

CHIPOTLE MEXICAN GRILL INC

Form 10-Q

April 25, 2019

Table of Contents

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 March 31, 2019

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.)

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

610 Newport Center Drive, Suite 1300 Newport Beach, CA 92660
(Address of Principal Executive Offices) (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 every Interactive Data File required to be submitted 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

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

| | |
|-------------------------|---------------------------|
| Large accelerated filer | Accelerated filer |
| Non-accelerated filer | Smaller reporting company |
| | Emerging growth company |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 April 22, 2019, there were 27,713,556 shares of the registrant's common stock, par value of \$0.01 per share outstanding.

Table of Contents

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> | 14 |
| Item 3. | <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 18 |
| Item 4. | <u>Controls and Procedures</u> | 19 |
| PART II | | |
| Item 1. | <u>Legal Proceedings</u> | 19 |
| Item 1A. | <u>Risk Factors</u> | 19 |
| Item 2. | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 20 |
| Item 3. | <u>Defaults Upon Senior Securities</u> | 20 |
| Item 4. | <u>Mine Safety Disclosures</u> | 20 |
| Item 5. | <u>Other Information</u> | 20 |
| Item 6. | <u>Exhibits</u> | 21 |
| | <u>Signatures</u> | 22 |

Table of Contents

PART I

ITEM 1. FINANCIAL STATEMENTS

Chipotle Mexican Grill, Inc.

Condensed Consolidated Balance Sheet

(in thousands, except per share data)

| | March 31, 2019 (unaudited) | December 31, 2018 |
|---|----------------------------------|----------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 277,661 | \$ 249,953 |
| Accounts receivable, net of allowance for doubtful accounts of \$203 and \$0 as of March 31, 2019 and December 31, 2018, respectively | 49,725 | 62,312 |
| Inventory | 18,780 | 21,555 |
| Prepaid expenses and other current assets | 34,217 | 54,129 |
| Investments | 457,363 | 426,845 |
| Total current assets | 837,746 | 814,794 |
| Leasehold improvements, property and equipment, net | 1,366,684 | 1,379,254 |
| Restricted cash | 28,382 | 30,199 |
| Operating lease assets | 2,349,993 | - |
| Other assets | 20,738 | 19,332 |
| Goodwill | 21,939 | 21,939 |
| Total assets | \$ 4,625,482 | \$ 2,265,518 |
| Liabilities and shareholders' equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 106,214 | \$ 113,071 |
| Accrued payroll and benefits | 119,689 | 113,467 |
| Accrued liabilities | 119,813 | 147,849 |
| Unearned revenue | 57,088 | 70,474 |
| Current operating lease liabilities | 157,665 | - |
| Income tax payable | 21,198 | 5,129 |
| Total current liabilities | 581,667 | 449,990 |
| Commitments and contingencies (Note 11) | | |
| Deferred rent | - | 330,985 |
| Long-term operating lease liabilities | 2,513,901 | - |
| Deferred income tax liabilities | 12,528 | 11,566 |
| Other liabilities | 33,587 | 31,638 |
| Total liabilities | 3,141,683 | 824,179 |
| Shareholders' equity: | | |
| Preferred stock, \$0.01 par value, 600,000 shares authorized, no shares issued as of March 31, 2019 and December 31, 2018, respectively | - | - |
| | 361 | 360 |

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

| | | |
|---|--------------|--------------|
| Common stock, \$0.01 par value, 230,000 shares authorized, 36,108 and 35,973 shares issued as of March 31, 2019 and December 31, 2018, respectively | | |
| Additional paid-in capital | 1,393,284 | 1,374,154 |
| Treasury stock, at cost, 8,386 and 8,276 common shares at March 31, 2019 and December 31, 2018, respectively | (2,563,410) | (2,500,556) |
| Accumulated other comprehensive loss | (5,858) | (6,236) |
| Retained earnings | 2,659,422 | 2,573,617 |
| Total shareholders' equity | 1,483,799 | 1,441,339 |
| Total liabilities and shareholders' equity | \$ 4,625,482 | \$ 2,265,518 |

See accompanying notes to condensed consolidated financial statements.

1

Table of Contents

Chipotle Mexican Grill, Inc.

Condensed Consolidated Statement of Income

(unaudited)

(in thousands, except per share data)

| | Three months ended March 31, | |
|---|---------------------------------|--------------|
| | 2019 | 2018 |
| Revenue | \$ 1,308,217 | \$ 1,148,397 |
| Restaurant operating costs (exclusive of depreciation and amortization shown separately below): | | |
| Food, beverage and packaging | 421,367 | 371,915 |
| Labor | 348,842 | 318,863 |
| Occupancy | 88,770 | 85,256 |
| Other operating costs | 174,743 | 148,069 |
| General and administrative expenses | 102,671 | 77,063 |
| Depreciation and amortization | 53,781 | 46,915 |
| Pre-opening costs | 940 | 2,649 |
| Impairment, closure costs, and asset disposals | 6,942 | 4,859 |
| Total operating expenses | 1,198,056 | 1,055,589 |
| Income from operations | 110,161 | 92,808 |
| Interest and other income, net | 3,129 | 1,394 |
| Income before income taxes | 113,290 | 94,202 |
| Provision for income taxes | (25,158) | (34,756) |
| Net income | \$ 88,132 | \$ 59,446 |
| Earnings per share: | | |
| Basic | \$ 3.18 | \$ 2.13 |
| Diluted | \$ 3.13 | \$ 2.13 |
| Weighted-average common shares outstanding: | | |
| Basic | 27,696 | 27,911 |
| Diluted | 28,118 | 27,950 |

Condensed Consolidated Statement of Comprehensive Income

(unaudited)

(in thousands)

| | Three months ended | |
|---|--------------------|-----------|
| | March 31, | |
| | 2019 | 2018 |
| Net income | \$ 88,132 | \$ 59,446 |
| Other comprehensive income (loss), net of income taxes: | | |
| Foreign currency translation adjustments | 278 | 132 |
| Unrealized gain (loss) on available-for-sale securities, net of tax | 100 | (101) |
| Other comprehensive income, net of income taxes | 378 | 31 |
| Comprehensive income | \$ 88,510 | \$ 59,477 |

See accompanying notes to condensed consolidated financial statements.

Table of Contents

Chipotle Mexican Grill, Inc.

