Chipotle Mexican Grill

Rick Munarriz | January 17, 2007

CURRENT PRICE: CMG $ 1048.90 ↑ $ 0.95 (0.1%) [illegible]

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- Fast-growing "fresh Mex" restaurant chain is expanding with stellar comps as its competition is wilting away.
- Chipotle has blown away most Wall Street profit targets in all four quarters as a public company.
- Margins continue to widen, with plenty of room to run.

- NYSE: CMG
- www.chipotle.com
- Ph: 303-595-4000

Recent Price: $39.51-$67.77

I'm back in familiar territory this month. I started out my life of Fooldom in 1995 as MF Edible, brought in by Tom Gardner to cover food and restaurant stocks. Once in a while, there was a glimmer of growth. The casual steakhouse frenzy was a good one. We may all want to forget the themed restaurants phase, though it was pretty potent while it lasted. We've also seen a few of the upscale chophouses go public recently, but it's pretty much as ho-hum as white rice on a bed of slippery noodles.

Restaurant stocks look good when the hunger pangs kick in and it's time for some field research, but they can be pretty boring as investments. For the most part, this isn't a sector ripe with disruptive innovators. I have to make an exception, though, when it comes to **Chipotle Mexican Grill** (NYSE: CMG).

On the surface, Chipotle may not seem all that exciting. The Mexican quick-service chain has been around since 1993. How many "fresh Mex" chains do you have near you? Probably too many to count.

But Chipotle is different. Most of its competition is blah when it comes to investing appeal. **Wendy's** (NYSE: WEN) is unloading its Baja Fresh restaurants, while **CKE** (NYSE: CKR) has seen its La Salsa concept go stale. There are some success stories -- like the fast-growing Moe's Southwest Grill and **Jack in the Box**'s (NYSE: JBX) Qdoba -- but they're still early in their growth spurts. This is Chipotle's race to lose.

Stagnant big-name rivals have granted Chipotle the luxury of expanding 32% annually since 2002. If anything, the company's success in a niche crowded with mediocrity is both a moat and its ticket to becoming a Rule Breaker.

Anatomy of a Winning IPO

Chipotle was one of last year's top-performing IPOs. Priced at $22 a stub last January, the shares jumped at the open and closed at exactly $44 on the first day of trading. That perfect double was the sign of good things to come, as Chipotle's stock continued to inch higher over the next few months before peaking at $67.77 in May. That's certainly not too shabby for a company that until its market debut was a subsidiary of **McDonald's** (NYSE: MCD).

Chipotel: Earnings-Per-Share

Wall Street may have moved on to the newest flavors of the week, but Chipotle's fundamentals have never betrayed the initial hype. Let's take a closer look at how the company has flattened earnings-per-share estimates like a flour tortilla in its brief tenure as a public company:

In other words, analysts have yet to grasp the true earnings power of a company that is coming around like a perfectly rolled burrito.

No Time for a Siesta

What's leading the way at Chipotle? The popularity and portability of its proven concept. The chain has been able to grow to more than 500 locations without losing any steam at the store level. Through the first nine months of 2006, operating profits doubled on the strength of widening margins coupled with a 33% top-line spurt. Comps have soared 15% higher. This isn't a fluke, as same-unit sales posted double-digit gains through all of 2004 and 2005 as well.

Financial Snapshot

Oh, and don't let the restaurant count fool you into thinking that you're late to the expansion game here. Chipotle still has plenty of real estate left to conquer in a fast-food industry where the larger players have tens of thousands of locations. Chipotle is looking to add 95 to 105 company-owned restaurants this year and will still be a tenth of the size of **Yum Brands**' (NYSE: YUM) Taco Bell (and please don't tell any Chipotle fan that I dared to mention Chipotle and Taco Bell in the same sentence). Chipotle is a mere 2% the size of former parent McDonald's.

Analysts expect Chipotle to earn $1.54 a share this year after posting net income of $1.27 a share in 2006. Wall Street wasn't always this bullish. Just three months ago, those numbers stood at $1.31 and $1.07. Go back every quarter-thumping turn in Chipotle's life, and you'll see Wall Street pros who had to shrug their heads and raise their targets.

So even if we go by the recent price of $55 a share to arrive at Chipotle's earnings multiples (43 times trailing, 36 times forward), the company has been trending toward humbling the market mavens. In short, you may be getting an even better deal than you think if Chipotle keeps Wall Street's finest ratcheting up those projections.

Putting It All Together

Chipotle is a quality chain in a sea of mundane -- check out unofficial fan clubs like ChipotleFan.com -- but what does that mean for your portfolio? Let's take a closer look at a few of the nitty-gritty details that I like about Chipotle. Remember those high-flying comps? This means that the 401 units open at the end of 2004 were averaging $1.36 million a year in sales. By the end of 2005, there were 481 locations ringing up an average of $1.44 million a year. Through the third quarter of 2006, Chipotle has 539 units averaging $1.58 million.

Growing a fast-food chain is tough. Rising minimum wages and growing occupancy costs factor in alongside the fickle whims of fluctuating food prices. Being able to increase sales at the store level can help offset the pressures that trip up the ordinary players. In fact, labor and occupancy expenses have clocked in lower at Chipotle through the first three quarters of 2006. That trend should continue as the proven eatery grows into new markets. While most chains rely on franchisees, Chipotle favors the company-owned approach. As a result, it can dictate its own growth terms as well as make more on each successful addition, despite bankrolling the actual expansion.

Cynics may note that net income dropped in 2006, but that's the result of favorable tax provisions in 2005 versus the full corporate tax burden in 2006. That is why I have put the pre-tax net income figures into the snapshot to show that Chipotle is doing pretty well on that front (up 93% in 2006, as a matter of fact).

That kind of heady growth will stabilize in 2007, but the company still sees respectable comps growth and record expansion. All of the right ingredients are there for Chipotle to continue to cook up market-thumping gains over the next several years.

Dig in!