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## Why Chipotle Could Become An Activist Target

■ If the share price continues on a downward trajectory, an activist could launch a campaign to reform executive pay and pressure the chain to sell off stores to franchisees

Ronald Orol Jul 22, 2016 6:00 AM EDT



Chipotle Burrito Bowl

2014 **Chipotle (CMG)** earned the dubious honor of garnering the largest protest vote by shareholders against its executive pay packages of any U.S. company. According to a report by Semler Brossy, an executive pay consulting company, only 23% of Chipotle shareholders voted to back its executive compensation scheme that year, putting it on the bottom of a list of 10 companies that failed their so-called 'say on pay' votes throughout the year.

2015 the burrito chain recovered getting 95% shareholder support for executive pay.

However, this year, it only received the backing of 72%, putting it in the bottom quartile and raising the specter that shareholders are turning disgruntled again.

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Until recently, the company was essentially immune to activist hedge funds because it was protected by a surging stock price, which traded as high as over \$700 a share at times last year.

But driven partly by last year's E. Coli and Salmonella outbreaks at the burrito chain, the stock has since dropped significantly and trades lately at around \$417 a share. Now, the Wall Street Journal reported Wednesday that short sellers, investors betting against the stock, have increased substantially in recent months, representing 16% of total outstanding shares.

And Chipotle's 2016 second quarter earnings results issued Thursday add to prospects that an activist could target the company. The burrito chain reported earnings of 87 cents a share which were lower than estimates of 93 cents a share. It also reported revenue of \$998.4 million, missing Wall Street's expected \$1.05 billion in revenue for the period.

<https://www.thestreet.com/story/13648449/1/chipotle-cmg-stock-rises-in-after-hours-trading-despite-q2-earnings-miss.html>

If the share price continues on a downward trajectory, an activist could launch a campaign to improve share price performance. In addition to putting pressure to reform executive pay packages, an activist could try to pressure the chain to sell off stores to franchisees and use the proceeds for dividends or stock buybacks. (Chipotle owns all its restaurant locations).

Activists have pushed for franchising in the past -- Engaged Capital's Glenn Welling successfully drove freshly squeezed juice retailer Jamba Inc. to franchise more locations and hike its share buybacks program and Glenview Capital Management LLC urged McDonalds Corp. (MCD) to franchise more as well.

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John Gordon, principal at restaurant chain focused Pacific Management Consulting Group, suggests that

least domestically, it didn't make sense to franchise units, partly because there could be disputes among franchisees and company owned locations over territory. "There is no upside to franchising their restaurant locations," Gordon explained. "They tried that in the past when they were owned by McDonald and had awful results."

However, Gordon suggested that an activist could push Chipotle to expand outside of the U.S. and find international operators for particular targeted countries, such as Germany or Australia. "That would jumpstart international development quickly," he said.

Chipotle has been slow to expand internationally, partly because it worries about maintaining its supply chain. However, Gordon notes that an activist could push them to find capable large international franchisees that operate similar businesses and know their home markets. "The movement towards franchising could develop those markets," he said.

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