Condensed Consolidated Statement of Shareholders' Equity

(unaudited)

(in thousands)

| | Common Stock | | | Treasury Stock | | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | | Total |
|--|--------------|--------|----------------------------|----------------|----------------|-------------------|---|------------------------------|--------------|
| | Shares | Amount | Additional Paid-In Capital | Shares | Amount | | Available-for-Sale Securities | Foreign Currency Translation | |
| Balance, December 31, 2017 | 35,852 | \$ 359 | \$ 1,305,090 | 7,826 | \$ (2,334,409) | \$ 2,397,064 | \$ (306) | \$ (3,353) | \$ 1,364,445 |
| Stock-based compensation | - | - | 12,376 | - | - | - | - | - | 12,376 |
| Stock plan transactions and other | 31 | - | (228) | - | - | - | - | - | (228) |
| Acquisition of treasury stock | - | - | - | 231 | (72,025) | - | - | - | (72,025) |
| Net income | - | - | - | - | - | 59,446 | - | - | 59,446 |
| Other comprehensive income (loss), net of income tax | - | - | - | - | - | - | (101) | 132 | 31 |
| Balance, March 31, 2018 | 35,883 | \$ 359 | \$ 1,317,238 | 8,057 | \$ (2,406,434) | \$ 2,456,510 | \$ (407) | \$ (3,221) | \$ 1,364,045 |
| Balance, December 31, 2018 | 35,973 | \$ 360 | \$ 1,374,154 | 8,276 | \$ (2,500,556) | \$ 2,573,617 | \$ (147) | \$ (6,089) | \$ 1,441,339 |
| Adoption of ASU No. 2016-02, Leases (Topic 842) | - | - | - | - | - | (2,327) | - | - | (2,327) |
| Stock-based compensation | - | - | 19,342 | - | - | - | - | - | 19,342 |
| | 135 | 1 | (212) | - | - | - | - | - | (211) |

| | | | | | | | | | |
|---|--------|--------|--------------|-------|----------------|--------------|---------|------------|--------------|
| Stock plan transactions and other | | | | | | | | | |
| Acquisition of treasury stock | - | - | - | 110 | (62,854) | - | - | - | (62,854) |
| Net income | - | - | - | - | - | 88,132 | - | - | 88,132 |
| Other comprehensive income, net of income tax | - | - | - | - | - | - | 100 | 278 | 378 |
| Balance, March 31, 2019 | 36,108 | \$ 361 | \$ 1,393,284 | 8,386 | \$ (2,563,410) | \$ 2,659,422 | \$ (47) | \$ (5,811) | \$ 1,483,799 |

See accompanying notes to condensed consolidated financial statements.

Table of Contents

Chipotle Mexican Grill, Inc.

Condensed Consolidated Statement of Cash Flows

(unaudited)

(in thousands)

| | Three months ended March 31, 2019 | 2018 |
|---|---|-----------|
| Operating activities | | |
| Net income | \$ 88,132 | \$ 59,446 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 53,781 | 46,915 |
| Amortization of operating lease assets | 38,105 | - |
| Deferred income tax provision | 1,772 | 5,683 |
| Impairment, closure costs, and asset disposals | 4,085 | 4,859 |
| Bad debt allowance | 206 | - |
| Stock-based compensation expense | 19,154 | 12,097 |
| Other | (1,269) | (320) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 15,946 | 13,767 |
| Inventory | 2,781 | 2,451 |
| Prepaid expenses and other current assets | (3,712) | (4,793) |
| Other assets | 242 | 3,855 |
| Accounts payable | (4,256) | 17,242 |
| Accrued payroll and benefits | 5,853 | 27,700 |
| Accrued liabilities | (4,773) | 6,407 |
| Unearned revenue | (13,386) | (15,276) |
| Income tax payable/receivable | 16,054 | 18,012 |
| Deferred rent | - | 5,420 |

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

| | | |
|---|------------|------------|
| Operating lease liabilities | (36,492) | - |
| Other long-term liabilities | 358 | (2,349) |
| Net cash provided by operating activities | 182,581 | 201,116 |
| Investing activities | | |
| Purchases of leasehold improvements, property and equipment | (64,226) | (57,524) |
| Purchases of investments | (89,111) | (168,749) |
| Maturities of investments | 60,000 | 145,000 |
| Net cash used in investing activities | (93,337) | (81,273) |
| Financing activities | | |
| Acquisition of treasury stock | (52,886) | (68,638) |
| Tax withholding on share-based compensation awards | (10,368) | (3,988) |
| Stock plan transactions and other financing activities | (277) | (22) |
| Net cash used in financing activities | (63,531) | (72,648) |
| Effect of exchange rate changes on cash, cash equivalents and restricted cash | 178 | (24) |
| Net change in cash, cash equivalents, and restricted cash | 25,891 | 47,171 |
| Cash, cash equivalents, and restricted cash at beginning of period | 280,152 | 214,170 |
| Cash, cash equivalents, and restricted cash at end of period | \$ 306,043 | \$ 261,341 |

See accompanying notes to condensed consolidated financial statements.

Table of Contents

Chipotle Mexican Grill, Inc.

Notes to Condensed Consolidated Financial Statements

(unaudited)

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

1. Basis of Presentation

In this quarterly report on Form 10-Q, Chipotle Mexican Grill, Inc., a Delaware corporation, together with its subsidiaries, is collectively referred to as “Chipotle,” “we,” “us,” or “our.”

We develop and operate restaurants that serve a focused menu of burritos, burrito bowls, tacos and salads, made using fresh, high-quality ingredients. As of March 31, 2019, we operated 2,464 Chipotle restaurants throughout the United States as well as 38 international Chipotle restaurants. We are also an investor in a consolidated entity that owns and operates two Pizzeria Locale restaurants, a fast-casual pizza concept. We managed our operations based on eight regions during the first quarter 2019 and have aggregated our operations to one reportable segment.

Certain prior year amounts have been reclassified for consistency with the current year presentation.

We have prepared the accompanying unaudited condensed consolidated financial statements 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 our 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 our annual report on Form 10-K for the year ended December 31, 2018.

2. Recent Accounting Standards

Recently Issued Accounting Standards

In August 2018, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2018-15, “Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract”, which clarifies the accounting for implementation costs in cloud computing arrangements. ASU 2018-15 is effective for us in the first quarter of fiscal 2020, and early adoption is permitted. We are currently evaluating the impact this guidance will have on our consolidated financial statements.

We reviewed all other recently issued accounting pronouncements and concluded that they were either not applicable or not expected to have a significant impact on the condensed consolidated financial statements.

Recently Adopted Accounting Standards

On January 1, 2019, we adopted ASU 2016-02, "Leases (Topic 842)," along with related clarifications and improvements. This pronouncement requires lessees to recognize a liability for lease obligations, which represents the discounted obligation to make future lease payments, and a corresponding right-of-use asset on the balance sheet. The guidance requires disclosure of key information about leasing arrangements that is intended to give financial statement users the ability to assess the amount, timing, and potential uncertainty of cash flows related to leases. We elected the optional transition method to apply the standard as of the effective date and therefore, we have not applied the standard to the comparative periods presented on our condensed financial statements.

