EXERCISES

is.hun.afp.060 Analyzing information to assess companies' future prospects

(Analysis Mini-Case Series)

This exercise has an open-ended question that allows for several good alternative responses. While there aren't correct responses to the question, some are definitely better than others. Generally, responses are better to the extent they identify and fully vet arguments, counterarguments, and rebuttals, include appropriate qualifiers, and provide insights regarding the way you assessed the relative merits of the arguments, counterarguments and rebuttals. See The Toulmin Model of Argumentation as a reference.

Additionally, responses must cite sources and use quotation marks when copying word for word. Admittedly, this is overkill here because you can only use the provided information. However, citing here is good practice for situations where there are fewer or no restrictions on the admissible information. Still, you needn't cite the provided tabular data.

Usage

This exercise helps you learn how to use accounting information.

Introduction

Financial analysts and others use financial models to derive their own assessments of the values of companies' shares, which generally differ from the prices at which the shares are currently traded in stock markets. To the extent these assessed values are significantly higher than the current share prices and investors have confidence in these assessments, they are motivated to buy the companies' shares, and to the extent the assessed values are significantly lower than the current share prices, they are motivated to sell shares.

While several models are used in practice, since the 1960s there has been widespread agreement in academia that the "discounted cash flow" model is the best conceptually. You will learn about this model in finance courses. For now all you need to know is the model depend on forecasts of future cash flows to shareholders (dividends or capital gains from increases in stock prices). A few years ago, a new model emerged: It converts the forecasted discounted cash flow model into four factors that are closely related to concepts we have studied in the course:

1. **Book value of owners' equity**: The current book value of owners' equity.
2. **ROEs**: The expected return on equity (ROE) for each future period.
3. **Risks:** The expected cost of capital at each future period – the interest rates the company is expected to pay on issued debt and its expected future share prices (the higher the share price, the fewer the number of shares the company has to issue to raise the same amount of capital). The cost of both sources of capital depends on investors' perceptions about the risks the company faces.
4. **Growth rates**: The expected growth rate of owners' equity for each future period, which depends on several factors including the expected growth rates of revenues and the expected distributions to owners and contributions from them.

Both of the models discussed above are relatively sophisticated mathematical formulas that allow investors to quantify their qualitative assessments of companies' future prospects into valuations. Our focus here is on the qualitative assessments of the two companies' future prospects.

More specifically, based on the provided information and concepts studied thus far in the course, you are to qualitatively assess the two companies' expected ROEs, risks, and growth rates. You should base these assessments on: (1) past performance that will persist in the future (based on plans already being executed and reflected in the financial statements) and (2) new plans (not yet reflected in the financials).

Required

In this question, you will explore **Chipotle Mexican Grill, Inc.'s** and **Panera Bread Company's** future return-on-equity (ROE), growth rates, and risks.

Based solely on concepts covered thus far in the course and the provided background information and tabular data, which company, Chipotle or Panera, appears to have the better future prospects at the most recent balance sheet dates, taking into consideration expected future ROEs, growth rates, and risks?

- Respond to this question by completing Parts I-II.

  Note: If you conclude one company doesn't dominate the other on all three factors (ROEs, growth rates and risk): (1) In your opening remarks, identify the company that has the best prospects for each of the factors; and (2) incorporate the companies' relative strengths into your arguments, counterarguments, and the confidence you attribute to your claim

- Use the **Analysis Consideration Map - Phase 2** (on page 18) to help you develop a response that integrates the qualitative and quantitate background information.

Background Information

Excerpt from Chipotle' Fiscal 2014 Annual Report/10K

"Chipotle Mexican Grill, Inc.… operate[s] Chipotle Mexican Grill restaurants, which serve a focused menu of burritos, tacos, burrito bowls… and salads, made using fresh ingredients. As of December 31, 2014, we operated 1,755 Chipotle restaurants throughout the United States, as well as seven in Canada, six in England, three in France, and one in Germany.

Additionally, our restaurants include nine ShopHouse Southeast Asian Kitchen restaurants, serving Asian-inspired cuisine, and we are an investor in… two Pizzeria Locale restaurants, a fast casual pizza concept, resulting in a total of 1,783 restaurants as of December 31, 2014.

We focus on trying to find the highest quality ingredients we can to make great tasting food; on building a special people culture that is centered on creating a team of top performers empowered to achieve high standards; on building restaurants that are operationally efficient and aesthetically pleasing; and on doing all of this with increasing awareness and respect for the environment. We have grown substantially over the past five years, and expect to open between 190 and 205 additional restaurants in 2015, including a small number of ShopHouse and Pizzeria Locale restaurants.

Our vision is to change the way people think about and eat fast food…We use high-quality raw ingredients, classic cooking methods and a distinctive interior design and have friendly people to take care of each customer—features that are more frequently found in the world of fine dining. Our approach is also guided by our belief in an idea we call "Food With Integrity." Our objective is to find the highest quality ingredients we can—ingredients that are grown or raised with respect for the environment, animals and people who grow or raise the food. "

Chipotle's' 2014 10K, pages 3-4

"It can take longer to identify and secure relationships with suppliers that are able to meet our criteria for meat, dairy and produce ingredients. Given the costs associated with what we believe are responsible farming practices, many large suppliers have not found it economical to pursue business in this area. However, we believe…consumers are increasingly concerned about where their food comes from and how it is raised…We believe that increased demand over the long term for the types of meat and produce items we strive to serve will continue to attract the interest and capital investment of larger farms and suppliers... If we are able to continue growing while focusing on Food With Integrity, we believe our sourcing flexibility will improve over time…

A Few Things, Thousands of Ways. Chipotle restaurants serve only a few things: burritos, burrito bowls, tacos and salads. But because customers can choose from four different meats or tofu, two types of beans and a variety of extras such as salsas, guacamole, cheese and lettuce, there's enough variety to extend our menu to provide countless choices. We plan to keep a simple menu, but we'll consider additions that we think make sense, such as the recent introduction… of Sofritas, our vegan protein option made with braised organic tofu. And if customers can't find something on the menu that's quite what they're after, we encourage them to let us know. If we can make it from the ingredients we have, we'll do it."

Chipotle's' 2014 10K, page 5

"Food Served Fast … So That Customers Can Enjoy It Slowly. Our employees spend hours preparing our food on-site, but each customer order can be ready in seconds. Customers select exactly what they want and how they want it by speaking directly to the employees that… are assembling the order. While we think that our customers return because of the great-tasting food, we also think that they like getting food served fast without having a typical "fast-food" experience. And while our restaurants often have lines, we try to serve customers as quickly as possible... We've even been able to serve more than 300 customers an hour at some locations. The natural flow of our restaurant layout, including the floor plan and the design of our serving line, are designed to make the food ordering process intuitive and, we believe, more efficient.

And we constantly strive to improve the speed of service in all of our restaurants, so that we can accommodate more customers and larger orders without disrupting restaurant traffic. For instance, our restaurants accept orders by fax, online or through an iPhone or Android ordering application in order to provide a more convenient experience by allowing customers to avoid standing in line. By emphasizing speed of service without compromising the genuine interactions between our customers and our crews, and by continually making improvements to our restaurant operations, we believe that we can provide a high quality experience to more and more customers."

Chipotle's' 2014 10K, pages 5-6

"Competition

The fast-casual, quick-service and casual dining segments of the restaurant industry are highly competitive with respect to… taste, price, food quality and presentation, service, location, and the ambience and condition of each restaurant. Our competition includes a variety of restaurants in each of these segments, including locally-owned restaurants and national and regional chains. Many of our competitors offer dine-in, carry-out and delivery services. Among our main competitors are a number of multi-unit, multi-market Mexican food or burrito restaurant concepts, some of which are expanding nationally. Unlike Chipotle, a number of our competitors grow through franchising."

