

CHIPOTLE MEXICAN GRILL INC  
Form 10-Q  
October 21, 2014

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

**FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended September 30, 2014**

**or**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number: 1-32731**

**CHIPOTLE MEXICAN GRILL, INC.**

**(Exact name of registrant as specified in its charter)**

**Delaware**  
**(State or other jurisdiction of**  
**incorporation or organization)**

**84-1219301**  
**(IRS Employer**  
**Identification No.)**

**1401 Wynkoop St., Suite 500 Denver, CO**  
**(Address of Principal Executive Offices)**

**80202**  
**(Zip Code)**

**Registrant's telephone number, including area code: (303) 595-4000**

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  Yes  No

Edgar Filing: CHIPOTLE MEXICAN GRILL INC - Form 10-Q

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  Yes  No

As of October 15, 2014 there were 31,012,663 shares of the registrant's common stock, par value of \$0.01 per share outstanding.

**TABLE OF CONTENTS**

**PART I**

Item 1.	<u>Financial Statements</u>	1
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	8
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	12
Item 4.	<u>Controls and Procedures</u>	13

**PART II**

Item 1.	<u>Legal Proceedings</u>	13
Item 1A.	<u>Risk Factors</u>	13
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	14
Item 3.	<u>Defaults Upon Senior Securities</u>	14
Item 4.	<u>Mine Safety Disclosures</u>	14
Item 5.	<u>Other Information</u>	14
Item 6.	<u>Exhibits</u>	14
	<u>Signatures</u>	15

## PART I

## ITEM 1. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

## Chipotle Mexican Grill, Inc.

## Condensed Consolidated Balance Sheet

(in thousands, except per share data)

	September 30 2014 (unaudited)	December 31 2013
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 442,618	\$ 323,203
Accounts receivable, net of allowance for doubtful accounts of \$1,180 and \$1,190 as of September 30, 2014 and December 31, 2013, respectively	18,949	24,016
Inventory	15,885	13,044
Current deferred tax asset	15,795	13,212
Prepaid expenses and other current assets	33,632	34,204
Income tax receivable		3,657
Investments	346,991	254,971
Total current assets	873,870	666,307
Leasehold improvements, property and equipment, net	1,052,684	963,238
Long term investments	440,949	313,863
Other assets	47,611	43,933
Goodwill	21,939	21,939
Total assets	\$ 2,437,053	\$ 2,009,280
<b>Liabilities and shareholders equity</b>		
Current liabilities:		
Accounts payable	\$ 88,398	\$ 59,022
Accrued payroll and benefits	78,159	67,195
Accrued liabilities	73,781	73,011
Income tax payable	24,648	
Total current liabilities	264,986	199,228
Deferred rent	211,918	192,739
Deferred income tax liability	38,978	55,434
Other liabilities	27,407	23,591
Total liabilities	543,289	470,992
Shareholders equity:		

Edgar Filing: CHIPOTLE MEXICAN GRILL INC - Form 10-Q

Preferred stock, \$0.01 par value, 600,000 shares authorized, no shares issued as of September 30, 2014 and December 31, 2013, respectively		
Common stock \$0.01 par value, 230,000 shares authorized, and 35,345 and 35,245 shares issued as of September 30, 2014 and December 31, 2013, respectively	353	352
Additional paid-in capital	1,015,621	919,840
Treasury stock, at cost, 4,328 and 4,212 common shares at September 30, 2014 and December 31, 2013, respectively	(723,826)	(660,421)
Accumulated other comprehensive income	579	1,620
Retained earnings	1,601,037	1,276,897
 Total shareholders' equity	 1,893,764	 1,538,288
 Total liabilities and shareholders' equity	 \$ 2,437,053	 \$ 2,009,280

*See accompanying notes to condensed consolidated financial statements.*

## Chipotle Mexican Grill, Inc.

## Condensed Consolidated Statement of Income and Comprehensive Income

(unaudited)

(in thousands, except per share data)

	Three months ended		Nine months ended	
	September 30		September 30	
	2014	2013	2014	2013
Revenue	\$ 1,084,222	\$ 826,907	\$ 3,038,458	\$ 2,370,444
Restaurant operating costs (exclusive of depreciation and amortization shown separately below):				
Food, beverage and packaging	372,063	277,503	1,047,003	787,602
Labor	230,360	188,709	667,097	545,982
Occupancy	58,838	50,128	169,938	146,312
Other operating costs	110,957	89,060	321,512	252,012
General and administrative expenses	71,172	52,726	212,968	147,889
Depreciation and amortization	27,961	24,618	80,724	71,151
Pre-opening costs	3,829	4,604	11,521	10,736
Loss on disposal of assets	1,606	2,405	4,767	5,144
Total operating expenses	876,786	689,753	2,515,530	1,966,828
Income from operations	207,436	137,154	522,928	403,616
Interest and other income (expense), net	785	765	2,618	1,361
Income before income taxes	208,221	137,919	525,546	404,977
Provision for income taxes	(77,420)	(54,540)	(201,406)	(157,161)
Net income	\$ 130,801	\$ 83,379	\$ 324,140	\$ 247,816
Earnings per share:				
Basic	\$ 4.22	\$ 2.70	\$ 10.44	\$ 8.01
Diluted	\$ 4.15	\$ 2.66	\$ 10.29	\$ 7.93
Weighted average common shares outstanding:				
Basic	31,020	30,897	31,043	30,937
Diluted	31,547	31,296	31,502	31,234
Comprehensive income	\$ 129,412	\$ 84,890	\$ 323,099	\$ 248,190

See accompanying notes to condensed consolidated financial statements.





