

Buy Chipotle Mexican Grill

Rick Munarriz | September 28, 2016 | [Buy Recommendation](#)

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

We've recommended Chipotle before! *When we re-recommend a stock, it's a sign of extra confidence in a company we already know well. While we don't advocate buying too much of any stock, we think you should give this one a longer look as you build a well-diversified portfolio of 15 or more stocks to own for at least three to five years.*

It's an understatement to say that the first time we recommended **Chipotle Mexican Grill** ([NYSE: CMG](#)), back in January 2007, its story was a little different. Back then, it was a fast-growing chain of more than 500 restaurants that was on its way to becoming the king of fast-casual dining; in the coming years, it would quadruple its store base as its stock price popped more than sixfold. Now, though, investors aren't so impressed with that glorious growth.

After hundreds of its customers were sickened by food-borne illnesses in a handful of separate outbreaks last year, Chipotle's garden-fresh image has taken a serious hit. Even though Chipotle has beefed up its food-safety practices and there have been no new confirmed outbreaks this year, the brand has been slow to recover.

But as painful as the fallout has been, we think better days are ahead. Chipotle has been aggressive in drumming up ways to get folks in front of its assembly lines again. And as they return, we think they'll rediscover what made these burritos beloved in the first place. We made Chipotle a Starter Stock this year believing in its ability to start earning serious guacamole again, and now, with the stock sitting less than 10% above its recent lows, we think this is a great time to invest in its comeback.

Placing a New Order

Let's get the unappetizing stuff out of the way first.

About 500 people are estimated to have gotten sick in a series of *E. coli*, norovirus, and salmonella outbreaks at Chipotle restaurants all over the country last year. Chipotle's stock began dropping as the news made the rounds, and by the time the federal Centers for Disease Control and Prevention pronounced the outbreaks over on Feb. 1, the stock had lost more than a third of its value from its peak in October. It's fallen a little more since then, and it's now down almost half.

You can see the loss of the public's trust in Chipotle's numbers: Same-store comps turned negative last November, and every quarter since then has brought double-digit percentage declines. The period ending this week is all but certain to stretch that streak to four. The comparisons should begin to get kinder this November, but positive comps will likely have to wait until early next year. Getting this business back to where it was before the stumble will take quite a bit longer than that.

We think time is the best medicine for what's ailing Chipotle. There hasn't been an outbreak since late last year, and the company's attempts to bring business back seem to be working. In September alone, we've seen free

WHAT IT DOES

Chipotle Mexican Grill is a fast-casual restaurant chain operating more than 2,000 eateries, specializing in burritos, tacos, bowls, and salads.

WHY BUY

- The stock is trading well below last October's peak, giving us a buying opportunity for a brand that should bounce back from its food-safety problems.
- Chipotle has been beefing up its promotional efforts through 2016, and same-restaurant sales comparisons will get easier in 2017.□
- There's more to Chipotle than its namesake chain, and the sibling concepts should be bigger parts of the story in the years to come.

KEY DATA

- **Headquarters:** Denver, Colo.
- **Website:** [www.chipotle.com](#)
- **Sign of a Breaker:** Top Dog and First Mover
- **Market Cap:** \$12,048
- **Cash/Debt:** \$270 / \$0
- **Revenue (2013/'14/'15):** \$3,215 / \$4,108 / \$4,501
- **Earnings (2013/'14/'15):** \$327 / \$445 / \$476
- **Recent Price:** \$413.81

BUYERS GUIDE

- **Industry:** Restaurants
- **Size:** Mid Cap
- **Region:** U.S.
- **Risk:** 9 out of 25 ([see all our stocks here](#))
- **Crushability:** Jawbreaker ([see the full scale here](#))
- **Most similar to:** Zoe's Kitchen, Middleby

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kid meals on Sunday and free non-alcoholic beverages for high school and college students. September is also the third and final month of Chiptopia, the company's temporary customer-loyalty program, where repeat visits in any given month would lead to free food prizes. Chiptopia has been modestly successful in getting the concept's biggest fans on board: Initial results this summer showed that its most frequent customers were picking up the pace on their repeat visits as a result of the program. It will now be up to more permanent loyalty rewards to reach deeper into mainstream audiences.