Chipotle's' 2014 10K, page 8

"Risks

Increasing our sales and profitability depends substantially on our ability to open new restaurants in sites and on terms attractive to us, which is subject to many unpredictable factors… We plan to increase the number of our restaurants significantly in the next three years…

Competition for suitable new restaurant sites in our target markets can be intense, and development and leasing costs are increasing, particularly for urban locations. These factors could negatively impact our ability to drive occupancy costs lower as a percentage of revenue, which would adversely impact our profitability growth…Our decision to delay or forego a significant number of new restaurant openings, or our inability to open the number of new restaurants we plan, due to any of the reasons set forth above could materially and adversely affect our growth strategy and our expected results. Moreover, as we open and operate more restaurants our rate of expansion relative to the size of our existing restaurant base will decline, which will make it increasingly difficult to maintain our past rates of sales and profitability growth."

Chipotle's 2014 10K, page 11

"Our success may depend on the continued service of key personnel.

Our Chairman and co-Chief Executive Officer Steve Ells founded our company, has been the principal architect of our business strategy, and has led our growth from a single restaurant in 1993 to over 1,700 restaurants today… We also believe that it may be difficult to locate and retain other executive officers who are able to grasp and implement our unique strategic vision…

Our marketing and advertising strategies may not be successful, which could adversely impact our business.

We have developed a marketing… strategy that we believe is unique in the restaurant industry. We have not generally advertised on television and engage in very limited price or value-based promotions. Instead we invest in marketing and advertising strategies that we believe will increase customers' connection with our brand."

Chipotle's 2014 10K, page 23

"Properties

The average restaurant size is about 2,550 square feet and seats about 58 people. Many of our restaurants also feature outdoor patio space."

Chipotle's 2014 10K, page 23

Chipotle's 2014-2012 statements of cash flows report it paid shareholders $0, $0, and $0 thousand of cash dividends, respectively, during these years.

Chipotle's 2014-2012 statements of cash flows report it paid shareholders $88,338, $138,903, and $217,092 thousand to repurchase shares, respectively, during these years.

Chipotle's 2014 10K, page 46

NOTE: Share repurchases and cash dividends decrease cash and owners' equity.

Excerpt from Chipotle' Fiscal 2014 Earnings Release Conference Call Executives had with Analysts

Shortly after the end of fiscal 2014, Chipotle held an on-line conference call with financial analysts and others to discuss its fiscal 2014: performance for the fourth quarter (Q4); for the entire year; its financial position at the end of the year; and future plans and strategies, including those not yet reflected in the company's financial statements. The following quotes are from a transcript of this conference call.

Steve Ells, Founder, Co-CEO, and Chairman of Chipotle

"From the very first Chipotle restaurant nearly 22 years ago we have chartered our own path for how a restaurant company should be run in every single way. We have shown that you can own and operate all of your restaurants rather than franchise and still grow at a rapid rate, that you can spend more on ingredients not less, still serve high quality food at reasonable prices and have industry leading margins and returns, that you can build teams of top performers and power them to deliver high standards while still maintaining an efficient labor model and that you can remain focused on doing just a few things extremely well rather than trying to be all things to all people or engaging in a kind of marketing gimmicks that have become the hallmarks of traditional fast food and still continue to attract new customers and profitably grow the business over the long-term."

"Food With Integrity…In January, we decided to suspend one of our pork suppliers after a routine audit reveal that they were not following all of our animal welfare protocols. Choosing to suspend the supplier meant that we would not be able to supply carnitas to about one third of our restaurants."

"While we could have chosen to replace this supply with pork from conventionally raised pigs, we decided not to because most conventionally raised pigs are subjected to conditions that we find unacceptable…Since we made this decision the majority of sentiment from our customers has been very supportive in the email and web comments along with social media posts, customers are applauding our commitment to our vision, thanking us for standing on principle, commending us for taking action against the inhumane treatment of animals and congratulating us for standing by our business values."

"According to industry research, Chipotle is one of the most popular restaurant chains among teens and has been growing in popularity among this demographic. This report from 2014 ranks Chipotle as the third most popular brand among teens up from number eight 2013…We believe that our popularity among these younger consumers is tied to our vision and the growing interest in issues related to food and how it is raised. Our own research shows that these issues are clearly becoming more relevant and important when customers choose where they will dine. Based on our ongoing tracking research… 69% try to eat meat that has been raised responsibly and that's up 53% in 2011."

John Hartung, CFO, Chipotle

"We don't have any plans for an across the board menu price increase in 2015 since we just increased prices and because we're currently earning at or near record margins and returns. In addition, it's important to us that we remain accessible or affordable to our customers as this is the core to our ability to change the way people think about any fast food."

"We're not in a hurry and never been in hurry to raise prices is part of our vision is to remain accessible. So it's important that we've got to source these high end premium ingredients, sustainably raised ingredients. But we want to be affordable. We want people to feel like they can come to Chipotle as often as they want: once a week, multiple times a week. And so we would rather err on the side of being more patient and not rushing to raise prices every time some of our ingredient costs move up so that as many people as possible can enjoy Chipotle and I think over time that strategy has worked well for us."

Excerpt from Panera's Fiscal 2014 Annual Report/10K

"Panera Bread Company … is a national bakery-cafe concept with 1,880 Company-owned and franchise-operated bakery-cafe locations in 45 states, the District of Columbia, and Ontario, Canada. We have grown from serving approximately 60 customers per day at our first bakery-cafe to currently serving nearly 7.8 million customers per week system-wide. We are currently one of the largest food service companies in the United States. We believe our success is based on our ability to create long-term concept differentiation... Our bakery-cafes are located in urban, suburban, strip mall, and regional mall locations. We feature high-quality food in a warm, inviting, and comfortable environment. With our identity rooted in handcrafted artisan bread, we bake fresh bread every day…

We operate as three business segments: Company bakery-cafe operations, franchise operations, and fresh dough and other product operations. As of December 30, 2014, our Company bakery-cafe operations segment consisted of 925 Company-owned bakery cafes and our franchise operations segment consisted of 955 franchise-operated bakery-cafes, located throughout the United States and in Ontario, Canada. As of December 30, 2014, our fresh dough and other product operations segment, which supplies fresh dough and other products daily to most Company-owned and franchise-operated bakery-cafes, consisted of 24 fresh dough facilities (22 Company-owned and two franchise-operated), located throughout the United States and one in Ontario, Canada. In the fiscal year ended December 30, 2014, or fiscal 2014, our revenues were $2,529 million, consisting of $2,230 million of Company-owned net bakery-cafe sales, $124 million of franchise royalties and fees, and $175 million of fresh dough and other product sales to franchisees."

Panera's 2014 10K, page 1

"We are committed to providing great tasting, quality food that people can trust. In 2014, we formalized our Food Policy, which is an articulation of Panera's long held values that expresses a commitment to clean ingredients, transparency, and a positive impact on the food system. Our bakery-cafes have a menu highlighted by flavorful, wholesome offerings, including select proteins raised without antibiotics, grass-fed beef, whole grain bread, and select organic and all-natural ingredients, with zero grams of artificial trans-fat per serving. We strive to create new standards in everyday food choices, and our menu includes a wide variety of year-round favorites complemented by new items introduced seasonally…

Our key menu groups are daily baked goods, including a variety of freshly baked bagels, breads, muffins, scones, rolls, and sweet goods, made-to-order sandwiches on freshly baked breads, hearty, unique soups, freshly prepared and hand-tossed salads, pasta dishes, and custom roasted coffees and cafe beverages, such as hot or cold espresso and cappuccino drinks and smoothies…

We regularly review and innovate our menu offerings to feature new taste profiles we believe our customers crave. Product rollouts are integrated into periodic or seasonal menu rotations, referred to as 'celebrations."

Panera's 2014 10K, pages 1-2

"We believe our competitive strengths include more than just great food and superior customer service. We are committed to creating an ambiance in our bakery-cafes and a culture within Panera that is warm, inviting, and embracing, and focus our investments on elevating this experience. We design each bakery-cafe to provide a distinctive environment... The distinctive design and environment of our bakery-cafes are intended to offer an oasis from the rush of daily life, where our associates are trained to greet our customers by name and have the skills, expertise, and personalities to make each visit a delight. Many of our bakery-cafes incorporate the warmth of a fireplace and cozy seating areas or outdoor cafe seating, which facilitate the use of our bakery-cafes as a gathering spot. Our bakery-cafes are designed to visually reinforce the distinctive difference between our bakery-cafes and other bakery-cafes and restaurants"

Panera's 2014 10K, page 2

"The average Company-owned bakery-cafe size was approximately 4,500 square feet as of December 30, 2014. We lease nearly all of our bakery-cafe locations and all of our fresh dough facilities…The average construction, equipment, furniture and fixtures, and signage cost excluding capitalized development overhead for the 65 Company-owned bakery-cafes that opened in fiscal 2014 was approximately $1.4 million per bakery-cafe."