## Chipotle Mexican Grill, Inc.

## Condensed Consolidated Statement of Cash Flows

(unaudited)

(in thousands)

	Nine months ended September 30	
	2014	2013
<b>Operating activities</b>		
Net income	\$ 324,140	\$ 247,816
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	80,724	71,151
Deferred income tax (benefit) provision	(19,045)	6,585
Loss on disposal of assets	4,767	5,144
Bad debt allowance	(10)	24
Stock-based compensation expense	82,156	50,622
Excess tax benefit on stock-based compensation	(12,971)	(17,694)
Other	9	403
Changes in operating assets and liabilities:		
Accounts receivable	5,250	2,200
Inventory	(2,851)	(1,415)
Prepaid expenses and other current assets	547	(7,304)
Other assets	(3,723)	(3,428)
Accounts payable	14,706	3,389
Accrued liabilities	11,462	(19,966)
Income tax payable/receivable	41,274	28,531
Deferred rent	19,380	18,939
Other long-term liabilities	3,941	3,718
<b>Net cash provided by operating activities</b>	<b>549,756</b>	<b>388,715</b>
<b>Investing activities</b>		
Purchases of leasehold improvements, property and equipment	(160,400)	(136,665)
Purchases of investments	(390,632)	(293,929)
Maturities of investments	171,250	106,750
<b>Net cash used in investing activities</b>	<b>(379,782)</b>	<b>(323,844)</b>
<b>Financing activities</b>		
Acquisition of treasury stock	(63,405)	(97,655)
Excess tax benefit on stock-based compensation	12,971	17,694
Other financing proceeds (payments)	(69)	185
<b>Net cash used in financing activities</b>	<b>(50,503)</b>	<b>(79,776)</b>
Effect of exchange rate changes on cash and cash equivalents	(56)	428

Net change in cash and cash equivalents	119,415	(14,477)
Cash and cash equivalents at beginning of period	323,203	322,553
Cash and cash equivalents at end of period	\$ 442,618	\$ 308,076

**Supplemental disclosures of cash flow information**

Increase in purchases of leasehold improvements, property and equipment accrued in accounts payable	\$ 13,804	\$ 8,181
---	-----------	----------

*See accompanying notes to condensed consolidated financial statements.*

**Chipotle Mexican Grill, Inc.**

**Notes to Condensed Consolidated Financial Statements**

**(unaudited)**

**(dollar and share amounts in thousands, unless otherwise specified)**

**1. Basis of Presentation**

Chipotle Mexican Grill, Inc. together with its subsidiaries, (the Company), a Delaware corporation, develops and operates fast-casual, fresh Mexican food restaurants. As of September 30, 2014, the Company operated 1,698 Chipotle restaurants throughout the United States. The Company also had seven Chipotle restaurants in Canada, six in England, three in France, and one in Germany. Further, the Company operated eight ShopHouse Southeast Asian Kitchen restaurants, serving fast-casual, Asian inspired cuisine, as well as is an investor in a consolidated entity that owned and operated one Pizzeria Locale, a fast casual pizza concept. The Company transitioned the management of its operations from nine to eight regions during the third quarter of 2014 and has aggregated its operations to one reportable segment.

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with U.S. generally accepted accounting principles for interim financial statements and pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments consisting of normal recurring adjustments necessary for a fair presentation of its financial position and results of operations. Interim results of operations are not necessarily indicative of the results that may be achieved for the full year. The financial statements and related notes do not include all information and footnotes required by U.S. generally accepted accounting principles for annual reports. This quarterly report should be read in conjunction with the consolidated financial statements included in the Company's annual report on Form 10-K for the year ended December 31, 2013.

The Company has evaluated subsequent events and transactions for potential recognition or disclosure in the financial statements through the day the financial statements are issued.

**2. Recently Issued Accounting Standards**

In May 2014, the Financial Accounting Standards Board (FASB) issued ASU No. 2014-09, Revenue from Contracts with Customers. The pronouncement was issued to clarify the principles for recognizing revenue and to develop a common revenue standard and disclosure requirements for U.S. GAAP and IFRS. The pronouncement is effective for reporting periods beginning after December 15, 2016. The adoption of ASU 2014-09 is not expected to have a significant impact on the Company's consolidated financial position or results of operations.

**3. Fair Value of Financial Instruments**

The carrying value of the Company's cash and cash equivalents, accounts receivable and accounts payable approximate fair value because of their short-term nature. Investments, all of which are classified as held-to-maturity, are carried at amortized cost, which approximates fair value. Investments consist of U.S. treasury notes and CDARS, certificates of deposit placed through an account registry service, with maturities up to approximately two years. Fair market value of U.S. treasury notes is measured using level 1 inputs (quoted prices for identical assets in active markets) and fair market value of CDARS is measured based on level 2 inputs (quoted prices for identical assets in markets that are not active).