Our practical expedients were as follows:

| | Implications as of January 1, 2019 |
|-------------------------------|---|
| Practical expedient package | We have not reassessed whether any expired or existing contracts are, or contain, leases. We have not reassessed the lease classification for any expired or existing leases. We have not reassessed initial direct costs for any expired or existing leases. |
| Hindsight practical expedient | We have not elected the hindsight practical expedient, which permits the use of hindsight when determining lease term and impairment of operating lease assets. |

Table of Contents

The impact on the consolidated balance sheet is as follows:

| | December 31, 2018 | Adjustments Due to the Adoption of Topic 842 | January 1, 2019 |
|---|----------------------|---|--------------------|
| Assets | | | |
| Current assets: | | | |
| Cash and cash equivalents | \$ 249,953 | \$ - | \$ 249,953 |
| Accounts receivable | 62,312 | - | 62,312 |
| Inventory | 21,555 | - | 21,555 |
| Prepaid expenses and other current assets | 54,129 | (23,653) | 30,476 |
| Investments | 426,845 | - | 426,845 |
| Total current assets | 814,794 | (23,653) | 791,141 |
| Leasehold improvements, property and equipment, net | 1,379,254 | (15,167) | 1,364,087 |
| Restricted cash | 30,199 | - | 30,199 |
| Operating lease assets | - | 2,363,020 | 2,363,020 |
| Other assets | 19,332 | - | 19,332 |
| Goodwill | 21,939 | - | 21,939 |
| Total assets | \$ 2,265,518 | \$ 2,324,200 | \$ 4,589,718 |
| Liabilities and shareholders' equity | | | |
| Current liabilities: | | | |
| Accounts payable | \$ 113,071 | \$ - | \$ 113,071 |
| Accrued payroll and benefits | 113,467 | - | 113,467 |
| Accrued liabilities | 147,849 | (23,860) | 123,989 |
| Unearned revenue | 70,474 | - | 70,474 |
| Income tax payable | 5,129 | - | 5,129 |
| Total current liabilities | 449,990 | (23,860) | 426,130 |
| Commitments and contingencies | | | |
| Deferred rent | 330,985 | (330,985) | - |
| Current and long-term operating lease liabilities | - | 2,682,203 | 2,682,203 |
| Deferred income tax liabilities | 11,566 | (831) | 10,735 |
| Other liabilities | 31,638 | - | 31,638 |
| Total liabilities | 824,179 | 2,326,527 | 3,150,706 |
| Shareholders' equity: | | | |
| Preferred stock, \$0.01 par value, 600,000 shares authorized, no shares issued as of December 31, 2018 and 2017, respectively | - | - | - |
| Common stock, \$0.01 par value, 230,000 shares authorized, 35,973 and 35,852 shares issued as of December 31, 2018 and 2017, respectively | 360 | - | 360 |

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

| | | | |
|--|--------------|--------------|--------------|
| Additional paid-in capital | 1,374,154 | - | 1,374,154 |
| Treasury stock, at cost, 8,276 and 7,826 common shares at December 31, 2018 and 2017, respectively | (2,500,556) | - | (2,500,556) |
| Accumulated other comprehensive loss | (6,236) | - | (6,236) |
| Retained earnings | 2,573,617 | (2,327) | 2,571,290 |
| Total shareholders' equity | 1,441,339 | (2,327) | 1,439,012 |
| Total liabilities and shareholders' equity | \$ 2,265,518 | \$ 2,324,200 | \$ 4,589,718 |

3. Revenue Recognition

We recognize revenue, net of discounts and incentives, when payment is tendered at the point of sale. We report revenue net of sales-related taxes collected from customers and remitted to governmental taxing authorities.

6

Table of Contents

We sell gift cards which do not have expiration dates and we do not deduct non-usage fees from outstanding gift card balances. We recognize revenue from gift cards when: (i) the gift card is redeemed by the customer; or (ii) we determine the likelihood of the gift card being redeemed by the customer is remote (gift card breakage) and there is not a legal obligation to remit the unredeemed gift cards to the relevant jurisdiction. Gift card breakage is recognized in revenue as the gift cards are used on a pro rata basis over an eight-month period beginning at the date of the gift card sale and is included in revenue on the condensed consolidated statement of income. We have determined that 4% of gift card sales will not be redeemed and will be retained by us. Gift card liability balances are typically highest at the end of each calendar year following increased gift card sales during the holiday season; accordingly, revenue recognized from gift card liability balances is highest in the first quarter of each calendar year.

During the first quarter of 2019 we launched a national loyalty program called Chipotle Rewards. Eligible customers who enroll in the program generally earn points for every dollar spent. After accumulating a certain number of points, the customer earns a reward that can be redeemed for a free entrée. We may also periodically offer promotions, which provide the customer with the opportunity to earn bonus points or free food vouchers (“Bonus Vouchers”). Earned rewards generally expire one to two months after they are issued, and points generally expire if an account is inactive for a period of six months.

We defer revenue associated with the estimated selling price of points or Bonus Vouchers earned by program members as each point or Bonus Voucher is earned. The estimated selling price of each point or Bonus Voucher earned is based on the estimated value of product for which the reward is expected to be redeemed, net of points we do not expect to be redeemed. Our estimate of points and Bonus Vouchers we expect to be redeemed is based on historical company specific data. We recognize loyalty revenue when a customer redeems an earned reward. Deferred revenue associated with Chipotle Rewards is included in unearned revenue on our condensed consolidated balance sheets.

The gift card and Chipotle Rewards loyalty liabilities included in unearned revenue on the condensed consolidated balance sheets are as follows:

| | March 31, 2019 | December 31, 2018 |
|----------------------------|----------------------|-------------------------|
| Gift card liability | \$ 53,622 | \$ 70,474 |
| Chipotle Rewards liability | 3,466 | - |
| Total unearned revenue | \$ 57,088 | \$ 70,474 |

Revenue recognized on the condensed consolidated statements of income for the redemption of gift cards that were included in accrued liabilities at the beginning of the year is as follows:

| | Three months ended March 31, 2019 | 2018 |
|--|---|-----------|
| Revenue recognized from gift card liability balance at the beginning of the year | \$ 24,703 | \$ 24,239 |

4. Fair Value of Financial Instruments

The carrying value of our cash and cash equivalents, accounts receivable and accounts payable approximate fair value because of their short-term nature.

Our investments consist of U.S. treasury notes with maturities of up to one year. Fair value of investments is measured using Level 1 inputs (quoted prices for identical assets in active markets). We designate the appropriate classification of our investments at the time of purchase based upon the intended holding period.

Investments, all of which are classified as held-to-maturity, are carried at amortized cost and approximated fair value as of March 31, 2019. We recognize impairment charges when management believes the decline in the fair value of the investment is other-than-temporary. No impairment charges were recognized on our investments for the three months ended March 31, 2019.

As of September 30, 2018, we transferred the classification of our investments from available-for-sale to held-to-maturity. The unrealized holding loss and offsetting discount, created as a result of this reclassification, will be amortized to interest and other income on the condensed consolidated statement of income over the remaining life of the securities and will be fully amortized by September 30, 2019.

Table of Contents

We also maintain 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 carried at fair value, are included in other assets on the condensed consolidated balance sheet. Fair value of mutual funds is measured using Level 1 inputs. The fair value of the investments in the rabbi trust was \$12,531 and \$10,872 as of March 31, 2019, and December 31, 2018, respectively. We record trading gains and losses in general and administrative expenses on the condensed consolidated statement of income, along with the offsetting amount related to the increase or decrease in deferred compensation to reflect our exposure to liabilities for payment under the deferred plan.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

Assets recognized or disclosed at fair value on the consolidated financial statements on a nonrecurring basis include items such as leasehold improvements, property and equipment, operating lease assets, goodwill, and other intangible assets. These assets are measured at fair value if determined to be impaired.

