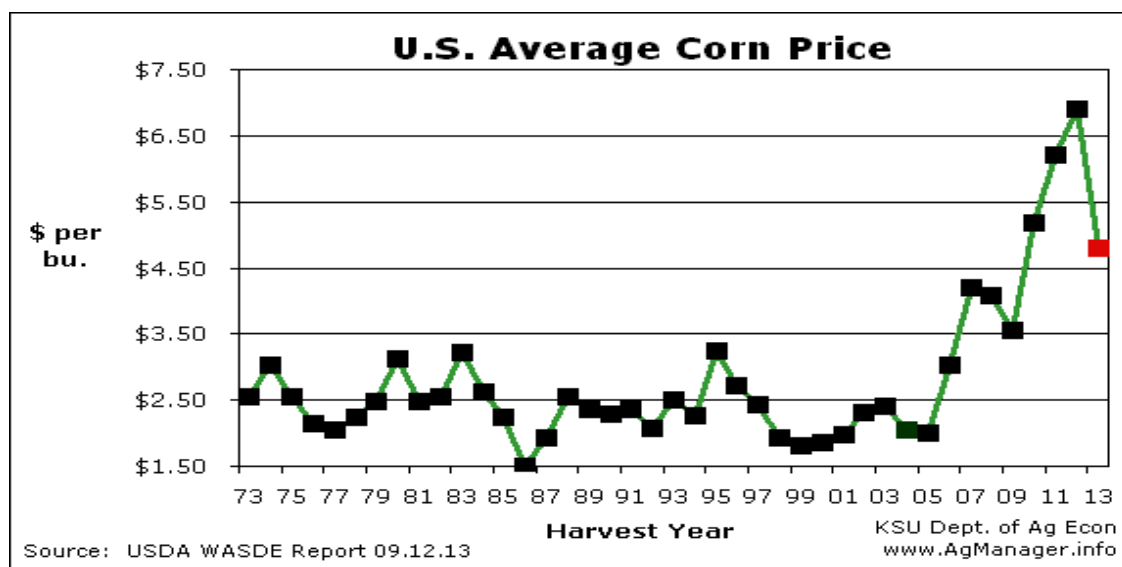
** High forecast on the sell-side.

Source: Company reports, Consensus Metrix, and Janney Capital Markets

GRAIN PRICES SUBSIDING... DOES THIS MEAN CHIPOTLE'S FOOD COSTS COULD GO DOWN OVER 2014-15?

In general, grain prices are coming down from their peaks. One example is corn, as shown in the following graph:

CORN – U.S. ANNUAL AVERAGE ANNUAL PRICE, 1973-2013



Source: <http://www.agmanager.info/livestock/marketing/graphs/Crops/Corn/U.S.AvgCornPr.htm>
(retrieved on October 10, 2013)

Generally speaking, as grain prices come down, this is usually good for other commodity costs such as beef and poultry. Chipotle Mexican Grill is a 100% company-owned company, with no franchised restaurants. Should we happen to enter an era of declining commodity costs at any point over the next 12-24 months, restaurant companies with a 100% (or close to 100%) company-owned approach should generally receive more benefits to their bottom line than a highly-franchised restaurant company. This is simply because at any franchised restaurant, it is the franchisee that pays for the food costs of the unit, not the franchisor.

Perhaps Chipotle's 2014-15 food, beverage, and packaging costs as a percentage of revenues can come down from the 2013 level. For 2013, we project that this will be 33.0%. We note that Chipotle's best year in this regard was 2010, in which food, beverage, and packaging costs as a percentage of revenues amounted to 30.6%. For 2014, we forecast ten basis points of improvement, to 32.9%. We calculate that for every ten basis points difference from this projection, Chipotle's annual EPS changes by about 7.2 cents. The following table shows how Chipotle's 2014 EPS would change under this assumption, under various scenarios for food, beverage, and packaging costs as a percentage of revenues:

CHIPOTLE MEXICAN GRILL – 2014E EPS SENSITIVITY ANALYSIS

Food, Beverage, and Packaging Costs as a Percentage of Revenues, 2014E	Estimated Effect on 2014E EPS, All Else Equal	Our 2014E EPS Estimate Under This Scenario, All Else Equal
30.6%	\$1.66	\$14.66
31.0%	\$1.37	\$14.37
31.5%	\$1.01	\$14.01
32.0%	\$0.65	\$13.65
32.5%	\$0.29	\$13.29
32.9%	none	\$13.00
33.5%	-\$0.43	\$12.57
34.0%	-\$0.79	\$12.21
34.5%	-\$1.15	\$11.85
35.0%	-\$1.51	\$11.49