The Company also maintains a rabbi trust to fund obligations under a deferred compensation plan. Amounts in the rabbi trust are invested in mutual funds, which are designated as trading securities and carried at fair value, and are included in other assets in the consolidated balance sheet. Fair market value of mutual funds is measured using level 1 inputs (quoted prices for identical assets in active markets). The fair value of the investments in the rabbi trust was \$15,644 and \$13,397 as of September 30, 2014 and December 31, 2013, respectively. The Company records trading gains and losses in general and administrative expenses in the consolidated statement of income, along with the offsetting amount related to the increase or decrease in deferred compensation to reflect its exposure to liabilities for payment under the deferred plan. The Company recorded \$360 in unrealized losses on investments held in the rabbi trust during the three months ended September 30, 2014, and \$76 of unrealized gains on investments held in the rabbi trust during the nine months ended September 30, 2014. The Company recorded \$289 and \$427 of unrealized gains on investments held in the rabbi trust during the three and nine months ended September 30, 2013, respectively.

#### **4. Shareholders Equity**

The Company has announced authorizations by its Board of Directors of repurchases of shares of common stock, which in the aggregate authorized expenditures of up to \$800,000. Under the remaining repurchase authorization, shares may be purchased from time to time in open market transactions, subject to market conditions.

During the nine months ended September 30, 2014, the Company repurchased 116 shares of common stock under authorized programs, for a total cost of \$63,405. The cumulative shares repurchased under authorized programs as of September 30, 2014 are 4,175 for a total cost of \$673,495. As of September 30, 2014, \$126,800 was available to repurchase shares under the current repurchase authorizations. The shares are being held in treasury stock until such time as they are reissued or retired at the discretion of the Board of Directors.

## 5. Stock-based Compensation

During the nine months ended September 30 2014, the Company granted stock only stock appreciation rights ( SOSARs ) on 763 shares of its common stock to eligible employees, of which 220 include performance conditions. The weighted average grant date fair value of the SOSARs was \$136.12 per share with a weighted average exercise price of \$545.45 per share based on the closing price of common stock on the date of grant. The SOSARs (other than those subject to performance conditions) vest in two equal installments on the second and third anniversary of the grant date. During the nine months ended September 30, 2014, 229 SOSARs were exercised, 37 SOSARs were forfeited, and 2 non-vested stock awards vested.

Total stock-based compensation expense was \$21,024 and \$83,021 (\$12,944 and \$51,116 net of tax) for the three and nine months ended September 30, 2014, respectively, and was \$16,567 and \$51,465 (\$10,069 and \$31,280 net of tax) for the three and nine months ended September 30, 2013, respectively. During the second quarter of 2014, the Company increased its estimate of the number non-vested stock awards subject to performance conditions that it expects will vest, which resulted in a cumulative adjustment to expense of \$1,616 (\$995 net of tax and \$0.03 to basic and diluted earnings per share). A portion of stock-based compensation totaling \$269 and \$865 for the three and nine months ended September 30, 2014, respectively, and \$278 and \$843 for the three and nine months ended September 30, 2013, respectively, was recognized as capitalized development and is included in leasehold improvements, property and equipment in the consolidated balance sheet.

## 6. Earnings Per Share

Basic earnings per share is calculated by dividing income available to common shareholders by the weighted-average number of shares of common stock outstanding during each period. Diluted earnings per share ( diluted EPS ) is calculated using income available to common shareholders divided by diluted weighted-average shares of common stock outstanding during each period. Potentially dilutive securities include common shares related to SOSARs and non-vested stock awards (collectively stock awards ). For the three and nine months ended September 30, 2014, 32 and 298 stock awards, respectively, were excluded from the calculation of diluted EPS and for the three and nine months ended September 30, 2013, 7 and 523 stock awards, respectively, were excluded from the calculation of diluted EPS because they were anti-dilutive. In addition, 382 and 386 stock awards for the three and nine months ended September 30, 2014, respectively, and 287 and 411 stock awards for the three and nine months ended September 30, 2013, respectively, were excluded from the calculation of diluted EPS because they were subject to performance conditions.

The following table sets forth the computations of basic and diluted earnings per share:

	Three months ended September 30		Nine months ended September 30	
	2014	2013	2014	2013
Net income	\$ 130,801	\$ 83,379	\$ 324,140	\$ 247,816
Shares:				
Weighted average number of common shares outstanding	31,020	30,897	31,043	30,937
Dilutive stock awards	527	399	459	297
Diluted weighted average number of common shares outstanding	31,547	31,296	31,502	31,234
Basic earnings per share	\$ 4.22	\$ 2.70	\$ 10.44	\$ 8.01
Diluted earnings per share	\$ 4.15	\$ 2.66	\$ 10.29	\$ 7.93

## 7. Commitments and Contingencies

### *Notices of Inspection of Work Authorization Documents and Related Civil and Criminal Investigations*

Following an inspection during 2010 by the U.S. Department of Homeland Security, or DHS, of the work authorization documents of the Company's restaurant employees in Minnesota, the Immigration and Customs Enforcement arm of DHS, or ICE, issued to the Company a Notice of Suspect Documents identifying a large number of employees who, according to ICE and notwithstanding the Company's review of work authorization documents for each employee at the time they were hired, appeared not to be authorized to work in the U.S. The Company approached each of the named employees to explain ICE's determination and afforded each employee an opportunity to confirm the validity of their original work eligibility documents, or provide valid work eligibility documents. Employees who were unable to provide valid work eligibility documents were terminated in accordance with the law. In December 2010, the Company was also requested by DHS to provide the work authorization documents of restaurant employees in the District of Columbia and Virginia, and the Company provided the requested documents in January 2011. The Company has subsequently received requests from the office of the U.S. Attorney for the District of Columbia for work authorization documents covering all of the Company's employees since 2007, plus employee lists and other documents concerning work authorization. The Company believes its practices with regard to the work

authorization of its employees, including the review and retention of work authorization documents, are in compliance with applicable law. However, the termination of large numbers of employees in a short period of time does disrupt restaurant operations and results in a temporary increase in labor costs as new employees are trained.