Panera's 2014 10K, page 4

"We believe technology is a differentiator in the restaurant business. We are committed to being a leader in technology that makes a difference to our customers by providing a greater degree of access and convenience. As a result, we are concentrating efforts and resources on our *Panera 2.0 initiative*, which is intended to enhance the experience for both our dine-in and to-go guests. The enhanced guest experience is enabled by technology, including the convenience of digital ordering and Rapid Pick-Up, and 6 operational improvements. We expect to continue to make substantial investments in technology designed to provide greater access for customers, increased operational capabilities including improved labor and inventory management tools, and improvements in core enterprise systems."

Panera's 2014 10K, page 5

"Competition

We compete with a variety of national, regional and locally-owned food service companies, including specialty food, casual dining and quick-service restaurants, bakeries, and restaurant retailers. Our bakery-cafes compete in several segments of the restaurant business: breakfast, lunch, gathering place, dinner, take home, and catering...Some of our competitors are larger than we are and have substantially greater financial resources than we do."

Panera's 2014 10K, page 6

"Risk Factors…

Our success depends in part on the operations of our franchisees. While we provide training and support to, and monitor the operations of our franchisees, the product quality and service they deliver may be diminished by any number of factors beyond our control, including financial pressures and their own business operations, such as employment related matters…Our customers may attribute to us problems which originate with one of our franchisees, particularly those affecting the quality of the service experience, food safety…thus damaging our reputation and brand value and potentially adversely affecting our results of operations.

Furthermore, our consolidated results of operations include revenues derived from royalties on sales from, and revenues from sales by our fresh dough facilities to, franchise-operated bakery-cafes. As a result, our growth expectations and revenues could be negatively impacted by a material downturn in sales at and to franchise-operated bakery-cafes or if one or more key franchisees becomes insolvent and unable to pay us royalties."

Panera's 2014 10K, page 11

Panera's 2014-2012 statements of cash flows report it paid shareholders $0, $0, and $0 thousand of cash dividends, respectively, during these years.

Panera's 2014-2012 statements of cash flows report it paid shareholders $159,503, $339,409, and $31,566 thousand to repurchase shares, respectively, during these years.

Panera's 2014 10K, page 43

Excerpt from Panera's Fiscal 2014 Earnings Release Conference Call Executives had with Analysts

Shortly after the end of fiscal 2014, Panera held an on-line conference call with financial analysts and others to discuss its fiscal 2014: performance for the fourth quarter (Q4); for the entire year; its financial position at the end of the year; and future plans and strategies, including those not yet reflected in the company's financial statements. The following quotes are from a transcript of this conference call.

Ronald M. Shaich, Founder, Chairman and CEO of Panera Bread

"Panera 2.0 has had a consistent and sustained impact on our guest experience. We've done that without adding anything different in food, marketing or essentially, design. It's really simply been about reducing friction. And that impact shows up in our customer health data and it shows up in the retail sales increases we're experiencing. And the rate of sales growth appears to continue to get better over time….

While the data is still relatively immature for our 2.0 cafes and we cannot say definitively what the long-term sales impact is, we do know that Panera 2.0 has the potential to be an important element in materially changing the trajectory of our business and in preparing Panera to compete more effectively in… a future that is increasingly more digital… ultimately all restaurant companies will need to meet the ante that Panera 2.0 represents.

…Sales growth is occurring because Panera 2.0 really delivers in reducing friction for guests. But reducing friction also requires a commitment to putting back in the labor that has been constraining our sales growth in the past, and it requires having the staff necessary to meet the demand that is opened up by unfettered digital access…

Margins, in our view, will be negatively impacted by 2.0, particularly in those quarters immediately following rollout. But with increased sales, greater digital uptake and the utilization of evolving tools like our new labor model, margins should continue to improve with time. …

Panera 2.0 is already generating improvements that can be spun out to the rest of the Panera system. For example, take Rapid PickUp or… RPU. RPU… offers our to-go customers the convenience of ordering and paying for their meals via our website or mobile app and then picking up their order at a designated time. As the name implies, RPU allows customers to grab their orders directly from our pickup shelves without ever having to stand in line…We expected adoption of RPU to be modest as the customer is still learning about it and how to use it. What we've seen has surprised us. Rapid Pick-Up is now representing 3% of company transactions…

In the latest period, approximately 8% of all of Panera's company sales occurred digitally… That is to say 8% of our sales came through consumer-facing digital access points, the Web, mobile or a kiosk. That rate of digital adoption is more than double where we were at the end of the second quarter... There's a William Gibson quote I love, and I use it often: 'The future is here, it's just not evenly distributed.' At Panera, we are living into that future through Panera 2.0.

Panera 2.0 requires us to retrain our organization to handle higher volumes in shorter bursts of demand, and to do so with a new range of disciplines and procedures.

So now the big question for 2015: how many Panera 2.0 cafes will we convert this year? We expect to convert approximately 300 more company cafes in 2015, which will bring us up to 400 or so company cafes or almost half of our company stores by year-end…Initially, we will remain focused on converting company cafes. Based on these continued learnings, we will begin the franchise conversions in late 2015 or early 2016…

Panera 2.0 is not a light switch. To do this right takes time and real effort. That's why Panera 2.0 will ultimately represent a barrier to entry for smaller players as well as competitive advantage generally for Panera."

Refranchising

"We have long stated that our long-term goal is to be in the 35% to 50% company-owned stores range. Today, that number sits very close to 50%. Every year, we conduct a review of markets, both company and franchise, and ask ourselves if we should adjust the ratio on the margin. It ends up being a fascinating discussion. Most of our company markets generate strong profits. Selling them would be materially dilutive to earnings, even after valuing the capital.

However, there are some markets that make sense to refranchise. These markets are all profitable, and many of them are growing. But they are at the lower end of the profitability range… Refranchising these markets could be accretive to ongoing earnings in the near term. With the other cost and investment pressures we are facing, we feel now is the right term to further explore refranchising. For 2015, we are targeting 50 to 150 cafes to be refranchised.

Let me emphasize something. These are markets that are making money today. These are markets we've spent time building. They are markets we believe have real long-term growth potential. We will only refranchise these markets if the deals make economic sense.

For the full system, we're targeting openings of 105 to 115 bakery-cafes."

Excerpt from Fast Casual Article: "Is Panera 2.0 starting to pay off?"

"As [Executive Vice President - Chief Transformation and Growth Officer Blaine] Hurst considered the biggest obstacles to Panera's growth, one issue kept surfacing for him: waiting. Nobody likes to wait in line, even for their favorite meal…

Perhaps taking a cue from the recent successes kiosks have offered for customer service, Panera Bread decided to follow the same path… Improving access to the Panera experience was the obvious first step, so the company implemented web, mobile and kiosk solutions as well as redesigned parts of its kitchens to reduce friction for guests…The result is Panera 2.0, a modern, technology sophisticated fast casual concept in the works since 2012. Ordering kiosks were the first step in modernizing Panera. Born out of improving access to ordering and payment, the kiosks number more than 700 in about 100 cafes…

Hurst and his team knew Panera's kiosks needed to be simple and easy to use… They settled on an iPad kiosk for its level of familiarity with the public, which allows the kiosks to be both friendly and approachable.

In designing the kiosk to provide a complete self-service experience, Hurst looked at how many clicks customers input to navigate an order to insure a more efficient route to the process. The kiosk software also brings up a customer's order history and favorites, and much like a host or hostess, they ask if a customer is dining in or carrying out. For dine-in orders, the kiosks instruct users to grab a pager-like device, input a number and grab a drink cup, all without the assistance of staff…

…the changes in 2.0 shops have produced more jobs as Panera employees at these locations now provide table service."