Other than as disclosed in Note 5. "Corporate Restructuring Costs" as of March 31, 2019 and December 31, 2018, we had no non-financial assets or liabilities that were measured using Level 3 inputs.

5. Corporate Restructuring Costs

In May 2018, we announced that we would open a headquarters office in Newport Beach, California, consolidate certain corporate administrative functions into our existing office in Columbus, Ohio, and close our existing headquarters offices in Denver, Colorado, as well as additional corporate offices in New York, New York. All affected employees were either offered an opportunity to continue in the new organization or were offered a severance package. We record severance as a one-time termination benefit and recognize the expense ratably over the employees' required future service period. We evaluate our operating lease assets for impairment whenever events or changes in circumstances indicate that the carrying amount of the operating lease asset (or asset group that includes the operating lease asset, referred to interchangeably throughout as an operating lease asset) may not be recoverable. We first compare the carrying value of the operating lease asset to the operating lease asset's estimated future undiscounted cash flows. If the estimated undiscounted future cash flows are less than the carrying value of the operating lease asset, we determine if we have an impairment loss by comparing the carrying value of the operating lease asset to the operating lease asset's estimated fair value. The estimated fair value of the operating lease asset is generally determined using a discounted cash flow projection model, using Level 3 inputs. The impairment charges represent the excess of each operating lease asset's carrying amount over its estimated fair value. All other costs, including other employee transition costs, recruitment and relocation costs, other office closure costs, and third-party costs, are recognized in the period incurred.

Corporate restructuring costs consist of the following:

| | Three months ended March 31, 2019 | | 2018 |
|---|--|------|------|
| Employee severance and other employee transition costs(1) | \$ 1,046 | \$ - | |
| Recruitment and relocation costs(1) | 2,093 | - | |

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

| | | |
|--|----------|------|
| Operating lease impairment and other office closure costs(2) | 1,395 | - |
| Third-party and other costs(1) | 1,007 | - |
| Stock-based compensation(1) | 134 | - |
| Total restructuring costs | \$ 5,675 | \$ - |

(1) Recorded in general and administrative expenses on the condensed consolidated statement of income.

(2) Recorded in impairment, closure costs, and asset disposals on the condensed consolidated statement of income.

Changes in our corporate restructuring liability which are included in accrued liabilities on the condensed consolidated balance sheet were as follows:

| | December | | | March |
|--|----------|----------|------------|--------|
| | 31, 2018 | Charges | Payments | 31, |
| | | | | 2019 |
| Employee severance and other employee transition costs | \$ 2,722 | \$ 1,046 | \$ (3,557) | \$ 211 |
| Recruitment and relocation costs | 224 | 2,093 | (2,242) | 75 |
| Third-party and other costs | 554 | 1,007 | (1,561) | - |
| Total restructuring liability | \$ 3,500 | \$ 4,146 | \$ (7,360) | \$ 286 |

Table of Contents

6. Shareholders' Equity

Through March 31, 2019, we had announced authorizations by our Board of Directors of repurchases of shares of common stock, which in the aggregate, authorized expenditures of up to \$2.6 billion. Under the remaining repurchase authorizations, shares may be purchased from time to time in open market transactions, subject to market conditions.

As of March 31, 2019, \$105,068 was available to repurchase shares under the announced repurchase authorizations. Shares repurchased are being held in treasury stock until they are reissued or retired at the discretion of the Board of Directors.

During the three months ended March 31, 2019, 17 shares of common stock at a total cost of \$10,368 were netted and surrendered as payment for minimum statutory withholding obligations in connection with the vesting of outstanding stock awards. Shares surrendered by the participants in accordance with the applicable award agreements and plan are deemed repurchased by us but are not part of publicly announced share repurchase programs.

7. Stock-Based Compensation

During the three months ended March 31, 2019, we granted stock only stock appreciation rights ("SOSARs") on 179 shares of our common stock to eligible employees. The weighted-average grant date fair value of the SOSARs was \$172.28 per share with a weighted-average exercise price of \$584.90 per share. The SOSARs vest in two equal installments on the second and third anniversary of the grant date. During the three months ended March 31, 2019, 412 SOSARs were exercised, 15 SOSARs were forfeited, and 45 SOSARs expired.

During the three months ended March 31, 2019, we granted restricted stock units ("RSUs") on 21 shares of our common stock to eligible employees. The weighted-average grant date fair value of the RSUs was \$585.62 per share. The RSUs generally vest in two equal installments on the second and third anniversary of the grant date. During the three months ended March 31, 2019, 42 RSUs vested and 6 RSUs were forfeited.

During the three months ended March 31, 2019, we awarded a total of 46 performance shares ("PSUs") that are subject to service and performance vesting conditions. The weighted-average grant date fair value of the PSUs was \$582.77 per share, and the quantity of shares that will vest range from 0% to 300% of the targeted number of shares. If the defined minimum targets are not met, then no shares will vest. During the three months ended March 31, 2019, there were two different PSU awards granted with different terms.

The first award, consisting of 33 PSUs, will vest based on our growth in comparable restaurant sales and average restaurant margin over defined periods. These PSU awards will vest fully on the third anniversary of the grant date.

The second award, consisting of 13 PSUs, will vest based on achievement of certain targets related to digital sales volume, general and administrative expenses as a percentage of revenue, and successful completion of a defined number of strategic initiatives. These PSU awards will vest 40% on the third anniversary of the grant date and 60% on the fourth anniversary of the grant date.

During the three months ended March 31, 2019, 12 PSUs that were subject to service and market conditions were forfeited for failure to meet the specified performance levels or service requirements.

The following table sets forth total stock-based compensation expense:

| | Three months ended March 31, | |
|---|---------------------------------|------------|
| | 2019 | 2018 |
| Stock-based compensation expense | \$ 19,342 | \$ 12,376 |
| Stock-based compensation expense, net of tax | \$ 14,402 | \$ 8,931 |
| Stock-based compensation expense recognized as capitalized development | \$ 188 | \$ 279 |
| Excess tax deficit on stock-based compensation recognized in provision for income taxes | \$ (5,434) | \$ (5,542) |

8. Income Taxes

The effective income tax rate for income taxes as a percentage of income before income taxes was 22.2% and 36.9% for the three months ended March 31, 2019 and 2018, respectively. The decrease was primarily due to unfavorable discrete tax items in the first quarter of 2018 including equity vesting at an amount less than original book value and negative impacts from tax reform, and favorable discrete tax items in the first quarter of 2019 related to stock option exercises.

9

Table of Contents

9. Leases

We determine if a contract contains a lease at inception. Our material operating leases consist of restaurant locations as well as office space. Our leases generally have remaining terms of 1- 20 years, most of which include options to extend the leases for additional 5-year periods. Generally, the lease term is the minimum of the noncancelable period of the lease or the lease term inclusive of reasonably certain renewal periods up to a term of 20 years.

