



Closing Danger Zone Pick: Zoe's Kitchen (ZOES) After 43% Gain

Danger Zone Pick, [Zoe's Kitchen](#) (ZOES: \$14/share), down 43% since publish date (S&P up 12% over same time), recently announced poor 2Q17 results and the stock fell over 20%. With the large price decline, the "[stupid money risk](#)" increases while the possibility of a short squeeze grows.

When we published our Danger Zone report, we noted that Zoe's Kitchen was destroying shareholder value. [Economic earnings](#) were in decline despite impressive revenue growth. Meanwhile, executives were incentivized with non-GAAP metrics that only fueled further shareholder destruction. Most alarming, Zoes' profitability ranked last amongst 18 peers including McDonalds (MCD), El Pollo Loco (LOCO), Shake Shack (SHAK), Panera Bread Company (PNRA), and Chipotle (CMG).

Zoe's Kitchen still earns our Dangerous rating. The company earns a bottom-quintile return on invested capital ([ROIC](#)) of 3%, and its NOPAT margins sit at 4%. In many ways, Zoe's Kitchen's issues have not abated. However, the lowered valuation changes the risk reward profile of the stock. We noted in our Danger Zone piece that the most Chipotle could pay for ZOES and not destroy shareholder value was \$15/share. With the current price below this implied price, a potential acquirer could surface.

At the same time, with 30% of ZOES float sold short, even the slightest bit of positive news could send shares soaring. We've seen such a short squeeze with another Danger Zone pick [Men's Wearhouse](#) (TLRD). In December 2016, the stock rose 55% after one positive quarter. At the risk of a similar squeeze in ZOES, we think the downside risk here is diminished and are closing this position.

We hope investors were able to avoid a portfolio blowup and participate in the 43% fall in the stock price since we placed ZOES in the Danger Zone.

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Disclosure: David Trainer, Kyle Guske II and Kenneth James receive no compensation to write about any specific stock, style, or theme.

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