In May 2012, the U.S. Securities and Exchange Commission notified the Company that it is conducting a civil investigation of the Company's compliance with employee work authorization verification requirements and its related disclosures and statements, and the office of the U.S. Attorney for the District of Columbia advised the Company that its investigation has broadened to include a parallel criminal and civil investigation of the Company's compliance with federal securities laws. The Company intends to continue to fully cooperate in the government's investigations. It is not possible at this time to determine whether the Company will incur, or to reasonably estimate the amount of, any fines, penalties or further liabilities in connection with these matters.

*Shareholder Derivative Actions*

On July 12, 2012, Ralph B. Richey filed a shareholder derivative action in the U.S. District Court for the District of Colorado alleging that the members of the Company's Board of Directors breached their fiduciary duties in connection with employee work authorization compliance matters. On September 21, 2012, Joanne Nelson filed a shareholder derivative action in the same court alleging that the members of the Company's Board of Directors and the Company's Chief Financial Officer breached their fiduciary duties, caused waste of corporate assets, and were unjustly enriched in connection with employee work authorization compliance matters, as well as in connection with the Company's alleged failure to disclose material information about the Company's business results and prospects, and in connection with compensation paid to some of the Company's officers. On October 4, 2012, Francis Schmitz filed a shareholder derivative action in the same court, making allegations substantially the same as those in the Nelson complaint. Each of these actions purports to state a claim for damages on behalf of the Company, and is based on statements in the Company's SEC filings and related public disclosures, as well as media reports and Company records, in part regarding the matters described above under *Notices of Inspection of Work Authorization Documents and Related Civil and Criminal Investigations*. On January 17, 2013, these three shareholder derivative actions were consolidated by the court and proceeded as a single action. On August 20, 2014, the court approved a settlement of the consolidated cases, under which the Company agreed to pay plaintiffs' attorneys' fees and to put in place additional oversight procedures related to employee work authorization compliance. Amounts payable under the settlement were accrued in the Company's financial statements in prior periods, and the additional procedures required under the settlement will not have a material impact on the Company. As a result of this settlement, these cases are now concluded.

*Miscellaneous*

The Company is involved in various other claims and legal actions that arise in the ordinary course of business. The Company does not believe that the ultimate resolution of these actions will have a material adverse effect on the Company's financial position, results of operations, liquidity or capital resources. However, a significant increase in the number of these claims, or one or more successful claims under which the Company incurs greater liabilities than the Company currently anticipates, could materially and adversely affect the Company's business, financial condition, results of operations and cash flows.



---

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### *Cautionary Note Regarding Forward-Looking Statements*

*Certain statements in this report, including projections of our number and type of new restaurant openings, comparable restaurant sales increases, food and labor cost trends, and general and administrative expenses, as well as discussion of possible stock repurchases and estimates of our effective tax rates, are forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. We use words such as anticipate, believe, could, should, estimate, expect, intend, may, predict, project, target, and similar terms and phrases, including references to assumptions, to identify forward-looking statements. These forward-looking statements are based on information available to us as of the date any such statements are made, and we assume no obligation to update these forward-looking statements. These statements are subject to risks and uncertainties that could cause actual results to differ materially from those described in the statements. These risks and uncertainties include, but are not limited to, the risk factors described in our annual report on Form 10-K for the year ended December 31, 2013, as updated in Part II, Item 1.A of this report.*

### **Overview**

Chipotle operates fresh Mexican food restaurants serving burritos, tacos, burrito bowls (a burrito without the tortilla) and salads. We began with a simple philosophy: demonstrate that food served fast doesn't have to be a traditional fast-food experience. We do this by avoiding a formulaic approach when creating our restaurant experience, looking to fine dining restaurants for inspiration. We use high-quality raw ingredients, classic cooking methods and distinctive interior design, and have friendly people to take care of each customer features that are more frequently found in the world of fine dining. Our approach is also guided by our belief in an idea we call Food With Integrity. Our objective is to find the highest quality ingredients we can ingredients that are grown or raised with respect for the environment, animals and people who grow or raise the food. A similarly focused people culture, with an emphasis on identifying and empowering top performing employees, enables us to develop future leaders from within.

