CHIPOTLE STOCK DOWN $50 OVERNIGHT - A BUYING OPPORTUNITY? - available to non-subscribers

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Chipotle reported earnings last evening and the stock promptly dropped from $705. To $650 overnight. Earnings were a few cents below street estimates and the same store sales were up 2.6% (on top of a phenomenal 19.6% figure a year ago), a scant 0.1% ahead of expectations. The corporate overview for the rest of the year was not changed materially, sales and traffic in line with the third quarter, a record number of store openings, and continued growth of the incubating Shophouse and Pizzeria Locale brands. A fine company with a great history of growth, debt free with over $600 million in cash ($20/share) up from $419 million nine months ago, generating a 24.6% after tax return on equity and a 19.6% after tax return on assets (according to Bloomberg). Seems to be a substantial overreaction (typical these days) to earnings that failed to beat expectations in a material way.

HOWEVER: STOCK PRICED TO PERFECTION, JULY WAS STRONGEST MONTH (WITH BOGOS), OCTOBER “CHOPPY”, LABOR COSTS COULD HURT, STOCK BUYBACKS UNWISE, NEW CONCEPTS ALWAYS QUESTIONABLE

Maintaining a price earnings multiple at substantially more than the growth rate is always difficult, requiring all the growth parameters to be in gear. Momentum investors require increasing same store sales and traffic, steady unit growth, steady margins at least, continued high returns on equity and assets. When the “second derivative”, the rate of increase in these parameters decreases, valuation metrics almost inevitably decrease. Within the conference call, the reference to “choppy sales” in August, September and October so far, expected increases in hourly wages, 2 million BOGO (Buy one, Get one free, basically a half price deal) transactions in July which was the strongest month of the quarter were all sobering considerations. Regarding the company spending $147 million in stock buybacks (“returning cash to shareholders”) the stock bought at an average of $642/share, almost 40x forward earnings and over 15s forward EBITDA, not exactly a bargain. It is also interesting that the average shares outstanding did not shrink during the nine month reporting period, so most of those shares were obviously reissued in stock options (“returning shareholder cash to executives?”) Finally, in reference to their two new concepts, Shophouse and Pizzeria Locale, no numbers have been provided regarding sales per square foot, investment per unit, or sales trends. We have no doubt that management is optimistic about these young concepts. However, we can think of NO successful restaurant company developing another concept that matched the first in terms of success. We go back as far as Wendy’s and it’s promising (at the time) Sister’s Chicken and Biscuits in the 1980s, and many other examples over the years.

CONCLUSION

We don’t doubt that Chipotle will continue to succeed in the future. It has been truly “disruptive” in the fast food space, spawning imitators from Tacos to Burgers, to Salad to Pizza. Trading, as I write this, at $656, down $50 from last night’s close, still over thirty times estimated 2016 earnings, I consider CMG far from a bargain.

You've Asked Rog:

I know that Whole Foods is not a restaurant stock, but food is food. If you follow it, what do you think?

Rog Answers:

I've followed it, from a distance, for many years, and of course have shopped there. The concern there has been increasing competition, which has lowered their margins as well as their same store sales trends. They report a couple of weeks from now so we will know more then. It's tempting at under 8 times trailing EBITDA, not much risk in any event. I would rather be long than short going into the earnings report.