Operating lease assets and liabilities are recognized at the lease commencement date. Operating lease liabilities represent the present value of lease payments not yet paid. Operating lease assets represent our right to use an underlying asset and are based upon the operating lease liabilities adjusted for prepayments or accrued lease payments, initial direct costs, lease incentives, and impairment of operating lease assets. To determine the present value of lease payments not yet paid, we estimate incremental secured borrowing rates corresponding to the maturities of the leases. As we have no outstanding debt nor committed credit facilities, secured or otherwise, we estimate this rate based on prevailing financial market conditions, comparable company and credit analysis, and management judgment.

Our leases typically contain rent escalations over the lease term. We recognize expense for these leases on a straight-line basis over the lease term. Additionally, tenant incentives used to fund leasehold improvements are recognized when earned and reduce our right-of-use asset related to the lease. These are amortized through the right-of-use asset as reductions of expense over the lease term.

Some of our leases include rent escalations based on inflation indexes and fair market value adjustments. Certain leases contain contingent rental provisions that include a fixed base rent plus an additional percentage of the restaurant's sales in excess of stipulated amounts. Operating lease liabilities are calculated using the prevailing index or rate at lease commencement. Subsequent escalations in the index or rate and contingent rental payments are recognized as variable lease expenses. Our lease agreements do not contain any material residual value guarantees or material restrictive covenants.

Related to the adoption of Topic 842, our policy elections were as follows:

| | |
|--|--|
| Separation of lease and non-lease components | We elected this expedient to account for lease and non-lease components as a single component for our entire population of operating lease assets. |
| Short-term policy | We have elected the short-term lease recognition exemption for all applicable classes of underlying assets. Short-term disclosures include only those leases with a term greater than one month and 12 months or less, and expense is recognized on a straight-line basis over the lease term. Leases with an initial term of 12 months or less, that do not include an option to purchase the underlying asset that we are reasonably certain to exercise, are not recorded on the balance sheet. |

Supplemental balance sheet information related to leases was as follows:

| | | March 31, 2019 |
|-------------------------------|---------------------------------------|-------------------|
| Operating Leases | Classification | |
| Right-of-use assets | Operating lease assets | \$ 2,349,993 |
| Current lease liabilities | Current operating lease liabilities | 157,665 |
| Non-current lease liabilities | Long-term operating lease liabilities | 2,513,901 |
| Total lease liabilities | | \$ 2,671,566 |

Lease term and discount rate were as follows:

| | March 31, 2019 |
|---|----------------------|
| Weighted average remaining lease term (years) | 13.5 |
| Weighted average discount rate | 5.27% |

10

Table of Contents

The components of lease cost were as follows:

| | Classification | Three months ended March 31, 2019 |
|-----------------------|---|-----------------------------------|
| Operating lease cost | Occupancy and General and administrative expenses | \$ 76,805 |
| Short-term lease cost | Other operating costs | 737 |
| Variable lease cost | Occupancy | 9,104 |
| Sublease income | General and administrative expenses | (766) |
| Total lease cost | | \$ 85,880 |

Supplemental disclosures of cash flow information related to leases were as follows:

| | Three months ended March 31, 2019 |
|--|-----------------------------------|
| Cash paid for operating lease liabilities | \$ 71,832 |
| Operating lease assets obtained in exchange for operating lease liabilities(1) | 2,401,239 |

(1) Amounts for the three months ended March 31, 2019 include the transition adjustment for the adoption of Topic 842 discussed in Note 2. "Accounting Policies."

Maturities of lease liabilities were as follows as of March 31, 2019:

| | Operating Leases |
|-------------------|------------------|
| Remainder of 2019 | \$ 194,583 |
| 2020 | 295,326 |
| 2021 | 292,860 |
| 2022 | 292,670 |

| | |
|------------------------------------|--------------|
| 2023 | 288,138 |
| Thereafter | 2,442,438 |
| Total lease payments | 3,806,015 |
| Less: imputed interest | 1,134,449 |
| Present value of lease liabilities | \$ 2,671,566 |

As of March 31, 2019, operating lease payments include \$2,082,123 related to options to extend lease terms that are reasonably certain of being exercised and exclude approximately \$87,500 of legally binding minimum lease payments for leases signed but not yet commenced and \$9,672 of future sublease income.

11

Table of Contents

As previously disclosed in our 2018 Annual Report on Form 10-K and under the previous lease accounting, maturities of lease liabilities were as follows as of December 31, 2018:

| | Operating Leases |
|------------------------------|---------------------|
| 2019 | \$ 294,191 |
| 2020 | 296,579 |
| 2021 | 294,941 |
| 2022 | 295,290 |
| 2023 | 290,980 |
| Thereafter | 2,478,397 |
| Total minimum lease payments | \$ 3,950,378 |

As of December 31, 2018, maturity of lease liabilities have not been reduced by minimum sublease rentals of \$11,790 due in the future under our subleases. As of December 31, 2018, we have \$90,484 of legally binding minimum lease payments related to restaurant leases that have not yet commenced.

We have six sale and leaseback transactions, which do not qualify for sale leaseback accounting due to fixed price renewal options prohibiting sale accounting. These transactions are accounted for under the financing method. Under the financing method, the assets remain on the condensed consolidated balance sheet and the proceeds from the transactions are recorded as a financing liability. A portion of lease payments are applied as payments of deemed principal and imputed interest. The deemed landlord financing liability was \$2,327 and \$2,390 as of March 31, 2019 and December 31, 2018, respectively, with the current portion of the liability included in accrued liabilities, and the remaining portion included in other liabilities on the condensed consolidated balance sheet.

10. Earnings Per Share

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

| | Three months ended March 31, | |
|--|---------------------------------|-----------|
| | 2019 | 2018 |
| Net income | \$ 88,132 | \$ 59,446 |
| Shares: | | |
| Weighted-average number of common shares outstanding | 27,696 | 27,911 |
| Dilutive stock awards | 422 | 39 |
| Diluted weighted-average number of common shares outstanding | 28,118 | 27,950 |
| Basic earnings per share | \$ 3.18 | \$ 2.13 |
| Diluted earnings per share | \$ 3.13 | \$ 2.13 |

The following stock awards were excluded from the calculation of diluted earnings per share:

| | Three months ended March 31, | |
|---|------------------------------------|-------|
| | 2019 | 2018 |
| Stock awards subject to performance conditions | 81 | 111 |
| Stock awards that were antidilutive | 343 | 2,226 |
| Total stock awards excluded from diluted earnings per share | 424 | 2,337 |

12

Table of Contents

11. Commitments and Contingencies

Purchase Obligations

We enter into various purchase obligations in the ordinary course of business, generally of a short-term nature. Those that are binding primarily relate to commitments for food purchases and supplies, amounts owed under contractor and subcontractor agreements, orders submitted for equipment for restaurants under construction, and marketing initiatives and corporate sponsorships.