"Is Panera 2.0 Starting to Pay off?, By Nicole Troxell, FastCasual.com, February 6, 2015

Accounting for Leases: Capitalizing Operating Leases

Both Chipotle and Panera lease most all of their stores. Here's some background on accounting for leases and related considerations for your analyses.

Investors often adjust for "off-balance sheet" leases

For accounting purposes, both Chipotle and Panera classify most all of their leases as "operating leases." This means, consistent with current accounting standards, the companies don't recognize these leases on their balance sheets, i.e., the leases are "off-balance sheet." However, to get more accurate assessments of companies' financial positions, rating agencies (such as Moody's and Standard & Poor's) and sophisticated investors use companies' footnote information to create adjusted balance sheets that include operating leases. Ratios based on these adjusted balance sheets are generally quite different than those based on reported balance sheets.

Including operating leases on adjusted balance sheets is called "capitalizing operating leases." This means adding assets and liabilities on the adjusted balance sheets. For example, for Chipotle and Panera, the assets (the benefit) represent the non-cancellable right to use the stores during the remaining years of the lease and the liabilities (the obligation) represent the non-cancellable commitment to make the lease payments.

Not everyone agrees that operating leases should be capitalized on balance sheets, which is one of the primary reasons capitalizing operating leases is not required under current accounting standards. Opponents to capitalizing operating leases have argued leases are similar to service or supplier contracts that extend over multiple years, which are not recognized on balance sheets. Nevertheless, after debating this issue for nearly twenty years, standard setters in the U.S. and elsewhere are expected to issue new standards in early 2016 that will require capitalization starting at a yet-to-be specified date.

Investors or others who decide operating leases should be capitalized to better reflect the underlying economics use ratios based on the adjusted balance sheets when assessing a company's financial health. However, the process investors or others follow to estimate the assets and liabilities to adjust the balance sheet is far beyond the scope of this exercise and explained later in *Navigating Accounting*.

You are required to use the balance sheets that have been adjusted for capitalized operating leases for your analyses. To underscore the importance of making these balance sheet adjustments when operating leases are prevalent, we included adjustment estimates for Chipotle and Panera in the first table in the Quantitative Tabular Data section of this exercise. While income-statement measures are not affected by these adjustments, ratios based on both income-statement and balance-sheet measures (such as asset turnover) are affected. Accordingly, we've included related adjustments in the second table in the Quantitative Tabular Data section.

What should you know about leases?

We want you to learn how ratios commonly used to assess a company's financial health can differ significantly depending on whether operating leases are capitalized. We also want you to learn how comparisons across companies' ratios can be altered by capitalizing operating leases. For example, we want you to understand why one company may have higher (lower) financial leverage than another when the ratios are based on adjusted (reported) balance sheets. At the same time, we want you to be prepared for the implications of the pending accounting standard requiring capitalization of leases on balance sheets.

There are a few more things you need to understand about the asset and liability adjustments related to capitalizing operating leases. First, they are assumed to be the same for the assets and liabilities. One way to think about this is the value of the future benefits to be received from the leased property (the asset) is equal to the value of the future lease payments (the liability). Second, the estimates are not as precise as they would be if the outsiders had access to the same information as company insiders. In particular, outsiders need to make assumptions to compensate for information that is not disclosed in the company's footnotes. Still, these measurement errors tend to be small relative to the estimates themselves. Third, here is how the adjusted balance sheets are created:

Reported Assets + Capitalized Operating Lease Asset = Reported Liabilities + Capitalized Operating Lease Liability + Reported Owners' Equity

More precisely, the lease asset is included in property, plant and equipment (PP&E) and the lease liability is split into two parts: the part associated with lease payments due within a year is classified current and remainder is non-current.

How does this affect the case companies?

For the case companies, Chipotle and Panera, the asset and liability adjustments from capitalizing the operating leases are very significant. For example, at December 31, 2014, Chipotle's balance sheet reports approximately $2.5 million of total assets and $.5 million of liabilities. But when the assets and liabilities associated with capitalizing operating leases are added, the adjusted balance sheet reports $3.9 million of total assets and $1.9 million of total liabilities. As a result, financial leverage, measured as total liabilities divided by total assets more than doubles when the operating leases are capitalized (from 21% to 48%). This means investors or others who don't know about off-balance sheet operating leases will significantly underestimate the risks associated with the company's financial leverage. Similarly, they will significantly underestimate the balance-sheet changes that will occur when the proposed new lease accounting standards become effective.

Quantitative Tabular Data and Locating Companies' Reported Financial Statements

The quantitative tabular data provided on the next few pages summarizes information from the companies' annual reports and computes related ratios. To facilitate comparison across companies, the tabular data combines related line items and includes some line items in "other". For example, "other current assets" in the tabular data includes all current asset line items reported by the company not presented elsewhere in the tabular data.

You may want to download the companies' actual annual reports for your analysis to determine what the tabular data summarized. To learn how to locate these documents watch Searching and Locating Annual Reports 1.

Importantly, base your response solely on concepts covered thus far in the course and the provided background information and tabular data (summarized from the company's financial statements). You may use the companies' financial statements from their annual report, however, other information in their annual report or elsewhere is beyond the scope of this exercise.

Comparing Balance Sheets - Adjusted for Capitalizing Operating Leases

Adjustments:

- Capitalized lease **asset** is classified as non-current (PP&E). Thus, the reported and adjusted current assets are the same.
- Capitalized lease **liability** is split: part associated with lease payments due within a year is classified current and remainder is non-current, consistent with the proposed standard.