### **2014 Highlights**

*Restaurant Development.* As of September 30, 2014, we had 1,724 restaurants in operation, including 1,698 Chipotle restaurants throughout the United States, with an additional seven in Canada, six in England, three in France, and one in Germany. Our restaurants also included eight ShopHouse Southeast Asian Kitchen restaurants, serving fast-casual, Asian inspired cuisine, and we are an investor in a consolidated entity that, as of the end of the third quarter of 2014, owned and operated one Pizzeria Locale, a fast casual pizza concept. New restaurants have contributed substantially to our revenue growth and we opened 132 restaurants during the nine months ended September 30, 2014. We expect to open between 180 and 195 restaurants in 2014 and between 190 and 205 in 2015. We expect new restaurant openings in the remainder of 2014 and full year 2015 to include a small number of international, ShopHouse and Pizzeria Locale restaurants.

*Sales Growth.* Average restaurant sales were \$2.403 million as of September 30, 2014. We define average restaurant sales as the average trailing 12-month sales for restaurants in operation for at least 12 full calendar months. Our comparable restaurant sales increased 17.0% for the first nine months of 2014, and 19.8% for the third quarter of 2014. Comparable restaurant sales represent the change in period-over-period sales for restaurants beginning in their 13th full month of operation. Comparable restaurant sales increases in the first nine months of 2014 were driven primarily by an increase in customer visits and to a lesser extent from an increase in average check, including the impact of a menu price increase. During the second quarter of 2014, we implemented menu price increases for all U.S. Chipotle locations. Menu price increases accounted for 6.3% of our comparable restaurant sales increases for the three months ended September 30, 2014, and 3.0% for the first nine months of the year. As a result of our strong transaction trends and the benefit of the recent menu price increases, we expect our 2014 full year comparable restaurant sales

increases to be in the mid-teens. We expect 2015 full year comparable restaurant sales increases to be in the low to mid-single digit range as comparisons become more difficult, particularly during the final three quarters of the year.

During 2013, we launched our catering service in Chipotle restaurants throughout the U.S, except New York City where we expect to introduce catering in 2015. Catering represented slightly more than 1% of sales in the first nine months of 2014.

*Food With Integrity.* In all of our restaurants, we endeavor to serve only meats that were raised without the use of subtherapeutic antibiotics or added hormones, and in accordance with criteria we've established in an effort to improve sustainability and promote animal welfare. We brand these meats as *Responsibly Raised*. In addition, a portion of some of the produce items we serve is organically grown, and/or sourced locally when in season (by which we mean within 350 miles of the restaurant where it is served), and a portion of the beans we serve is organically grown and a portion is grown using conservation tillage methods that improve soil conditions, reduce erosion and help preserve the environment in which they are grown. The sour cream and cheese we buy is made with milk that comes from cows that are not given rBGH. Milk used to make much of our cheese and sour cream is sourced from pasture-based dairies that provide an even higher standard of animal welfare by providing outdoor access for their cows. Further, we disclose on our website which ingredients contain genetically modified organisms, or GMOs, and we are working to replace ingredients containing GMOs in our food (not including beverages) with non-GMO ingredients. While the meat and poultry we serve is not genetically modified, the animals are likely fed a diet containing GMOs. We will continue to search for quality ingredients that not only taste delicious, but also benefit local farmers or the environment, or otherwise benefit or improve the sustainability of our supply chain.

One of our primary goals is for all of our restaurants to continue serving meats that are raised to meet our standards, but we have and will continue to face challenges in doing so. Some of our restaurants served conventionally raised beef and some of our restaurants served conventionally raised chicken during portions of the first nine months of 2014. More of our restaurants may periodically serve conventionally raised meats in the future due to supply constraints. When we become aware that one or more of our restaurants will serve conventionally raised meat, we clearly and specifically disclose this temporary change on signage in each affected restaurant, so that customers can avoid those meats if they choose to do so.

Our food costs increased as a percentage of revenue for the first nine months of 2014 as compared to 2013 as a result of inflationary pressures on many of our ingredients, particularly beef, avocados, and dairy, partially offset by the impact of menu price increases. We expect food cost inflation will continue and food costs as a percentage of revenue will increase in the fourth quarter of 2014 and for the full year 2015.

*Stock Repurchases.* In accordance with stock repurchases authorized by our Board of Directors, we purchased stock with an aggregate total repurchase price of \$63.4 million during the first nine months of 2014. As of September 30, 2014, \$126.8 million was available to be repurchased under the current repurchase authorizations announced on February 5, 2013 and April 17, 2014. We have entered into an agreement with a broker under SEC rule 10b5-1(c), authorizing the broker to make open market purchases of common stock from time to time, subject to market conditions. The existing repurchase agreement and the Board's authorization of the repurchases may be modified, suspended, or discontinued at any time.

## Restaurant Activity

The following table details restaurant unit data for the periods indicated.

	For the three months ended September 30		For the nine months ended September 30	
	2014	2013	2014	2013
Beginning of period	1,681	1,502	1,595	1,410
Openings	43	37	132	129
Relocations			(3)	
<b>Total restaurants at end of period</b>	<b>1,724</b>	<b>1,539</b>	<b>1,724</b>	<b>1,539</b>

## Results of Operations

Our results of operations as a percentage of revenue and period-over-period variances are discussed in the following section. As our business grows and we open more restaurants and hire more employees, our aggregate restaurant operating costs increase.