Extra Meat

Chipotle can also draw on its experience packing in customers without bells and whistles. The company had long been a favorite with Fools and diners alike before its contamination woes, and we think its quality will reassert itself.

Chipotle expects to add chorizo as a new protein later this year. The spiced pork-and-chicken sausage has been a hit in test markets, and a national rollout is slated for the fall. That should drum up some initial demand as a novelty, but the new offering should ultimately encourage repeat visits.

And the company isn't just relying on Mexican specialties: It has also expanded into Southeast Asian food with ShopHouse Kitchen and hopped on the quick-bake gourmet pizza craze with Pizzeria Locale. Both concepts are still in their early stages but growing. There are now 15 ShopHouse and seven Pizzeria Locale locations, and one day they could grow big enough to make the stock less dependent on the ups and downs of a single concept.

Meanwhile, Chipotle's traditional store base continues to expand. It expects to add another 220 to 235 units this year alone. By the time store-level sales return to peak levels — whether this happens in 2018 or beyond — the company will have meatier potential on both the top line and, ideally, the bottom..

Some will argue that this traditionally pricey stock is overvalued even now, but it's not fair to compare Chipotle's share price to its current state of depressed earnings and unit-level sales. Trailing earnings peaked in the third quarter of last year at \$16.76 per share. The stock is trading at roughly 25 times those peak earnings, but when it does come back it will be a slightly larger company with more catalysts and earnings potential than it had before.

Risks and When We'd Sell

The only thing falling harder than Chipotle's top line has been its bottom line. Ramped-up promotional efforts, costs related to extra food-safety initiatives, and the negative impact of sales deleverage have smacked earnings. Restaurant-level operating margin has fallen from 27.7% to 11.6% year over year through the first six months of 2016, and that includes the chain's first loss as a public company during the first quarter. It is starting to recover on that front, but we will have to see where margins are when things get back to normal.

We will naturally grow less patient with Chipotle if it takes longer than expected for comps to turn positive. Comps were already starting to decelerate before the outbreaks hit, and a big part of our bullish thesis is that the chain will regain some of its former glory as a popular concept. If folks continue to eat elsewhere in the future, we would naturally reconsider.

The stock has always commanded a premium to the market, and it's been mostly justified. But even we have our limits when it comes to valuation. Our second recommendation of Chipotle, from September 2009, is off our scorecard now because we recommended members cut their exposure in half in June 2012, calling the stock "uncomfortably overvalued." So far, that's proven to be wise; the stock has trailed the S&P 500 by more than 50 points since then (in fairness, Chipotle was ahead last year before news of the illnesses emerged).

The Foolish Bottom Line

Chipotle has been proven mortal, and the memory of the outbreaks will linger. However, as much as of a disappointment as it's been over the past year, it's been a dream stock over the past decade, and we think it's a great candidate to beat the market in the future.



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Dollar amounts are in millions (except recent price)
Data as of Sept. 23, 2016

[Aaron Bush](#) owns shares of Chipotle Mexican Grill and Middleby. [David Gardner](#) owns shares of Chipotle Mexican Grill and Middleby. [David Kretzmann](#) owns shares of Chipotle Mexican Grill, Middleby, and Zoe's Kitchen. [Rick Munarriz](#) owns shares of Zoe's Kitchen. [Tim Beyers](#) owns shares of Chipotle Mexican Grill. [Tom Gardner](#) owns shares of Chipotle Mexican Grill and Middleby. The Motley Fool owns shares of Chipotle Mexican Grill, Middleby, and Zoe's Kitchen.



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Market data provided by FactSet and Web Financial Group.