INVESTOR'S EDGE

Split creates compelling entry point for Chipotle

The fast casual chain expected to grow its profits 22% a year for the next five years.

"Focus on just a few things, and do them better than anybody else." — Steve Ells, Chipotle founder

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Guest columnist

As a stock investor, I like simple, easy to understand businesses that are highly profitable. If I use their products or services, all the better.

Chipotle Mexican Grill (ticker symbol: CMG) is one such company. I enjoy having a meal there, as it is simple, clean eating at a very affordable price. And I like their stock too, which recently split 50-for-1 and sells about 10% off its high at the time of this writing — providing a compelling entry point.

As you may know, Chipotle is the largest fast casual restaurant chain in the United States. The company sells highly popular burritos, tacos, quesadillas, and its famous guacamole. Chipotle's brand is built around freshness, convenience, and taste. They are based in Newport Beach, California and have 120,000 full-time employees.

The investment thesis for Chipotle Mexican Grill is centered around simplicity and profitability. Chipotle rents out a relatively small space — roughly 2,000-3,000 square feet — for its restaurants. Their focus on fresh, never frozen ingredients keeps their inventory light and overhead costs very low. In fact, it costs Chipotle on average $2.95 per burrito bowl, which it then sells for $10-12.

Sounds like a license to print money.

In fact, Chipotle is projected to grow its profits by 22% a year for the next five years. That's double the projected earnings of the broad S&P 500 Index and almost triple that of rivals McDonald's and Yum Brands.

Chipotle is aggressively expanding on this successful business model. So, while Chipotle is very popular in urban areas, it is underrepresented in suburban areas, where many of its affluent customers live. The company currently has 3,500 locations in North America and plans to grow that by more than 40% to 5,000 stores within the next five years. Chipotle's long-run target for North American stores is a whopping 7,000 — double from where it is now.

The company is also accelerating its international presence, opening its first stores in the Middle East this past April and increasing its hold in Western Europe. Chipotle recently expressed confidence about its international expansion plans and its eagerness to spread its brand beyond North America.

Simply put, Chipotle's restaurant growth has a long runway to go, which should bolster the company's stock price going forward.

As I mentioned above, last month Chipotle completed a 50-for-1 stock split, bringing its share price from more than $3,000 per share to about $60 at the time of this writing — or by my math — about five or six burrito bowls per share. Yummy.

The primary goal of the split is to make the stock more accessible to small investors and, most importantly, Chipotle's employees. So, while the value of the company's stock doesn't change because of a stock split, there is an indication that splits do attract investors and thus improve stock returns. In fact, companies who split their stock see an average return of 25% a year later, or double that of the S&P 500 Index, according to Bank of America. Another reason to give Chipotle's stock a look.

My fellow Chipotle fans know that the company's brand is more than just a restaurant chain. It's a significant part of our popular culture, with a heavy following across multiple generations. Five years ago, Chipotle rolled out a membership rewards program which now stands at over 40 million members. That's a lot of hungry burrito fans!

As with any investment, there are risks. Chipotle is not a cheap stock, selling at a rich valuation, and the company is also sensitive to both inflation and consumer confidence, which directly impacts sales and profit margins.

However, given the growth profile of the stock, its loyal customer base, and delicious food, I believe a premium is warranted.

As some of you may recall, I wrote about Chipotle back in 2017 back when it was in the throes of its E-coli scandal. The stock has been piping hot since then, but the recent pullback, along with the stock split, presents a real opportunity to own a growing brand name franchise.

Buy the food. Buy the stock. You'll feel full of good things.

Jim Burns, a chartered financial analyst, is president of J.W. Burns & Co. The opinions expressed here are his and do not necessarily reflect those of The Post-Standard. Readers should do research before deciding on an investment. Contact him at jburns@jwburns.com

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