Litigation

Data Security Incident

In April 2017, our information security team detected unauthorized activity on the network that supports payment processing for our restaurants, and immediately began an investigation with the help of leading computer security firms. We also self-reported the issue to payment card processors and law enforcement. Our investigation detected malware designed to access payment card data from cards used at point-of-sale devices at most Chipotle restaurants, primarily in the period from March 24, 2017 through April 18, 2017. The malware searched for track data, which may include cardholder name, card number, expiration date, and internal verification codes; however, no other customer information was affected. We removed the malware from our systems and continue to work to enhance our security measures. Substantially all of our investigation costs have been covered by insurance; however, we may incur legal and other expenses in excess of our insurance coverage limits associated with the data security incident in future periods. We will recognize these expenses as services are received.

As of March 31, 2019, we had a balance of \$24,701 included in accrued liabilities on the condensed consolidated balance sheet which represents an estimate of potential liabilities associated with anticipated claims and assessments by payment card networks in connection with the data security incident. We may ultimately be subject to liabilities greater than or less than the amount accrued.

Litigation Arising from Data Security Incident

During the three months ended March 31, 2019, we reached agreements to settle the consolidated action captioned Bellwether Community Credit Union, et. al. v. Chipotle Mexican Grill, Inc., as well as the consolidated action captioned Todd Gordon, et. al. v. Chipotle Mexican Grill, Inc., each of which was pending in the United States District Court for the District of Colorado. Settlement of the Bellwether matter has been finalized and a stipulation of dismissal was filed with the court on March 28, 2019. Court approval of the Gordon settlement is pending. We do not expect that the settlements will exceed applicable insurance coverages or will have a material financial impact on us, although the total liabilities arising from the Gordon settlement will be dependent in part on the number of claims filed, and may exceed our expectations and applicable insurance coverage.

Receipt of Grand Jury Subpoenas

On January 28, 2016, we were served with a Federal Grand Jury Subpoena from the U.S. District Court for the Central District of California in connection with an official criminal investigation being conducted by the U.S. Attorney's Office for the Central District of California, in conjunction with the U.S. Food and Drug Administration's Office of Criminal Investigations. The subpoena required the production of documents and information related to company-wide food safety matters dating back to January 1, 2013. Since then we have received two other subpoenas on the following dates requesting information related to illness incidents associated with the following specific restaurants: July 19, 2017, requesting information about a single Chipotle restaurant in Sterling, Virginia; and February 14, 2018, requesting information about a single Chipotle restaurant in Los Angeles, California. On April 18, 2019, we received a new subpoena requesting information related to illness incidents associated with the specific restaurants in Simi Valley, California, Boston, Massachusetts, Sterling, Virginia, and Los Angeles, California that were covered under the previous subpoenas, plus one additional restaurant in Powell, Ohio. We have fully cooperated and intend to continue to fully cooperate in the investigation. It is not possible at this time to determine whether we will incur, or to reasonably estimate the amount of, any fines or penalties in connection with the investigation pursuant to which the subpoenas were issued.

Shareholder Class Actions

On January 8, 2016, Susie Ong filed a complaint in the U.S. District Court for the Southern District of New York on behalf of a purported class of purchasers of shares of our common stock between February 4, 2015 and January 5, 2016. The complaint purports to state claims against us, each of the co-Chief Executive Officers serving during the claimed class period and the Chief Financial Officer under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, as amended, and related rules, based on our alleged failure during the claimed class period to disclose material information about our quality controls and safeguards in relation to consumer and employee health. The complaint asserts that those failures and related public statements were false and misleading and that, as a result, the market price of our stock was artificially inflated during the claimed class period. The complaint seeks damages on behalf of the purported class in an unspecified amount, interest, and an award of reasonable attorneys' fees, expert fees and other costs. On March 8, 2017, the court granted our motion to dismiss the complaint, with leave to amend. The plaintiff filed an amended complaint on April 7, 2017. On March 22, 2018, the court granted our motion to dismiss, with prejudice. On April 20, 2018, the plaintiffs filed a motion for relief from the judgment and seeking leave to file a third amended complaint, and on

Table of Contents

November 20, 2018, the court denied the motion. On December 20, 2018, the plaintiff initiated an appeal to the U.S. Court of Appeals for the Second Circuit.

Additionally, on July 20, 2017, Elizabeth Kelley filed a complaint in the U.S. District Court for the District of Colorado on behalf of a purported class of purchasers of shares of our common stock between February 5, 2016 and July 19, 2017, with claims and factual allegations similar to the Ong complaint, based primarily on media reports regarding illnesses associated with a Chipotle restaurant in Sterling, Virginia. On March 29, 2019, the court granted our motion to dismiss, with prejudice.

We intend to continue to vigorously defend the Ong and Kelley cases through any further appeals, but it is not possible at this time to reasonably estimate the outcome of or any potential liability from either of these cases.

Miscellaneous

We are involved in various other claims and legal actions that arise in the ordinary course of business. We do not believe that the ultimate resolution of these actions will have a material adverse effect on our 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 we incur greater liabilities than we currently anticipate, could materially and adversely affect our business, financial condition, results of operations and cash flows.

Table of Contents

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 expected comparable restaurant sales increases for 2019, estimates of restructuring-related costs, projected restaurant closures and the resulting financial impacts, projected new restaurant openings for 2019, 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," "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, 2018, as updated in Part II, Item 1A. of this report.

Overview

As of March 31, 2019, we operated 2,504 restaurants in the United States, Canada, the United Kingdom, France and Germany. We are committed to making our food more accessible to everyone while continuing to be a brand with a demonstrated purpose. Steve Eells, our founder and executive chairman, first opened Chipotle with a single restaurant in Denver, Colorado in 1993.

2019 Highlights

Sales Trends. Average restaurant sales were \$2.048 million as of March 31, 2019, an increase from \$1.941 million as of March 31, 2018. We define average restaurant sales as the average trailing 12-month sales for restaurants in operation for at least 12 full calendar months.

Comparable restaurant sales increased 9.9% for the three months ended March 31, 2019, including the adverse impact of 0.3% as a result of deferred revenue associated with the new Chipotle Rewards loyalty program. We expect full year 2019 comparable restaurant sales increases to be in the mid to high single digits, including the impact of revenue deferral associated with Chipotle Rewards. Comparable restaurant sales and transactions represent the change in period-over-period sales or transactions for restaurants in operation for at least 13 full calendar months.

We continue to invest in improving our digital platforms and equipping select restaurants with an upgraded second make line dedicated to fulfilling out-of-restaurant orders. Sales from out-of-restaurant orders increased 690 basis points to 15.7% of revenue during the three months ended March 31, 2019, an increase from 8.8% of revenue during the three months ended March 31, 2018.

Restaurant Operating Costs. Our restaurant operating costs (food, beverage and packaging; labor; occupancy; and other operating costs) as a percentage of revenue decreased 150 basis points to 79.0% in the three months ended March 31, 2019, as compared to 80.5% in the three months ended March 31, 2018. The decrease was primarily due to comparable restaurant sales increases.

