

TheStreet

Chipotle May Further Franchise, Prep for Sale as Ackman Launches Campaign

■ Pershing Square said it intends to engage in discussions with Chipotle about its strategic plans, which suggests the fund could push the restaurant chain into more franchising or a sale.

Ronald Orol Sep 7, 2016 7:52 AM EDT

 **TheStreet Video**

Chipotle Mexican Grill's (CMG) shares shot up late Tuesday and continued to climb Wednesday before markets opened as embattled activist Bill Ackman and his **Pershing Square Capital Management** launched an activist campaign at the restaurant operator.

In a securities filing, Pershing Square reported owning a 9.9% stake at Chipotle and said it believes it has a strong brand and visionary leadership. Nevertheless, the activist fund said it intends to engage in discussions with Chipotle about its strategic plans, capitalization and financial condition, suggesting that Ackman could seek to put it in play for a sale or at least to have it franchise locations.

While it is unclear what strategic options Ackman wants to discuss. One option could be to force the chain to sell off stores to franchisees and use the proceeds for dividends or stock buybacks. In addition, an activist could try to push Chipotle to expand outside of the U.S. and find international operators for particular targeted countries, such as Germany or Australia. Currently Chipotle has very few international stores, no franchises and no owned real estate.

STOCKS TO BUY: TheStreet Quant Ratings has identified a handful of stocks with serious

Upside potential in the next 12-months. [Learn more.](#)

The Deal, a sister publication of TheStreet issued a Large Cap Target of the Week on Chipotle in July, predicting it could be targeted by an activist. The report noted that Chipotle in 2014 earned the dubious honor of garnering the largest protest vote by shareholders against its executive pay packages of any U.S. company. According to 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 60 companies that failed their so-called say on pay votes throughout the year.

In 2015, the burrito chain recovered getting 95% of shareholder support for executive pay. However, this year, it received the backing of only 72%, putting it in the bottom quartile and raising the specter that shareholders are turning disgruntled again.

Ackman could seize upon the disgruntled shareholder base, especially as the stock has dropped significantly from a high of over \$700 a share to trade lately at around \$414 a share. The drop was driven partly by last year's E. Coli and Salmonella outbreaks at the burrito chain.

The activist manager could put pressure on Co-CEOs Steve Ells and Monty Moran to reduce their executive pay packages.

In addition, John Gordon, restaurant analyst at Pacific Management Consulting Group, said a move to franchise internationally would make sense once the brand is "righted" from its lack of U.S. sales momentum.

"Chipotle needs first to insure an international supply chain giving it the specific products it wants," he said. "Otherwise, out of scope products could destroy the Chipotle 'brand promise' as it currently exists. The risk of franchising is loss of control."

In addition, Gordon suggested that franchising in the U.S. may not make sense given that when at its current lower sales levels the company's operating store margins exceed the break-even point where franchising makes sense.

COMPARE
BROKERS

The Wall Street Journal reported in July that short sellers, investors betting against the stock, had increased substantially in recent months, and at the time represented 16% of total outstanding shares.

In any event it is likely that Chipotle has until February to make some changes -- otherwise there is a real possibility the burrito chain will find itself in the crosshairs of a proxy contest. According to a Chipotle securities filing, shareholders seeking to nominate a dissident slate of directors for the 2017 annual meeting must do so between Jan. 11 and Feb. 10.

The campaign comes after Ackman last month liquidated its remaining 6.6% stake in **Canadian Pacific Railway (CP)**, the fund's latest effort to unload shares in the wake of losses stemming from its large minority investment in embattled **Valeant Pharmaceuticals International (VRX)**.

Despite the Valiant struggles, a new activist campaign by Ackman may not be a surprise. Ackman said in a press release in August that the fund intends to use the proceeds from the liquidation of the CP stake to allocate towards one or more new investments.

He announced Tuesday that Ackman has resigned from the board of the railroad operator, bringing to a conclusion a five-plus year campaign at the railroad company that had its ups and downs.

IF YOU LIKED THIS ARTICLE YOU MIGHT LIKE

Fall Should Bring Sizzle Back to Casual Dining Stocks

Strength in the dining sector only appears to be rising as people return to their busy lives and a quick bite to eat with the passage of summer.

Timothy Collins | Sep 22, 2016 11:41 AM EDT

Chipotle (CMG) Takes Out Full-Page Ads to Win Back Customers

Chipotle (CMG) launched an ad campaign today in an attempt to win back customers after the food from the Mexican restaurant caused food-borne illness outbreaks last year.

Natalie Walters | Sep 21, 2016 11:38 AM EDT

The Best Way to Play the Antibiotic-Free Meat Trend

A new study has graded 25 popular restaurant chains. Here's one stock that's received high grades... and is priced at a discount today.

Kat McKerrow | Sep 21, 2016 9:19 AM EDT

Chipotle's European Initiative Won't Compensate for Recent Decline in U.S. Business

Mexican food has been a hard sell in Europe. The company is still struggling to repair its image in the U.S. following a food safety scare last year.

Kat McKerrow | Sep 20, 2016 9:06 AM EDT

©1996-2016 TheStreet, Inc. All rights reserved. Action Alerts PLUS is a registered trademark of TheStreet, Inc.

**COMPARE
BROKERS**