### Revenue

For the three months ended September 30		%	For the nine months ended September 30		% increase
2014	2013		2014	2013	
(dollars in millions)					

Edgar Filing: CHIPOTLE MEXICAN GRILL INC - Form 10-Q

Revenue	\$ 1,084.2	\$ 826.9	31.1%	\$ 3,038.5	\$ 2,370.4	28.2%
Average restaurant sales	\$ 2.403	\$ 2.140	12.3%	\$ 2.403	\$ 2.140	12.3%
Comparable restaurant sales increases	19.8%	6.2%		17.0%	4.3%	
Number of restaurants as of the end of the period	1,724	1,539	12.0%	1,724	1,539	12.0%
Number of restaurants opened in the period, net of relocations	43	37		132	129	

The significant factors contributing to our increase in revenue were comparable restaurant sales increases and new restaurant openings. Comparable restaurant sales increases contributed \$161.1 million of the increase in revenue for the third quarter of 2014, and \$397.3 million of the increase in sales for the first nine months of 2014. Comparable restaurant sales increases were driven primarily by an increase in customer visits, and an increase in average check, including the benefit from menu price increases. For the three and nine months ended September 30, 2014, revenue from restaurants not in the comparable restaurant base contributed \$96.4 million and \$271.1 million of the increase in sales, respectively, of which \$55.0 million and \$95.5 million, respectively, was attributable to restaurants opened in 2014.

**Food, Beverage and Packaging Costs**

	For the three months ended September 30			For the nine months ended September 30		% increase
	2014	2013	% increase	2014	2013	
	(dollars in millions)					
Food, beverage and packaging	\$ 372.1	\$ 277.5	34.1%	\$ 1,047.0	\$ 787.6	32.9%
As a percentage of revenue	34.3%	33.6%		34.5%	33.2%	

Food, beverage and packaging costs increased as a percentage of revenue for the three and nine months ended September 30, 2014 as a result of inflation on many of our food items, particularly beef, avocados, and dairy, partially offset by the impact of menu price increases. We expect food cost inflation will continue and food costs as a percentage of revenue will increase in the fourth quarter of 2014 and for the full year 2015.

**Labor Costs**

	For the three months ended September 30			For the nine months ended September 30		% increase
	2014	2013	% increase	2014	2013	
	(dollars in millions)					
Labor costs	\$ 230.4	\$ 188.7	22.1%	\$ 667.1	\$ 546.0	22.2%
As a percentage of revenue	21.2%	22.8%		22.0%	23.0%	

Labor costs as a percentage of revenue decreased in the three and nine months ended September 30, 2014 primarily due to the benefit of higher average restaurant sales, including the impact of menu price increases, partially offset by an increased number of managers and crew in each of our restaurants and wage inflation. In 2015, we expect labor costs to increase as a percentage of revenue due to the Affordable Care Act and minimum wage increases in a number of jurisdictions.

**Occupancy Costs**

	For the three months ended September 30			For the nine months ended September 30		% increase
	2014	2013	% increase	2014	2013	
	(dollars in millions)					
Occupancy costs	\$ 58.8	\$ 50.1	17.4%	\$ 169.9	\$ 146.3	16.1%
As a percentage of revenue	5.4%	6.1%		5.6%	6.2%	

Occupancy costs as a percentage of revenue decreased in the three and nine months ended September 30, 2014 primarily due to the benefit of higher average restaurant sales on a partially fixed-cost base.

**Other Operating Costs**

	For the three months ended September 30		%	For the nine months ended September 30		% increase
--	--	--	---	---	--	------------

Edgar Filing: CHIPOTLE MEXICAN GRILL INC - Form 10-Q

	2014	2013	increase	2014	2013	
						(dollars in millions)
Other operating costs	\$ 111.0	\$ 89.1	24.6%	\$ 321.5	\$ 252.0	27.6%
As a percentage of revenue	10.2%	10.8%		10.6%	10.6%	

Other operating costs include, among other items, marketing and promotional costs, bank and credit card fees, and restaurant utilities and maintenance costs. Other operating costs decreased for the three months ended September 30, 2014 primarily due to lower marketing spend and utilities expenses as a percentage of revenue. Other operating costs remained consistent as a percentage of revenue in the nine months ended September 30, 2014.

**General and Administrative Expenses**

	For the three months ended September 30			For the nine months ended September 30		% increase
	2014	2013	% increase	2014	2013	
	(dollars in millions)					
General and administrative expense	\$ 71.2	\$ 52.7	35.0%	\$ 213.0	\$ 147.9	44.0%
As a percentage of revenue	6.6%	6.4%		7.0%	6.2%	

The increase in general and administrative expenses in dollar terms in the three months ended September 30, 2014 primarily resulted from our biennial All Managers Conference which we held during the quarter, payroll and bonus costs, and increased non-cash stock-based compensation expense. However, we expect general and administrative expenses to be lower in the fourth quarter compared to the first three quarters of 2014 due primarily to lower stock-based compensation expense.

The increase in general and administrative expenses in dollar terms in the nine months ended September 30, 2014 primarily resulted from increased non-cash stock-based compensation expense; higher payroll, bonus, and benefits costs; as well as costs from our All Managers Conference.