Corporate Restructuring. During 2018, we opened a new headquarters office in Newport Beach, California, consolidated certain corporate administrative functions into our existing office in Columbus, Ohio, closed a corporate

office in New York, New York, and commenced the closure of our previous headquarters office in Denver, Colorado. All affected employees were either offered an opportunity to continue in the new organization or were offered a severance package. We expect to incur corporate restructuring costs, including costs already incurred, aggregating approximately \$49 million to \$58 million including (i) employee severance and other employee transition costs of approximately \$9 million to \$11 million; (ii) recruitment and relocation costs of approximately \$12 million to \$14 million; (iii) operating lease impairment and other office closure costs of approximately \$17 million to \$21 million; and (iv) third-party and other costs of approximately \$11 million to \$12 million. We recognized a total of \$5.7 million during the three months ended March 31, 2019, and \$48 million in total since the restructuring activities commenced in 2018. We expect to incur additional restructuring charges of \$1 million to \$9 million during the remainder of 2019. For additional information, please see Note 5. "Corporate Restructuring Costs" in the notes to the consolidated financial statements included in Item 1. "Financial Statements."

Planned Restaurant Closures. In June 2018, we announced planned restaurant closures of approximately 55 to 65 restaurants beginning in the second quarter of 2018 and continuing over the next several quarters. As a result, we expect to incur total restaurant exits costs aggregating approximately \$37.0 million to \$43.0 million, of which \$35.9 million has been incurred to date. We have closed 47 Chipotle restaurants and five Pizzeria Locale restaurants in connection with this initiative since the initiative commenced in 2018.

Restaurant Development. During the three months ended March 31, 2019, we opened 15 new restaurants, and closed 2 restaurants. For the full year 2019 we expect to open approximately 140 to 155 new restaurants.

Table of Contents

Restaurant Activity

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

| | Three months ended | |
|------------------------------------|--------------------|-------|
| | March 31, | |
| | 2019 | 2018 |
| Beginning of period | 2,491 | 2,408 |
| Openings | 15 | 35 |
| Chipotle closures | (2) | (1) |
| Tasty Made closures | - | (1) |
| Total restaurants at end of period | 2,504 | 2,441 |

Our results of operations as a percentage of revenue and period-over-period changes are discussed in the following section.

Revenue

| | Three months ended | | |
|---------------------------------------|-----------------------|------------|------------|
| | March 31, | | Percentage |
| | 2019 | 2018 | change |
| | (dollars in millions) | | |
| Revenue | \$ 1,308.2 | \$ 1,148.4 | 13.9% |
| Average restaurant sales | \$ 2.048 | \$ 1.941 | 5.5% |
| Comparable restaurant sales increases | 9.9% | 2.2% | |

Comparable restaurant sales increased for the three months ended March 31, 2019. The significant factors contributing to the increase in revenue were comparable restaurant sales increases of \$102.4 million and revenue from restaurants not yet in the comparable base of \$61.5 million, of which \$57.6 million was attributable to restaurants opened in 2018. For the three months ended March 31, 2019, the increase in comparable restaurant sales was attributable to a 5.8% increase in comparable restaurant transactions, and a 4.5% increase in the average check which includes a 2.5% benefit from menu price increases that were implemented during 2018.

Food, Beverage and Packaging Costs

| | Three months ended | | |
|--|--------------------|------|------------|
| | March 31, | | Percentage |
| | 2019 | 2018 | change |

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

(dollars in millions)

| | | | |
|------------------------------|----------|----------|--------|
| Food, beverage and packaging | \$ 421.4 | \$ 371.9 | 13.3% |
| As a percentage of revenue | 32.2% | 32.4% | (0.2%) |

Food, beverage and packaging costs decreased as a percentage of revenue for the three months ended March 31, 2019, primarily due to the benefit of menu price increases nationwide at the end of 2018, partially offset by an increased demand for steak (a higher priced ingredient), and higher paper cost.

Labor Costs

Three months ended
 March 31, Percentage
 2019 2018 change
 (dollars in millions)

| | | | |
|----------------------------|----------|----------|--------|
| Labor costs | \$ 348.8 | \$ 318.9 | 9.4% |
| As a percentage of revenue | 26.7% | 27.8% | (1.1%) |

Labor costs decreased as a percentage of revenue for the three months ended March 31, 2019, primarily due to sales leverage, and to a lesser extent, improved workers' compensation claim management and lower unemployment expense, partially offset by wage inflation.

Table of Contents

Occupancy Costs

| | Three months ended | | |
|----------------------------|-----------------------|---------|-------------------|
| | March 31, 2019 | 2018 | Percentage change |
| | (dollars in millions) | | |
| Occupancy costs | \$ 88.8 | \$ 85.3 | 4.1% |
| As a percentage of revenue | 6.8% | 7.4% | (0.6%) |

Occupancy costs decreased as a percentage of revenue for the three months ended March 31, 2019, primarily due to sales leverage on a partially fixed-cost base.

Other Operating Costs

| | Three months ended | | |
|----------------------------|-----------------------|----------|-------------------|
| | March 31, 2019 | 2018 | Percentage change |
| | (dollars in millions) | | |
| Other operating costs | \$ 174.7 | \$ 148.1 | 18.0% |
| As a percentage of revenue | 13.4% | 12.9% | 0.5% |

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 increased as a percentage of revenue for the three months ended March 31, 2019, primarily due to increased marketing and promotional expenses and, to a lesser extent, increased delivery expense associated with increased delivery sales, partially offset by sales leverage and elevated spend on repairs and maintenance in the comparative 2018 period.

General and Administrative Expenses

| | Three months ended | | |
|------------------------------------|-----------------------|---------|-------------------|
| | March 31, 2019 | 2018 | Percentage change |
| | (dollars in millions) | | |
| General and administrative expense | \$ 102.7 | \$ 77.1 | 33.2% |
| As a percentage of revenue | 7.8% | 6.7% | 1.1% |

General and administrative expenses increased in dollar terms for the three months ended March 31, 2019, primarily due to \$13.1 million in increased performance based compensation expense including non-cash stock-based compensation, bonus expense, and associated taxes; \$4.3 million related to corporate restructuring; \$3.4 million in outside service expense to support restaurant growth, and digitizing and modernizing the restaurant experience; and

\$1.3 million in increased other expense.

Depreciation and Amortization

| | Three months ended | | Percentage change |
|-------------------------------|--------------------------|---------|----------------------|
| | March 31, 2019 | 2018 | |
| | (dollars in millions) | | |
| Depreciation and amortization | \$ 53.8 | \$ 46.9 | 14.6% |
| As a percentage of revenue | 4.1% | 4.1% | 0.0% |

Depreciation and amortization remained flat as a percent of revenue for the three months ended March 31, 2019, as sales leverage was offset by an increase in depreciation expense from multiple administrative offices with short-term leases, new stores in the base, and new projects such as the installation of second make lines.

Table of Contents

Impairment, Closure Costs, and Asset Disposals

| | Three months ended | | Percentage change |
|--|-----------------------|--------|-------------------|
| | March 31, 2019 | 2018 | |
| | (dollars in millions) | | |
| Impairment, closure costs, and asset disposals | \$ 6.9 | \$ 4.9 | 42.9% |
| As a percentage of revenue | 0.5% | 0.4% | 0.1% |

Impairment, closure costs and asset disposals increased in dollar terms during the three months ended March 31, 2019, primarily as a result of asset retirements associated with our restaurant refresh project.