ADJUSTED BALANCE SHEET NUMBERS	Chipotle Mexican Grill, Inc.				Panera Bread Company			
	year end				year end			
	31-Dec-14	31-Dec-13	31-Dec-12	31-Dec-11	30-Dec-14	31-Dec-13	25-Dec-12	27-Dec-11
Assets	USD Thousands $				USD Thousands $			
Current assets								
Cash and cash equivalents	419,465	323,203	322,553	401,243	196,493	125,245	297,141	222,640
Receivables	34,839	24,016	16,800	8,389	106,653	84,602	86,262	54,709
Inventories	15,332	13,044	11,096	8,913	22,811	21,916	19,714	17,016
Other current assets	408,843	306,044	196,158	82,647	80,209	70,953	75,725	58,754
Total current assets	**878,479**	**666,307**	**546,607**	**501,192**	**406,166**	**302,716**	**478,842**	**353,119**
Property, plant and equipment net	3,236,464	2,941,241	2,565,780	2,201,551	1,872,434	1,690,782	1,521,826	1,613,176
Goodwill and intangible assets	21,939	21,939	21,939	21,939	191,718	202,781	209,976	175,340
Other non-current assets	538,883	357,796	233,418	150,226	5,724	5,956	7,591	6,841
Total assets	**4,675,765**	**3,987,283**	**3,367,744**	**2,874,908**	**2,476,042**	**2,202,235**	**2,218,235**	**2,148,476**
Liabilities								
Current liabilities								
Accounts payable	69,613	59,022	58,700	46,382	19,511	17,533	9,371	15,884
Other current liabilities	372,681	317,221	279,562	238,512	472,589	413,996	384,941	325,132
Total current liabilities	**442,294**	**376,243**	**338,262**	**284,894**	**492,100**	**431,529**	**394,312**	**341,016**
Long-term debt (less current maturities)	1,932,896	1,800,988	1,547,667	1,322,159	1,045,752	893,170	833,300	1,018,472
Other noncurrent liabilities	288,206	271,764	235,889	223,629	202,006	177,645	168,704	133,912
Total liabilities	**2,663,396**	**2,448,995**	**2,121,818**	**1,830,682**	**1,739,858**	**1,502,343**	**1,396,316**	**1,493,400**
Stockholders' equity								
Common stock (paid-in capital less treasury stock)	290,527	259,771	295,443	372,570	(491,633)	(349,659)	(32,468)	(25,499)
Retained Earnings	1,722,271	1,276,897	949,459	671,459	1,229,177	1,049,884	853,715	680,267
Other stockholders' equity	(429)	1,620	1,024	197	(1,360)	(333)	672	308
Noncontrolling interests	-	-	-	-	-	-	-	-
Total stockholders' equity	2,012,369	1,538,288	1,245,926	1,044,226	736,184	699,892	821,919	655,076
Total liabilities and shareholders' equity	**4,675,765**	**3,987,283**	**3,367,744**	**2,874,908**	**2,476,042**	**2,202,235**	**2,218,235**	**2,148,476**
RATIOS BASED ON ADJUSTED BALANCE SHEET NUMBERS								
Level 1								
Financial leverage (year-end)								
Liabilities/assets	57%	61%	63%	64%	70%	68%	63%	70%
Level 2								
Working capital	436,185	290,064	208,345	216,298	(85,934)	(128,813)	84,530	12,103
Current assets - current liabilities								
Current ratio	1.99	1.77	1.62	1.76	0.83	0.70	1.21	1.04
Current assets/ current liabilities								
Level 3								
Common Size Balance Sheet								
Line item/total assets								
Assets								
Cash and cash equivalents	9%	8%	10%	14%	8%	6%	13%	10%
Receivables	1%	1%	0%	0%	4%	4%	4%	3%
Inventories	0%	0%	0%	0%	1%	1%	1%	1%
Other current assets	9%	8%	6%	3%	3%	3%	3%	3%
Total current assets	19%	17%	16%	17%	16%	14%	22%	16%
Property, plant and equipment net	69%	74%	76%	77%	76%	77%	69%	75%
Goodwill and intangible assets	0%	1%	1%	1%	8%	9%	9%	8%
Other non-current assets	12%	9%	7%	5%	0%	0%	0%	0%
Total assets	100%	100%	100%	100%	100%	100%	100%	100%
Liabilities								
Accounts payable	1%	1%	2%	2%	1%	1%	0%	1%
Other current liabilities	8%	8%	8%	8%	19%	19%	17%	15%
Total current liabilities	9%	9%	10%	10%	20%	20%	18%	16%
Long-term debt (less current maturities)	41%	45%	46%	46%	42%	41%	38%	47%
Other noncurrent liabilities	6%	7%	7%	8%	8%	8%	8%	6%
Total liabilities	57%	61%	63%	64%	70%	68%	63%	70%
Stockholders' equity								
Common stock (paid-in capital less treasury stock)	6%	7%	9%	13%	-20%	-16%	-1%	-1%
Retained Earnings	37%	32%	28%	23%	50%	48%	38%	32%
Other stockholders' equity	0%	0%	0%	0%	0%	0%	0%	0%
Noncontrolling interests	0%	0%	0%	0%	0%	0%	0%	0%
Total stockholders' equity	43%	39%	37%	36%	30%	32%	37%	30%
Total liabilities and shareholders' equity	100%	100%	100%	100%	100%	100%	100%	100%
Market's perception of missed or incorrectly measured BS items								
Market-to-book ratio								
Shares outstanding (issued - treasury)	31,027	31,033	31,093	31,252	20,182	22,007	25,959	26,217
Fiscal year-end price per share (historical quote)	$ 684.51	$ 532.78	$ 297.46	$ 212.66	$ 174.89	$ 176.69	$ 158.34	$ 141.01
Market value of stockholders' equity	21,238,292	16,533,762	9,248,924	6,646,050	3,529,627	3,888,424	4,110,369	3,696,906
Book value of stockholders' equity	2,012,369	1,538,288	1,245,926	1,044,226	736,184	699,892	821,919	655,076
Market-to-book ratio	10.55	10.75	7.42	6.36	4.79	5.56	5.00	5.64

Source: Companies' websites
See accompanying notes in annual reports.

Comparing Income Statements - Ratios Adjusted for Capitalizing Operating Leases

Adjustments:
• Capitalized lease **asset** is classified as non-current (PP&E).
Thus, total assets and average total assets increased and affected related ratios.

	Chipotle Mexican Grill, Inc.				Panera Bread Company			
	Year end				Year end			
	31-Dec-14	31-Dec-13	31-Dec-12	31-Dec-11	30-Dec-14	31-Dec-13	25-Dec-12	27-Dec-11
INCOME STATEMENTS	USD Thousands $				USD Thousands $			
Net revenues	**4,108,269**	**3,214,591**	**2,731,224**	**2,269,548**	**2,529,195**	**2,385,002**	**2,130,057**	**1,822,032**
Cost of goods or services sold	2,325,401	1,813,314	1,532,839	1,281,839	1,507,703	1,393,239	1,243,032	1,070,679
Gross profit	**1,782,868**	**1,401,277**	**1,198,385**	**987,709**	**1,021,492**	**991,763**	**887,025**	**751,353**
Other operating income and (expenses)	(1,072,068)	(868,557)	(742,520)	(637,147)	(745,549)	(682,007)	(604,155)	(531,094)
Operating profit	**710,800**	**532,720**	**455,865**	**350,562**	**275,943**	**309,756**	**282,870**	**220,259**
Other income and (expenses)	3,503	1,751	1,820	(857)	1,351	2,964	126	(356)
Profit before taxes	**714,303**	**534,471**	**457,685**	**349,705**	**277,294**	**312,720**	**282,996**	**219,903**
Income tax refund (expense)	(268,929)	(207,033)	(179,685)	(134,760)	(98,001)	(116,551)	(109,548)	(83,951)
Net profit (loss) from continuing operations	**445,374**	**327,438**	**278,000**	**214,945**	**179,293**	**196,169**	**173,448**	**135,952**
SELECTED FINANCIAL DATA								
(controlling and non-controlling)								
Comprehensive Income	**443,325**	**328,034**	**278,827**	**214,536**	**178,266**	**195,164**	**173,812**	**135,985**
Beginning total assets- adjusted for leases	3,987,283	3,367,744	2,874,908	2,392,903	2,202,235	2,218,235	2,148,476	1,687,020
Ending total assets- adjusted for leases	4,675,765	3,987,283	3,367,744	2,874,908	2,476,042	2,202,235	2,218,235	2,148,476
Average total assets- adjusted for leases	**4,331,524**	**3,677,514**	**3,121,326**	**2,633,905**	**2,339,138**	**2,210,235**	**2,183,356**	**1,917,748**
(beginning + ending total assets)/2								
Beginning owners' equity	1,538,288	1,245,926	1,044,226	810,873	699,892	821,919	655,076	595,608
Ending owners' equity	2,012,369	1,538,288	1,245,926	1,044,226	736,184	699,892	821,919	655,076
Average owners' equity	**1,775,329**	**1,392,107**	**1,145,076**	**927,550**	**718,038**	**760,906**	**738,498**	**625,342**
(beginning + ending owners' equity)/2								
RATIOS BASED ON ADJUSTED BALANCE SHEET NUMBERS								
Level 1: Comprehensive income								
Return-on-equity-Comprehensive Income (ROE-CI)	24.97%	23.56%	24.35%	23.13%	24.83%	25.65%	23.54%	21.75%
CI/average owners' equity								
Level 2: Major categories								
Return-on-equity (ROE)	25.09%	23.52%	24.28%	23.17%	24.97%	25.78%	23.49%	21.74%
net profit/average owners' equity								
Level 3: Significant Subcategories--DuPont Model								
Profit margin ratio	17.39%	16.63%	16.76%	15.41%	10.96%	13.11%	13.29%	12.07%
profit before taxes/revenue								
Asset turnover	0.95	0.87	0.88	0.86	1.08	1.08	0.98	0.95
revenue/average total assets								
Financial leverage	2.44	2.64	2.73	2.84	3.26	2.90	2.96	3.07
average total assets/average owners' equity								
Income tax factor	0.62	0.61	0.61	0.61	0.65	0.63	0.61	0.62
1- (tax expense/pretax income)								
Level 4: Line items								
Common size income statements:	Percent of revenues				Percent of revenues			
Net revenues	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
Cost of goods or services sold	56.60%	56.41%	56.12%	56.48%	59.61%	58.42%	58.36%	58.76%
Gross profit margin	43.40%	43.59%	43.88%	43.52%	40.39%	41.58%	41.64%	41.24%
Other operating income and (expenses)	-26.10%	-27.02%	-27.19%	-28.07%	-29.48%	-28.60%	-28.36%	-29.15%
Operating profit margin	17.30%	16.57%	16.69%	15.45%	10.91%	12.99%	13.28%	12.09%
Other income and (expenses)	0.09%	0.05%	0.07%	-0.04%	0.05%	0.12%	0.01%	-0.02%
Profit margin before taxes	17.39%	16.63%	16.76%	15.41%	10.96%	13.11%	13.29%	12.07%
Income tax expense	-6.55%	-6.44%	-6.58%	-5.94%	-3.87%	-4.89%	-5.14%	-4.61%
Net profit margin (loss)	10.84%	10.19%	10.18%	9.47%	7.09%	8.23%	8.14%	7.46%
Revenue growth	27.80%	17.70%	20.34%		6.05%	11.97%	16.91%	
(current year-prior year)/prior year								

Source: Companies' websites
See accompanying notes in the annual reports.