**Depreciation and Amortization**

	For the three months ended September 30			For the nine months ended September 30		% increase
	2014	2013	% increase	2014	2013	
	(dollars in millions)					
Depreciation and amortization	\$ 28.0	\$ 24.6	13.6%	\$ 80.7	\$ 71.2	13.5%
As a percentage of revenue	2.6%	3.0%		2.7%	3.0%	

The increase in depreciation and amortization in dollar terms was primarily due to restaurants opened in 2014 and 2013. Depreciation and amortization decreased as a percentage of revenue as a result of the benefit of higher average restaurant sales on a partially fixed cost base.

**Provision for Income Taxes**

	For the three months ended September 30			For the nine months ended September 30		% increase
	2014	2013	% increase	2014	2013	
	(dollars in millions)					
Provision for income taxes	\$ 77.4	\$ 54.5	42.0%	\$ 201.4	\$ 157.2	28.2%
Effective tax rate	37.2%	39.5%		38.3%	38.8%	

We expect our 2014 annual effective tax rate to be 38.5% compared to 38.7% for 2013. The 2014 estimated annual effective tax rate decreased due to a decrease in the estimated state tax rate and an adjustment related to filing the 2013 tax return in the three months ended September 30, 2014. The decrease is partially offset by the expiration of certain federal tax credits that benefitted us in 2013, including the recognition of certain federal tax credits for the 2012 tax year during the first quarter of 2013. Congress has not extended the tax credits from which we last benefitted in 2013 and as a result we estimate our 2015 annual effective tax rate to be 39.1%. If Congress extends these tax

credits to 2014 and /or 2015, we estimate that our tax rate would benefit by approximately 0.5% each year it is extended.



## **Seasonality**

Seasonal factors cause our profitability to fluctuate from quarter to quarter. Historically, our average daily restaurant sales are lower in the first and fourth quarters due, in part, to the holiday season and because fewer people eat out during periods of inclement weather (the winter months) than during periods of mild or warm weather (the spring, summer and fall months). Other factors also have a seasonal effect on our results. For example, restaurants located near colleges and universities generally do more business during the academic year. The number of trading days can also affect our quarterly results. Overall, on an annual basis, changes in trading days do not have a significant impact on our results.

Our quarterly results are also affected by other factors such as the amount and timing of non-cash stock-based compensation expense, the number of new restaurants opened in a quarter, timing of marketing and promotional spend and both planned and unanticipated events. New restaurants typically have lower margins following opening as a result of the expenses associated with opening new restaurants and their operating inefficiencies in the months immediately following opening. Accordingly, results for a particular quarter are not necessarily indicative of results to be expected for any other quarter or for any year.

## **Liquidity and Capital Resources**

Our primary liquidity and capital requirements are for new restaurant construction, working capital and general corporate needs. We have a cash and investment balance of \$1.23 billion that we expect to utilize, along with cash flow from operations, to provide capital to support the growth of our business (primarily through opening restaurants), to repurchase, as currently authorized, additional shares of our common stock subject to market conditions, to continue to maintain our existing restaurants and for general corporate purposes. We believe that cash from operations, together with our cash and investment balance, will be enough to meet ongoing capital expenditures, working capital requirements and other cash needs for the foreseeable future. We expect capital expenditures to total about \$260 million in 2014, including costs of about \$23 million for the purchase and refurbishment of a corporate aircraft.

We haven't required significant working capital because customers pay using cash or credit cards and because our operations do not require significant receivables, nor do they require significant inventories due, in part, to our use of various fresh ingredients. In addition, we generally have the right to pay for the purchase of food, beverage and supplies sometime after the receipt of those items, generally within ten days, thereby reducing the need for incremental working capital to support growth.

## **Off-Balance Sheet Arrangements**

As of September 30, 2014 we had no off-balance sheet arrangements or obligations.

## **Critical Accounting Estimates**

Critical accounting estimates are those that we believe are both significant and that require us to make difficult, subjective or complex judgments, often because we need to estimate the effect of inherently uncertain matters. We base our estimates and judgments on historical experiences and various other factors that we believe to be appropriate under the circumstances. Actual results may differ from these estimates, and we might obtain different estimates if we used different assumptions or conditions. We had no significant changes in our critical accounting estimates since our last annual report. Our critical accounting estimates are identified and described in our annual report on Form 10-K for the year ended December 31, 2013.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

#### **Commodity Price Risks**

We are exposed to commodity price risks. Many of the ingredients we use to prepare our food, as well as our packaging materials, are commodities or ingredients that are affected by the price of other commodities, exchange rates, foreign demand, weather, seasonality, production, availability and other factors outside our control. We work closely with our suppliers and use a mix of forward pricing protocols under which we agree with our supplier on fixed prices for deliveries at some time in the future, fixed pricing protocols under which we agree on a fixed price with our supplier for the duration of that protocol, and formula pricing protocols under which the prices we pay are based on a specified formula related to the prices of the goods, such as spot prices. However, a majority of the dollar value of goods purchased by us is effectively at spot prices. Generally our pricing protocols with suppliers can remain in effect for periods ranging from one to 18 months, depending on the outlook for prices of the particular ingredient. In several cases, we have minimum purchase obligations. We've tried to increase, where necessary, the number of suppliers for our ingredients, which we believe can help mitigate pricing volatility, and we follow industry news, trade issues, exchange rates, foreign demand, weather, crises and other world events that may affect our ingredient prices. Increases in ingredient prices could adversely affect our results if we choose not to increase menu prices at the same pace for competitive or other reasons.