Source: Company reports and Janney Capital Markets

We DO NOT expect Chipotle's 2014 food, beverage, and packaging costs to be at (or even near) the company's all-time best annual showing of 30.6% of revenues. That said, we do believe it enlightening to understand that – all else equal – our 2014 EPS estimate would be \$1.66 higher, and \$14.66, if we were to incorporate a 30.6% projection as our forecast for that line item. **If commodity costs in general come down in 2014 and/or beyond, there could be sizable upside to existing long-term Street EPS expectations.**

CHIPOTLE MEXICAN GRILL – FOOD, BEVERAGE, AND PACKAGING COSTS AS A PERCENTAGE OF REVENUES, 2000-14E

Year	Food, Beverage, and Packaging Costs as a Percentage of Revenues
2014E	32.9%
2013E	33.0%
2012	32.6%
2011	32.5%
2010	30.6%
2009	30.7%
2008	32.4%
2007	31.9%
2006	31.4%
2005	32.2%
2004	32.7%
2003	33.3%
2002	33.1%
2001	34.4%
2000	35.3%

Source: Company reports and Janney Capital Markets

“FOOD WITH INTEGRITY”

We believe that Chipotle will continue to remain a standout concept in years to come from a customer standpoint due to this “food with integrity” approach, one benefit of which is – in our view – better-tasting food. Some favorable comments we published back in our August 3, 2010 CMG initiation report about Chipotle’s “food with integrity” approach continue to hold true today:

“One of the key reasons for Chipotle’s success to date is its approach incorporating “food with integrity.” Essentially, the food quality (including the ingredient quality and the cooking techniques) at Chipotle far surpasses that which would typically be encountered at most quick-service restaurant chains. In our view, the exceptional food quality at Chipotle will continue to attract a much wider customer base in coming years. The tasty food also accounts for the phenomenon we’ve seen: customer lines at several Chipotle outlets are consistently longer than the lines we’ve seen at any other quick-service restaurant concept with which we are familiar. This is testament to the “gourmet restaurant where you eat with your hands” experience that Chipotle offers.

“Founder, Chairman, and co-CEO Steve Ells is a classically-trained chef, having graduated from the Culinary Institute of America (located in Hyde Park, New York, the CIA is regarded by many knowledgeable folks as the most prestigious cooking school in the U.S.) and having worked at Stars, Jeremiah Tower’s highly-regarded fine dining restaurant in San Francisco. (In fact, in a January 1999 interview with *Nation’s Restaurant News*, Ells proclaimed ‘When other kids were watching television cartoons while growing up... I was watching cooking shows, like

Julia Child. I loved that kind of stuff.’ Also, in a January 2004 interview with *Nation’s Restaurant News*, Mr. Ells commented that ‘Under Jeremiah Tower and [chef] Mark Franz, I really learned how to taste and really learned how to cook.’) We believe that someone with his background is much more likely to display a level of attention to detail that is usually not found within the quick-service restaurant segment. As such, as *Nation’s Restaurant News* notes, Ells’ ‘deep appreciation for fresh ingredients, classic culinary technique, and a sharp-edged contemporary atmosphere’ help Chipotle stand out from its rivals.”

We encourage those of you interested in learning more about our general thoughts regarding the Chipotle Mexican Grill concept from a customer standpoint to access our CMG initiation report, which we believe remains available through the following link:

<https://jms.bluematrix.com/docs/pdf/1b19031d-78d7-46b0-b64f-3ef3bc6ff6ac.pdf>

THE MAIN RISK REMAINS VALUATION

As of this writing, CMG is up by about +46% year-to-date – and we had been at a Neutral rating, until today. Our main concern during the time we had a Neutral on CMG remains our main concern about CMG now that we are at a Buy: valuation.

At a stock price of about \$435, CMG trades at 33.5x our updated 2014 EPS estimate of \$13.00. On a 2014E firm value-to-EBITDA basis, the multiple is about 16.5x.

Should the market in general take a dive, Chipotle could take an even worse dive as a high-beta stock (and as it may be more susceptible to multiple compression in this type of market scenario). And, should Chipotle happen to miss consensus same-store sales and/or consensus earnings forecasts, the stock could also nosedive quite hard, given its status as a relatively high multiple stock. Investors in CMG should be highly aware of these risks.

That said... here are the current 2014E firm value-to-EBITDA multiples for several of our covered companies. CMG seems to be a relative bargain compared to most once its unit growth rate is taken into account, and it should also generally provide above-average same-store sales gains, too.

SELECTED RESTAURANT STOCKS – FIRM VALUE-TO-EBITDA, 2014E

Company Name	Ticker Symbol	Janney Rating	Unit Growth, 2014E	EPS Growth, 2014E	Firm Value -to- EBITDA, 2014E
Cheesecake Factory	CAKE	Neutral	4.9%	12.7%	8.0
Chipotle Mexican Grill	CMG	Buy	12.9%	23.2%	16.5
Domino's Pizza	DPZ	Neutral	3.8%	12.7%	14.2
Dunkin' Brands	DNKN	Buy	3.9%	17.1%	15.3
Krispy Kreme	KKD	Buy	9.3%	14.4%	28.3
Starbucks	SBUX	Buy	7.1%	21.4%	19.5
Wendy's	WEN	Buy	1.9%	18.5%	11.6

* Statistics for Krispy Kreme Doughnuts correspond to its fiscal 2015. Krispy Kreme Doughnuts' fiscal year ends in January.