Comparing Balance Sheets and Select Financial Position Ratios - As reported

Numbers below are either disclosed on the company's balance sheets with similar captions or they combine numbers with related captions.

Note: The calendar date for the companies' fiscal year ends are within a few months of each other; this can be ignored for your analyses.

	Chipotle Mexican Grill, Inc.				Panera Bread Company			
	Year end				Year end			
	31-Dec-14	31-Dec-13	31-Dec-12	31-Dec-11	30-Dec-14	31-Dec-13	25-Dec-12	27-Dec-11
Assets	USD Thousands $				USD Thousands $			
Current assets								
Cash and cash equivalents	419,465	323,203	322,553	401,243	196,493	125,245	297,141	222,640
Receivables	34,839	24,016	16,800	8,389	106,653	84,602	86,262	54,709
Inventories	15,332	13,044	11,096	8,913	22,811	21,916	19,714	17,016
Other current assets	408,843	306,044	196,158	82,647	80,209	70,953	75,725	58,754
Total current assets	**878,479**	**666,307**	**546,607**	**501,192**	**406,166**	**302,716**	**478,842**	**353,119**
Property, plant and equipment net	1,106,984	963,238	866,703	751,951	787,294	669,409	571,754	492,022
Goodwill and intangible assets	21,939	21,939	21,939	21,939	191,718	202,781	209,976	175,340
Other non-current assets	538,883	357,796	233,418	150,226	5,724	5,956	7,591	6,841
Total assets	**2,546,285**	**2,009,280**	**1,668,667**	**1,425,308**	**1,390,902**	**1,180,862**	**1,268,163**	**1,027,322**
Liabilities								
Current liabilities								
Accounts payable	69,613	59,022	58,700	46,382	19,511	17,533	9,371	15,884
Other current liabilities	176,097	140,206	128,152	111,071	333,201	285,792	268,169	222,450
Total current liabilities	**245,710**	**199,228**	**186,852**	**157,453**	**352,712**	**303,325**	**277,540**	**238,334**
Long-term debt (less current maturities)	-	-	-	-	100,000	-	-	-
Other noncurrent liabilities	288,206	271,764	235,889	223,629	202,006	177,645	168,704	133,912
Total liabilities	**533,916**	**470,992**	**422,741**	**381,082**	**654,718**	**480,970**	**446,244**	**372,246**
Stockholders' equity								
Common stock (paid-in capital less treasury stock)	290,527	259,771	295,443	372,570	(491,633)	(349,659)	(32,468)	(25,499)
Retained Earnings	1,722,271	1,276,897	949,459	671,459	1,229,177	1,049,884	853,715	680,267
Accumulated other comprehensive income (loss)	(429)	1,620	1,024	197	(1,360)	(333)	672	308
Noncontrolling interests	-	-	-	-	-	-	-	-
Total stockholders' equity	**2,012,369**	**1,538,288**	**1,245,926**	**1,044,226**	**736,184**	**699,892**	**821,919**	**655,076**
Total liabilities and shareholders' equity	**2,546,285**	**2,009,280**	**1,668,667**	**1,425,308**	**1,390,902**	**1,180,862**	**1,268,163**	**1,027,322**
RATIOS BASED ON REPORTED BALANCE SHEET NUMBERS								
Level 1								
Financial leverage (year-end)								
Liabilities/assets	21%	23%	25%	27%	47%	41%	35%	36%
Level 2								
Working capital	632,769	467,079	359,755	343,739	53,454	(609)	201,302	114,785
Current assets - current liabilities								
Current ratio	3.58	3.34	2.93	3.18	1.15	1.00	1.73	1.48
Current assets/ current liabilities								
Level 3								
Common Size Balance Sheet								
Line item/total assets								
Assets								
Cash and cash equivalents	16%	16%	19%	28%	14%	11%	23%	22%
Receivables	1%	1%	1%	1%	8%	7%	7%	5%
Inventories	1%	1%	1%	1%	2%	2%	2%	2%
Other current assets	16%	15%	12%	6%	6%	6%	6%	6%
Total current assets	35%	33%	33%	35%	29%	26%	38%	34%
Property, plant and equipment net	43%	48%	52%	53%	57%	57%	45%	48%
Goodwill and intangible assets	1%	1%	1%	2%	14%	17%	17%	17%
Other non-current assets	21%	18%	14%	11%	0%	1%	1%	1%
Total assets	100%	100%	100%	100%	100%	100%	100%	100%
Liabilities								
Accounts payable	3%	3%	4%	3%	1%	1%	1%	2%
Other current liabilities	7%	7%	8%	8%	24%	24%	21%	22%
Total current liabilities	10%	10%	11%	11%	25%	26%	22%	23%
Long-term debt (less current maturities)	0%	0%	0%	0%	7%	0%	0%	0%
Other noncurrent liabilities	11%	14%	14%	16%	15%	15%	13%	13%
Total liabilities	21%	23%	25%	27%	47%	41%	35%	36%
Stockholders' equity								
Common stock (paid-in capital less treasury stock)	11%	13%	18%	26%	-35%	-30%	-3%	-2%
Retained Earnings	68%	64%	57%	47%	88%	89%	67%	66%
Accumulated other comprehensive income (loss)	0%	0%	0%	0%	0%	0%	0%	0%
Noncontrolling interests	0%	0%	0%	0%	0%	0%	0%	0%
Total stockholders' equity	79%	77%	75%	73%	53%	59%	65%	64%
Total liabilities and shareholders' equity	100%	100%	100%	100%	100%	100%	100%	100%
Market's perception of missed or incorrectly measured BS items								
Market-to-book ratio								
Shares outstanding (issued - treasury)	31,027	31,033	31,093	31,252	20,182	22,007	25,959	26,217
Fiscal year-end price per share (historical quote)	$ 684.51	$ 532.78	$ 297.46	$ 212.66	$ 174.89	$ 176.69	$ 158.34	$ 141.01
Market value of stockholders' equity	21,238,292	16,533,762	9,248,924	6,646,050	3,529,627	3,888,424	4,110,369	3,696,906
Book value of stockholders' equity	2,012,369	1,538,288	1,245,926	1,044,226	736,184	699,892	821,919	655,076
Market-to-book ratio	10.55	10.75	7.42	6.36	4.79	5.56	5.00	5.64

Source: Companies' websites. See accompanying notes in annual reports.

Comparing Income Statements and Select Performance Ratios - As reported

Numbers below are either disclosed on the company's statements with similar captions or they combine numbers with related captions.