#### **Changing Interest Rates**

We are also exposed to interest rate risk through fluctuations of interest rates on our investments. Changes in interest rates affect the interest income we earn, and therefore impact our cash flows and results of operations. As of September 30, 2014, we had \$919.8 million in investments and interest-bearing cash accounts, including insurance related restricted trust accounts classified in other assets, and \$312.1 million in accounts with an earnings credit we classify as interest income, which combined bear a weighted-average interest rate of 0.38%.

### **Foreign Currency Exchange Risk**

A portion of our operations consists of activities outside of the U.S. and we have currency risk on the transactions in other currencies and translation adjustments resulting from the conversion of our international financial results into the U.S. dollar. However, a substantial majority of our operations and investment activities are transacted in the U.S. and therefore our foreign currency risk is limited at this date.

### **ITEM 4. CONTROLS AND PROCEDURES**

We maintain disclosure controls and procedures (as defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act )) that are designed to ensure that information required to be disclosed in Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our Co-Chief Executive Officers and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

As of September 30, 2014, we carried out an evaluation, under the supervision and with the participation of our management, including our Co-Chief Executive Officers and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on the foregoing, our Co-Chief Executive Officers and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

There were no changes during the three months ended September 30, 2014 in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

## **PART II**

### **ITEM 1. LEGAL PROCEEDINGS**

For information regarding legal proceedings, see Note 7 Commitments and Contingencies in our notes to condensed consolidated financial statements included in Item 1. Financial Statements and Supplementary Data.

### **ITEM 1A. RISK FACTORS**

There have been no material changes in our risk factors since our annual report on Form 10-K for the year ended December 31, 2013.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS***Purchases of Equity Securities by the Issuer*

The table below reflects shares of common stock we repurchased during the third quarter of 2014.

	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid Per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs(1)</b>	<b>Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs(2)</b>
July <i>Purchased 7/1 through 7/31</i>	7,076	\$ 620.88	7,076	\$ 135,520,103
August <i>Purchased 8/1 through 8/31</i>	6,182	\$ 678.31	6,182	\$ 131,326,793
September <i>Purchased 9/1 through 9/30</i>	6,798	\$ 665.87	6,798	\$ 126,800,193
<b>Total</b>	<b>20,056</b>	<b>\$ 653.83</b>	<b>20,056</b>	<b>\$ 126,800,193</b>

- (1) Shares were repurchased pursuant to a repurchase program announced on February 5, 2013. Repurchases under the program are limited to \$100 million in total repurchase price, and there is no expiration date. Authorization of the ongoing repurchase program may be modified, suspended, or discontinued at any time.
- (2) This column includes \$100 million in authorized repurchases announced on April 17, 2014.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

**ITEM 5. OTHER INFORMATION**

On September 17, 2014, the independent directors of Chipotle's Board of Directors appointed Neil Flanzraich to serve as Lead Director of the Board. A description of the roles and responsibilities of the Lead Director is included in the Chipotle Mexican Grill, Inc. Corporate Governance Guidelines, available at <http://ir.chipotle.com/phoenix.zhtml?c=194775&p=irol-govGuidelines>.

**ITEM 6. EXHIBITS**

The exhibits listed in the exhibit index following the signature page are filed or furnished as part of this report.



**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CHIPOTLE MEXICAN GRILL, INC.

By: /s/ JOHN R. HARTUNG

Name: John R. Hartung

Title: Chief Financial Officer (principal financial  
officer and duly authorized signatory for the  
registrant)

Date: October 20, 2014

**Exhibit Index**

**Exhibit**

<b>Number</b>	<b>Description of Exhibit</b>
3.1	Amended and Restated Certificate of Incorporation of Chipotle Mexican Grill, Inc.*
3.2	Certificate of Amendment of Amended and Restated Certificate of Incorporation of Chipotle Mexican Grill, Inc.**
3.3	Amended and Restated Bylaws of Chipotle Mexican Grill, Inc.***
4.1	Form of Stock Certificate for Common Stock.*
31.1	Certification of Co-Chief Executive Officer of Chipotle Mexican Grill, Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Co-Chief Executive Officer of Chipotle Mexican Grill, Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.3	Certification of Chief Financial Officer of Chipotle Mexican Grill, Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Co-Chief Executive Officers and Chief Financial Officer of Chipotle Mexican Grill, Inc. pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	The following financial statements, formatted in XBRL: (i) Condensed Consolidated Balance Sheet as of September 30, 2014 and December 31, 2013, (ii) Condensed Consolidated Statement of Income and Comprehensive Income for the three and nine months ended September 30, 2014 (iii) Condensed Consolidated Statement of Cash Flows for the nine months ended September 30, 2014; and (iv) Notes to the Condensed Consolidated Financial Statements.

\* Incorporated by reference to Chipotle Mexican Grill, Inc. s Registration Statement on Form 8-A/A filed with the Securities and Exchange Commission on December 16, 2009 (File No. 001-32731).

\*\* Incorporated by reference to Chipotle Mexican Grill, Inc. s Quarterly Report on Form 10-Q filed on July 19, 2013 (File No. 001-32731).

\*\*\* Incorporated by reference to Chipotle Mexican Grill, Inc. s Current Report on Form 8-K filed on January 5, 2009 (File No. 001-32731).