Provision for Income Taxes

| | Three months ended | | Percentage change |
|----------------------------|-----------------------|---------|-------------------|
| | March 31, 2019 | 2018 | |
| | (dollars in millions) | | |
| Provision for income taxes | \$ 25.2 | \$ 34.8 | (27.6%) |
| Effective tax rate | 22.2% | 36.9% | (14.7%) |

The effective income tax rate for income taxes as a percentage of income before income taxes was 22.2% and 36.9% for the three months ended March 31, 2019 and 2018, respectively. The decrease in the effective income tax rate for the three months ended March 31, 2019, when compared to 2018, was primarily due to unfavorable discrete tax items in the first quarter of 2018 including equity vesting at an amount less than original book value and negative impacts from tax reform, and favorable discrete tax items in the first quarter of 2019 related to stock option exercises.

Seasonality

Seasonal factors cause our profitability to fluctuate from quarter to quarter. Historically, our average daily restaurant sales are lower and net income has generally been 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. Seasonal factors, however, might be moderated or outweighed by other factors that may influence our quarterly results, such as unexpected publicity impacting our business in a positive or negative way, fluctuations in food or packaging costs, or the timing of menu price increases. The number of trading days in a quarter can also affect

our results, although, on an overall annual basis, changes in trading days do not have a significant impact.

Our quarterly results are also affected by other factors such as the amount and timing of non-cash stock-based compensation expense and related tax rate impacts, the number and timing of new restaurants opened in a quarter, closure of restaurants, and anticipated and unanticipated events. New restaurants typically have lower margins following opening as a result of the expenses associated with their opening and 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, initiatives to improve the guest experience in our restaurants, working capital and general corporate needs. As of March 31, 2019, we had a cash and short-term investment balance of \$735.0 million that we expect to utilize, along with cash flow from operations, to provide capital in support of the growth of our business and to invest in, maintain, and refurbish our existing restaurants, to repurchase additional shares of our common stock subject to market conditions, and for general corporate purposes. As of March 31, 2019, \$105.1 million remained available for repurchases of shares of our common stock under previously-announced repurchase authorizations. Under the remaining repurchase authorizations, shares may be purchased from time to time in open market transactions, subject to market conditions. We believe that cash from operations, together with our cash and investment balances, will be enough to meet ongoing capital expenditures, working capital requirements and other cash needs for the foreseeable future.

We have not required significant working capital because customers generally pay using cash or credit and debit 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 our growth.

Table of Contents

Off-Balance Sheet Arrangements

As of March 31, 2019, 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 factors. 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, 2018.

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 and utilities to run our restaurants, are ingredients or commodities 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, 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, and range forward protocols under which we agree on a price range for the duration of that protocol. However, a majority of the dollar value of our purchases is effectively at spot prices. Generally, our pricing protocols with suppliers can remain in effect for periods ranging from one to 36 months, depending on the outlook for prices of the particular ingredient. In several cases, we have minimum purchase obligations. We have tried to increase, where practical, 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 for competitive or other reasons not to increase menu prices at the same rate at which ingredient costs increase, or if menu price increases are met with customer resistance.

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 March 31, 2019, we had \$693.5 million in investments and interest-bearing cash accounts, including insurance-related restricted trust accounts classified in restricted cash, and \$11.0 million in accounts with an earnings credit we classify as interest and other income, which combined earned a weighted-average interest rate of 2.29%.

Foreign Currency Exchange Risk

A portion of our operations consist 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 not material 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 chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

During the quarter ended March 31, 2019, we implemented controls to ensure we adequately evaluated our contracts and properly assessed the impact of the new lease accounting standard on our financial statements to facilitate adoption of the standard on January 1, 2019. We further completed upgrades to our lease administration software to support our accounting for leases and have integrated the new software functionality with our processes, systems and controls.

There were no other changes during the fiscal quarter ended March 31, 2019, 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.

Table of Contents

PART II

ITEM 1. LEGAL PROCEEDINGS

For information regarding legal proceedings, see Note 11. "Commitments and Contingencies" in the notes to the condensed consolidated financial statements included in Item 1. "Financial Statements."

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, 2018.

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 first quarter of 2019.

| | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs(1) | Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs(2) |
|-------------------------------|-------------------------------------|---------------------------------------|---|--|
| January | 39,025 | \$ 499.56 | 39,025 | \$ 138,055,805 |
| Purchased 1/1 through 1/31 | | | | |
| February | 23,777 | \$ 580.17 | 23,777 | \$ 124,261,186 |
| Purchased 2/1 through 2/28 | | | | |
| March | 29,743 | \$ 645.30 | 29,743 | \$ 105,067,943 |
| Purchased 3/1 through 3/31 | | | | |
| Total | 92,545 | \$ 567.11 | 92,545 | \$ 105,067,943 |

(1) Shares were repurchased pursuant to a \$100 million repurchase program announced on April 25, 2018.

(2) This column includes an additional \$100 million in authorized repurchases announced on February 6, 2019. Each repurchase program has no expiration date. Authorization of repurchase programs may be modified, suspended or discontinued at any time.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

20

Table of Contents

ITEM 6. EXHIBITS

EXHIBIT INDEX

| Exhibit Number | Exhibit Description | Description of Exhibit Incorporated Herein by Reference | | | |
|-------------------|---|--|----------------|-------------------|-------------------|
| | | File Form No. | Filing Date | Exhibit Number | Filed Herewith |
| 10.1 | <u>Form of 2019 Performance Share Unit Agreement</u> | - | - | - | X |
| 10.2 | <u>Form of 2019 Transformation Performance Share Unit Agreement (1)</u> | - | - | - | X |
| 31.1 | <u>Certification of Chief Executive Officer of Chipotle Mexican Grill, Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u> | - | - | - | X |
| 31.2 | <u>Certificate of Chief Financial Officer of Chipotle Mexican Grill, Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u> | - | - | - | X |
| 32.1 | <u>Certification of Chief Executive Officer and Chief Financial Officer of Chipotle Mexican Grill, Inc. pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u> | - | - | - | X |
| 101 | The following financial statements, formatted in XBRL: (i) Condensed Consolidated Balance Sheet as of March 31, 2019 and December 31, 2018, (ii) Condensed Consolidated Statement of Income for the three months ended March 31, 2019 and 2018, (iii) Condensed Consolidated Statement of Comprehensive Income for the three months ended March 31, 2019 and 2018, (iv) Condensed Consolidated Statement of Shareholders' Equity for the three months ended March 31, 2019 and 2018, (v) Condensed Consolidated Statement of Cash Flows for the three months ended March 31, 2019 and 2018; and (vi) Notes to the Condensed Consolidated Financial Statements | - | - | - | X |

(1) Portions of this exhibit have been omitted as permitted by applicable regulations.

Test

21

Table of Contents

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: April 24, 2019