	Chipotle Mexican Grill, Inc.				Panera Bread Company			
	Year end				Year end			
	31-Dec-14	31-Dec-13	31-Dec-12	31-Dec-11	30-Dec-14	31-Dec-13	25-Dec-12	27-Dec-11
INCOME STATEMENTS	USD Thousands $				USD Thousands $			
Net revenues	**4,108,269**	**3,214,591**	**2,731,224**	**2,269,548**	**2,529,195**	**2,385,002**	**2,130,057**	**1,822,032**
Cost of goods or services sold	2,325,401	1,813,314	1,532,839	1,281,839	1,507,703	1,393,239	1,243,032	1,070,679
Gross profit	**1,782,868**	**1,401,277**	**1,198,385**	**987,709**	**1,021,492**	**991,763**	**887,025**	**751,353**
Other operating income and (expenses)	(1,072,068)	(868,557)	(742,520)	(637,147)	(745,549)	(682,007)	(604,155)	(531,094)
Operating profit	**710,800**	**532,720**	**455,865**	**350,562**	**275,943**	**309,756**	**282,870**	**220,259**
Other income and (expenses)	3,503	1,751	1,820	(857)	1,351	2,964	126	(356)
Profit before taxes	**714,303**	**534,471**	**457,685**	**349,705**	**277,294**	**312,720**	**282,996**	**219,903**
Income tax refund (expense)	(268,929)	(207,033)	(179,685)	(134,760)	(98,001)	(116,551)	(109,548)	(83,951)
Net profit (loss) from continuing operations	**445,374**	**327,438**	**278,000**	**214,945**	**179,293**	**196,169**	**173,448**	**135,952**
SELECTED FINANCIAL DATA								
(controlling and non-controlling)								
Comprehensive Income	**443,325**	**328,034**	**278,827**	**214,536**	**178,266**	**195,164**	**173,812**	**135,985**
Beginning total assets	2,009,280	1,668,667	1,425,308	1,121,605	1,180,862	1,268,163	1,027,322	924,581
Ending total assets	2,546,285	2,009,280	1,668,667	1,425,308	1,390,902	1,180,862	1,268,163	1,027,322
Average total assets	**2,277,783**	**1,838,974**	**1,546,988**	**1,273,457**	**1,285,882**	**1,224,513**	**1,147,743**	**975,952**
(beginning + ending total assets)/2								
Beginning owners' equity	1,538,288	1,245,926	1,044,226	810,873	699,892	821,919	655,076	595,608
Ending owners' equity	2,012,369	1,538,288	1,245,926	1,044,226	736,184	699,892	821,919	655,076
Average owners' equity	**1,775,329**	**1,392,107**	**1,145,076**	**927,550**	**718,038**	**760,906**	**738,498**	**625,342**
(beginning + ending owners' equity)/2								
RATIOS BASED ON REPORTED NUMBERS								
Level 1: Comprehensive income								
Return-on-equity-Comprehensive Income (ROE-CI)	24.97%	23.56%	24.35%	23.13%	24.83%	25.65%	23.54%	21.75%
CI/average owners' equity								
Level 2: Major categories								
Return-on-equity (ROE)	25.09%	23.52%	24.28%	23.17%	24.97%	25.78%	23.49%	21.74%
net profit/average owners' equity								
Level 3: Significant Subcategories--DuPont Model								
Profit margin ratio	17.39%	16.63%	16.76%	15.41%	10.96%	13.11%	13.29%	12.07%
profit before taxes/revenue								
Asset turnover	1.80	1.75	1.77	1.78	1.97	1.95	1.86	1.87
revenue/average total assets								
Financial leverage	1.28	1.32	1.35	1.37	1.79	1.61	1.55	1.56
average total assets/average owners' equity								
Income tax factor	0.62	0.61	0.61	0.61	0.65	0.63	0.61	0.62
1- (tax expense/pretax income)								
Level 4: Line items								
Common size income statements:	Percent of revenues				Percent of revenues			
Net revenues	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
Cost of goods or services sold	56.60%	56.41%	56.12%	56.48%	59.61%	58.42%	58.36%	58.76%
Gross profit margin	43.40%	43.59%	43.88%	43.52%	40.39%	41.58%	41.64%	41.24%
Other operating income and (expenses)	-26.10%	-27.02%	-27.19%	-28.07%	-29.48%	-28.60%	-28.36%	-29.15%
Operating profit margin	17.30%	16.57%	16.69%	15.45%	10.91%	12.99%	13.28%	12.09%
Other income and (expenses)	0.09%	0.05%	0.07%	-0.04%	0.05%	0.12%	0.01%	-0.02%
Profit margin before taxes	17.39%	16.63%	16.76%	15.41%	10.96%	13.11%	13.29%	12.07%
Income tax expense	-6.55%	-6.44%	-6.58%	-5.94%	-3.87%	-4.89%	-5.14%	-4.61%
Net profit margin (loss)	10.84%	10.19%	10.18%	9.47%	7.09%	8.23%	8.14%	7.46%
Revenue growth	27.80%	17.70%	20.34%		6.05%	11.97%	16.91%	
(current year-prior year)/prior year								

Source: Companies' websites

See accompanying notes in the annual reports.

Restaurant Count Growth

	FY 2012	FY 2013	FY 2014	Planned FY 2015
Chipotle Mexican Grill, Inc.				
Company-owned Mexican Grill: US	1,398	1,572	1,755	
Company-owned Mexican Grill: International	11	16	17	
Company-owned: ShopHouse	1	6	9	
Company-owned: Pizzeria Locale		1	2	
Total	1,410	1,595	1,783	1,973-1,988
Panera Bread Company				
Company-owned: US	803	860	916	
Company-owned: Canada	6	7	9	
Franchise-operated: US	840	905	949	
Franchise-operated: Canada	3	5	6	
Total	1,652	1,777	1,880	1,985-1,995

Source: Companies

Year-Over-Year Comparable Sales Growth

	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
Chipotle Mexican Grill, Inc.					
Overall comp. resturant sales	9.4%	11.2%	7.1%	5.6%	16.8%
Panera Bread Company					
Company-owned	7.5%	4.9%	6.5%	2.6%	1.4%
Franchise-operated	8.2%	3.4%	5.0%	2.0%	0.9%

Comparable Sales is a non-GAAP metric widely used in retail that measures growth in sales for a comparable group of stores over time. Usually, companies report the change in sales for a group of stores that have been open for the duration of both time periods. This strips out sales growth due to store openings.

Source: Companies

Capitalizing Operating Leases: Balance Sheet Effects

Adjustments:

- Capitalized lease **asset** is classified as a non-current asset (PP&E). Thus, the reported and adjusted current assets are the same.
- Capitalized lease **liability** is split: part associated with lease payments due within a year is classified current and remainder is non-current, consistent with the proposed new accounting standard.

	Chipotle Mexican Grill, Inc.				Panera Bread Company			
	year end				year end			
	31-Dec-14	31-Dec-13	31-Dec-12	31-Dec-11	30-Dec-14	31-Dec-13	25-Dec-12	27-Dec-11
Assets	USD Thousands $				USD Thousands $			
Estimated non-current asset associated with capitalizing operating leases	2,129,480	1,978,003	1,699,077	1,449,600	1,085,140	1,021,373	950,072	1,121,154
Liabilities								
Estimated current liability associated with capitalizing operating leases	196,584	177,015	151,410	127,441	139,388	128,204	116,772	102,682
Estimated non-current liabiltiy associated with capitalizing operating leases	1,932,896	1,800,988	1,547,667	1,322,159	945,752	893,170	833,300	1,018,472
Estimated total liability associated with capitalizing operating leases	2,129,480	1,978,003	1,699,077	1,449,600	1,085,140	1,021,373	950,072	1,121,154

Source: Companies' websites
See accompanying notes in annual reports.

Capitalizing Operating Leases: Balance Sheet and Ratio Effects

Adjustments:

- Capitalized lease **asset** is classified as a non-current asset (PP&E). Thus, the reported and adjusted current assets are the same.
- Capitalized lease **liability** is split: part associated with lease payments due within a year is classified current and remainder is non-current, consistent with the proposed new accounting standard.

