A Review of My Investment in Chipotle

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Chipotle Mexican Grill (CMG: NYSE)	
First bought on:	21/Feb/2017
Last sold on:	5/Aug/2019
Avg. buy price:	$432.50
Avg. sell price:	$780.45
Annualized return:	27%
80.45% realized gain over a holding period of 2.45 years	

CMG is one of the most successful restaurant concepts in the last 30 years. The company was founded in 1993 by Steve Ells who helped pioneer the concept of high-quality food made with fresh ingredients in a fast-casual environment.

When I first invested in CMG its market cap was around $12.5 billion. Back then, the sentiment surrounding the company was extremely negative. The company had just been hit with a series of E. Coli outbreaks and same-store-sales were rapidly dropping.

What intrigued me was that many restaurant companies have had food safety issues. For example, Jack in the Box suffered an E. Coli outbreak in 1993. It was a horrible tragedy in which over 700 people were infected, 171 people hospitalized and 4 children died. Other chains such as Taco Bell have also suffered similar food safety issues. In both cases, sales eventually recovered over time.

I believed that the problems at CMG were less serious and addressable. The problem was that the company was opening restaurants very rapidly and its supply chain couldn't keep up. To make matters worse, it didn't have a system to track fresh ingredients and therefore couldn't isolate the problem.

Usually, I have no interest in investing in troubled companies because most turnarounds don't turn. However, CMG appeared attractive for 3 main reasons:

1. Firstly, the company was profitable and free cash flow positive throughout the food safety issues. Additionally, the company had *zero* debt on the balance sheet. This highlighted the strength and resilience of the brand.

2. Secondly, all CMG restaurants are company-owned. This is important because by having control over its real estate, management can make quick operational changes.

3. Thirdly, before the food safety issues, average sales per CMG restaurant was about $2.5 million with peak restaurant margins of 27% – nearly the highest in the industry. This was achieved with no contribution from breakfast, dessert, late hours, drive-thru, loyalty program, mobile ordering, delivery sales, and international expansion.

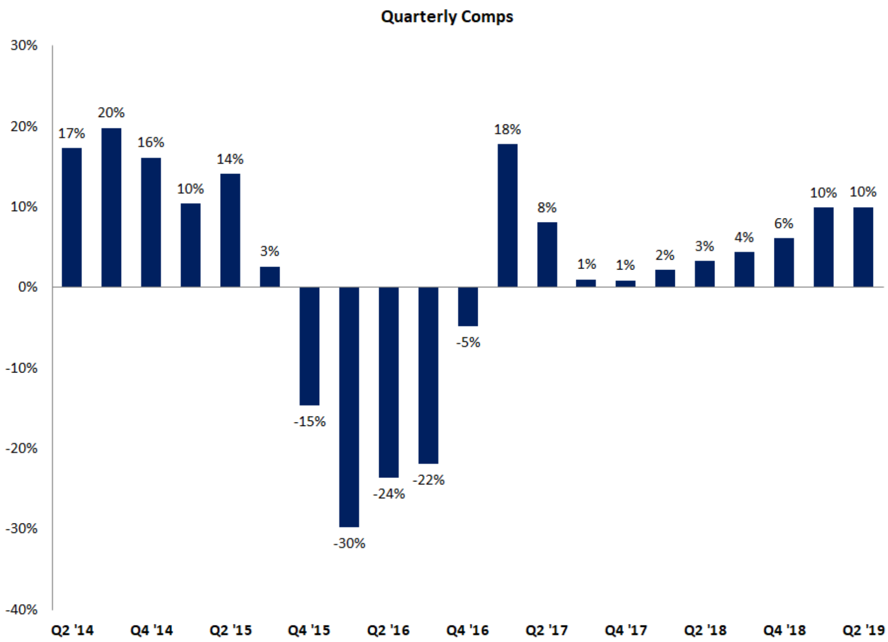
After investing, the company made several key changes:

12 Dec. 2016:	Drops dual CEO model. Founder Steve Ells becomes sole CEO
16 Dec. 2016:	Board refresh. New directors added
7 Mar. 2017:	Announces closure of all 15 ShopHouse Asian Kitchen restaurants
11 May 2017:	Hires Scott Boatwright from Arby's as Chief Restaurant Officer
13 Feb. 2018:	Hires Brian Niccol from Yum! Brands Taco Bell as new CEO
20 Mar. 2018:	Hires Chris Brandt as new Chief Marketing Officer

The most significant development was the hiring of Brian Niccol from Taco Bell as the company's new CEO. Under Brian and his new leadership team, the company has undergone a cultural and operational transformation. Recent quarterly results reflect the outstanding job by Brian and his team.

Chipotle CEO Brian Niccol

Same-store-sales have rebounded strongly:



I got very lucky when Congress rewrote the US Tax Code in 2017. The lower corporate tax rate boosted the company's intrinsic value by increasing the value of every pretax dollar the company earns by more than 15%. Since CMG is a US business it reaped the full benefit of the tax cut. Moreover, the business will not suffer from any direct impact from the Chinese tariffs.

With digital sales accelerating, healthy delivery business, improving restaurant margins, the addition of new menu items, the rolling out of a second make-line, in-store pick-up, supply chain efficiencies, and a new loyalty program – the company is pretty much firing on all cylinders. Besides, CMG's delivery business is highly incremental. This means it attracts new orders without replacing existing orders. Management has also indicated that the company has the potential to double its existing store count and eventually reach 5,000 units in the US.

It was fortunate that the market corrected itself quickly and "pulled forward" two or three years' worth of gains in a year or so. It appears that CMG is still in the early innings of its transformation and I may have exited too soon. Nevertheless, I believe that you make money with old friends and I would be keen to own it again if the opportunity arises.