** Statistics for Starbucks correspond to its fiscal 2014. Starbucks' fiscal year ends in September.

Source: Company reports and Janney Capital Markets

Company Description

Chipotle Mexican Grill, Inc. and its subsidiaries operate fast casual dining restaurants, which serve a focused menu of burritos, tacos, burrito bowls and salads, made using fresh ingredients. As of December 31, 2012, the company operated 1,410 restaurants, including Chipotle restaurants throughout the United States, as well as five in Canada, five in London, England, and one in Paris, France, and also one ShopHouse Southeast Asian Kitchen, a restaurant in Washington, D.C. serving Asian-inspired cuisine. The company focuses on trying to find the highest quality ingredients to make great tasting food; on recruiting and retaining top performing people to ensure that the restaurant experience provided is exceptional; on building restaurants that are operationally efficient and aesthetically pleasing; and on doing all of this with increasing awareness and respect for the environment. The company was founded in 1993 and is based in Denver, Colorado.

IMPORTANT DISCLOSURES

Research Analyst Certification

I, Mark Kalinowski, the Primarily Responsible Analyst for this research report, hereby certify that all of the views expressed in this research report accurately reflect my personal views about any and all of the subject securities or issuers. No part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views I expressed in this research report.

Janney Montgomery Scott LLC ("Janney") Equity Research Disclosure Legend

Janney Montgomery Scott LLC currently acts as a market-maker in the securities of Chipotle Mexican Grill.

Janney Montgomery Scott LLC intends to seek or expects to receive compensation for investment banking services from Chipotle Mexican Grill in the next three months.

The research analyst is compensated based on, in part, Janney Montgomery Scott's profitability, which includes its investment banking revenues.

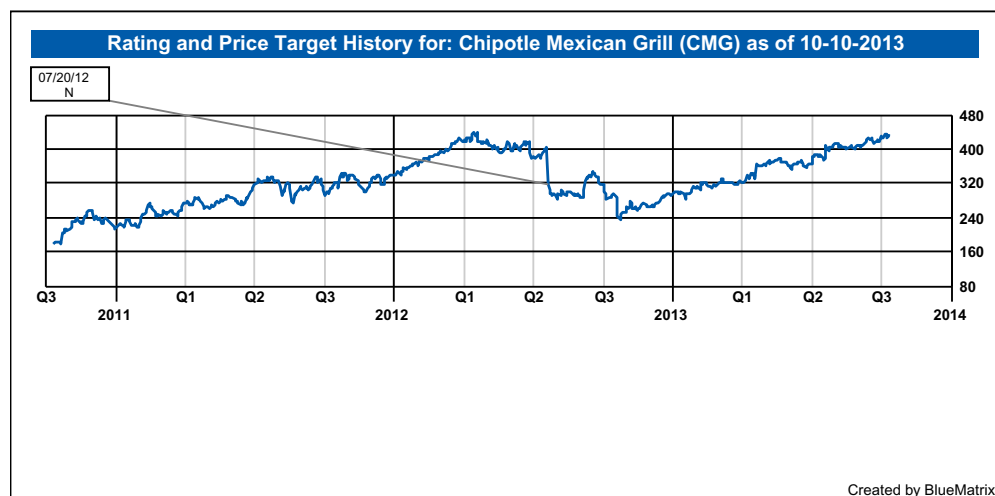
Definition of Ratings

BUY: Janney expects that the subject company will appreciate in value. Additionally, we expect that the subject company will outperform comparable companies within its sector.

NEUTRAL: Janney believes that the subject company is fairly valued and will perform in line with comparable companies within its sector. Investors may add to current positions on short-term weakness and sell on strength as the valuations or fundamentals become more or less attractive.

SELL: Janney expects that the subject company will likely decline in value and will underperform comparable companies within its sector.

Price Charts



Janney Montgomery Scott Ratings Distribution as of 6/30/13

Rating	IB Serv./Past 12 Mos.			
	Count	Percent	Count	Percent
BUY [B]	218	51.90	34	15.60
NEUTRAL [N]	198	47.14	21	10.61
SELL [S]	4	0.95	0	0.00

***Percentages of each rating category where Janney has performed Investment Banking services over the past 12 months.**

Other Disclosures

Janney Montgomery Scott LLC, is a U.S. broker-dealer registered with the U.S. Securities and Exchange Commission and a member of the New York Stock Exchange, the Financial Industry Regulatory Authority and the Securities Investor Protection Corp.

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