	Chipotle Mexican Grill, Inc.				Panera Bread Company			
	year end				year end			
	31-Dec-14	31-Dec-13	31-Dec-12	31-Dec-11	30-Dec-14	31-Dec-13	25-Dec-12	27-Dec-11
REPORTED & ADJUSTED BALANCE SHEET NUMBERS								
Assets	USD Thousands $				USD Thousands $			
Current assets								
Reported and adjusted current assets (are the same)	878,479	666,307	546,607	501,192	406,166	302,716	478,842	353,119
Total assets								
Total assets based on book values or adjusted book values:								
Reported total assets	2,546,285	2,009,280	1,668,667	1,425,308	1,390,902	1,180,862	1,268,163	1,027,322
Estimated non-current asset associated with capitalizing operating leases	2,129,480	1,978,003	1,699,077	1,449,600	1,085,140	1,021,373	950,072	1,121,154
Total assets adjusted for capitalizing operating leases	**4,675,765**	**3,987,283**	**3,367,744**	**2,874,908**	**2,476,042**	**2,202,235**	**2,218,235**	**2,148,476**
Total assets based on market values assuming operating leases NOT capitalized:								
Assumed market value of liabilities: reported liabilities (see below)	533,916	470,992	422,741	381,082	654,718	480,970	446,244	372,246
Market value of owners' equity	21,238,292	16,533,762	9,248,924	6,646,050	3,529,627	3,888,424	4,110,369	3,696,906
Estimated market value of total assets assuming operating leases NOT capitalized	**21,772,208**	**17,004,754**	**9,671,665**	**7,027,132**	**4,184,345**	**4,369,394**	**4,556,613**	**4,069,152**
Total assets based on market values assuming operating leases capitalized:								
Assumed market value of liabilities: reported plus capitalized (see below)	2,663,396	2,448,995	2,121,818	1,830,682	1,739,858	1,502,343	1,396,316	1,493,400
Market value of owners' equity	21,238,292	16,533,762	9,248,924	6,646,050	3,529,627	3,888,424	4,110,369	3,696,906
Estimated market value of total assets assuming operating leases capitalized	**23,901,688**	**18,982,757**	**11,370,742**	**8,476,732**	**5,269,485**	**5,390,767**	**5,506,685**	**5,190,306**
Liabilities								
Current liabilities based on book values or adjusted book values:								
Reported total current liabilities	245,710	199,228	186,852	157,453	352,712	303,325	277,540	238,334
Estimated current liability associated with capitalizing operating leases	196,584	177,015	151,410	127,441	139,388	128,204	116,772	102,682
Total current liabilities adjusted for capitalizing operating leases	**442,294**	**376,243**	**338,262**	**284,894**	**492,100**	**431,529**	**394,312**	**341,016**
Total liabilities based on book values or adjusted book values:								
Reported total liabilities	533,916	470,992	422,741	381,082	654,718	480,970	446,244	372,246
Estimated total liability associated with capitalizing operating leases	2,129,480	1,978,003	1,699,077	1,449,600	1,085,140	1,021,373	950,072	1,121,154
Total liabilities adjusted for capitalizing operating leases	**2,663,396**	**2,448,995**	**2,121,818**	**1,830,682**	**1,739,858**	**1,502,343**	**1,396,316**	**1,493,400**
RATIOS BASED ON REPORTED & ADJUSTED BALANCE SHEET NUMBERS								
Financial leverage *(year-end)*								
Liabilities/assets								
Based on book values or adjusted book values:								
Based on reported assets and liabilities	21%	23%	25%	27%	47%	41%	35%	36%
Based on reported assets and liabilities adjusted for capitalized operating leases	57%	61%	63%	64%	70%	68%	63%	70%
Based on market values:								
Assuming operating leases are NOT capitalized	2%	3%	4%	5%	16%	11%	10%	9%
Assuming operating leases are capitalized	11%	13%	19%	22%	33%	28%	25%	29%
Current ratio								
Current assets/ current liabilities								
Based on book values or adjusted book values:								
Based on reported assets and liabilities	3.58	3.34	2.93	3.18	1.15	1.00	1.73	1.48
Based on reported assets and liabilities adjusted for capitalized operating leases	1.99	1.77	1.62	1.76	0.83	0.70	1.21	1.04

Source: Companies' websites
See accompanying notes in annual reports.

Part I: Your overall claim, qualifier, and opening remarks

Analyze the two companies' future prospects at the most recent balance sheet dates, taking into consideration expected future return-on-equity (ROEs), risks, and growth rates. Importantly, base your analyses solely on concepts covered thus far in the course and the provided background information and tabular data (summarized from the company's financial statements). You may use the companies' balance sheets and income statements from their annual reports (to identify details not included in the tabular deta), however, other information in their annual report or elsewhere is beyond the scope of this exercise.

Write your responses in the template posted with the exercise materials, complying with the word limits stated therein.

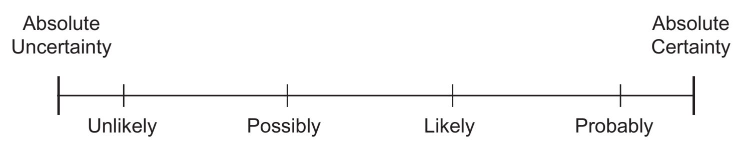
Overall Claim:

Fill in the blank with either Chipotle or Panera:

________________________________ appears to have the better future prospects at the most recent balance sheet dates, taking into consideration expected future ROEs, risks, and growth rates.

Qualifiers:

Put an X at the spot on the scale below that indicates the likelihood your overall claim is correct.



The Toulmin Method of Argumentation: The Second Triad, Keith Green
http://www.youtube.com/watch?v=-gRaC_vZiD8

Put an X at the spot on the scale that indicates the likelihood your overall claim is correct, given the available information and concepts covered thus far.

Your response should depend on the strength of your arguments, counterarguments, and rebuttals. For example, when you conclude your arguments and counterarguments are equally strong, your X will be near the middle of the scale. By contrast, when you conclude your arguments are very strong and there are no viable counterarguments, your X will be near the right end of the scale.

Given these directions, your response should ignore the possibility that other relevant information exists that could change your arguments, counterarguments, or rebuttals, and thus the confidence you have in your claim. As the course progresses and you learn how to acquire and use a wider range of information, your confidence will become more informed and your certainty will increase.

Your assessment of the likelihood the overall claim is correct (and thus where you place the X) may not agree with an expert's assessment (conditional on the same background information and concepts covered thus far). For example, you will be too confident if you overlook important counterarguments. Similarly, you will not be confident enough if you overlook strong rebuttals to your counterarguments.

Learning how to make informed claims by identifying and thoroughly vetting more arguments, counterarguments and rebuttals is the first step towards making good decisions based on these claims. For example, deciding whether you should invest in a stock after concluding it will outperform other stocks. The second step, which is equally important, is properly assessing the confidence you should attribute to a claim. The third is convincing others your analysis is solid and your confidence is justified.

Opening Remarks:

Assume you are presenting your analysis to an audience and your opening remarks will present your overall claim and briefly preview the way you assess the relative strengths of your arguments, counterarguments, and rebuttals without explicitly stating them. For example, if one company's future prospects didn't dominate in all three factors (future ROEs, risks, and growth rates), select the best overall company and explain how you weighed the factors for your overall claim.

Part II: Your arguments, counterarguments and rebuttals

Your response should be organized around the three factors considered in this exercise: **expected future** ROEs, growth rates, and risks. Importantly, ***you are required to use the balance sheets that have been adjusted for capitalized operating leases for your analyses.***

For each factor:

- Identify which company appears to have the better expected future prospects for the factor considered.
- Provide at least one, but no more than two, arguments supporting the company you identified as having the better expected future prospects for the factor considered, arranged according to your assessment of the company's strength for the factor (from strongest to weakest).
- Provide at least one, but no more than two, counterarguments, arranged according to your assessment of their challenge to the argument (from strongest to weakest).
- If possible provide rebuttals for your counterarguments.

Optional: Include other compelling points beyond those associated with the above three factors that bolster your analyzes, but still keeping within the allotted word limit.

Consistent with The Toulmin Model, each argument should provide evidence, and possibly a warrant and backing for the warrant. You need not identify the components. For example, you needn't state here is my evidence and here is its warrant. However, both must be present for each argument and while the warrant can be implied, the evidence and backing must be explicit. Keep in mind that the quality of your response depends more on the strength of the arguments you present rather than the number of arguments. For example, one concise, exceptional argument may be all you need.

Analysis Consideration Map - Phase 2