CHIPOTLE MEXICAN GRILL INC
Form 10-K
February 26, 2008
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**WASHINGTON, D.C. 20549**

# FORM 10-K

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

**For the fiscal year ended December 31, 2007**

**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** | **84-1219301** |
| (State or other jurisdiction of<br>incorporation or organization) | (IRS Employer<br>Identification No.) |

| | |
|---|---|
| **1543 Wazee Street, Suite 200 Denver, CO** | **80202** |
| (Address of Principal Executive Offices) | (Zip Code) |

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

Securities registered pursuant to Section 12(b) of the Act:

| **Title of each class** | **Name of each exchange on which registered** |
|---|---|
| Class A common stock, par value $0.01 per share | New York Stock Exchange |
| Class B common stock, par value $0.01 per share | New York Stock Exchange |

Securities Registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 of 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 x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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 the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act (check one).

| | | | |
|---|---|---|---|
| x 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 Act). Yes ¨ No x

As of June 30, 2007, the aggregate market value of the registrant s outstanding common equity held by nonaffiliates was $1.73 billion, based on the closing prices of the registrant s class A and class B common stock on June 29, 2007, the last trading day of the registrant s most recently completed second fiscal quarter. For purposes of this calculation, shares of class A and class B common stock held by each executive officer and director and by holders of more than 5% of the outstanding class A or class B common stock have been excluded since those persons may under certain circumstances be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of February 18, 2008 there were 14,553,855 shares of the registrant s class A common stock, par value of $0.01 per share, and 18,424,690 shares of the registrant s class B common stock, par value of $0.01 per share, outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Part III incorporates certain information by reference from the registrant s definitive proxy statement for the 2008 annual meeting of shareholders, which will be filed no later than 120 days after the close of the registrant s fiscal year ended December 31, 2007.

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PART I

## ITEM 1. BUSINESS

### General

Chipotle Mexican Grill, Inc. ( Chipotle , the Company , or We ) operates more than 700 restaurants in 33 states and the District of Columbia as of December 31, 2007. Our restaurants serve a focused menu of tacos, burritos, salads and burrito bowls (a burrito without the tortilla), made using fresh ingredients. People outside our company tend to categorize us as a fast casual concept restaurants that are a step up from traditional fast food, but not casual, sit-down places. We ve never worried much about what category we re in. Instead, we remain focused on trying to find the highest quality ingredients we can to make great tasting food; on recruiting and retaining top performing people to ensure that the restaurant experience we provide is exceptional; and on building restaurants that are operationally efficient, esthetically pleasing and with increasing awareness and respect for the environment.

Chipotle began with a simple philosophy: Demonstrate that food served fast doesn t have to be a traditional fast-food experience. Over the years, that vision has evolved. Our vision is to change the way the world thinks about and eats fast food. We do this by avoiding a formulaic approach when creating our restaurant experience, looking to fine-dining restaurants for inspiration. We purchase high-quality fresh and raw ingredients, use classic cooking methods and we have a distinctive interior design where friendly people take care of each customer features that are more frequently found in the world of fine dining. Our approach is also guided by our strategy called 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.

We are transitioning the management of our operations and restaurants from three regions to five regions that all report into a single segment. Financial information about our operations, including our revenues and net income for the years ended December 31, 2007, 2006, and 2005 and our total assets as of December 31, 2007 and 2006, is included in our consolidated financial statements and accompanying notes in Item 8, Financial Statements and Supplementary Data .

Our predecessor corporation, World Foods, Inc., was founded in Colorado in 1993. McDonald s Corporation made an equity investment in us in February 1998, becoming our majority shareholder, and simultaneous with McDonald s initial investment in us, World Foods, Inc. merged with Chipotle Mexican Grill, Inc., a newly-formed Delaware corporation. We completed our initial public offering of class A common stock in January 2006. McDonald s sold a portion of its interest in us in the initial public offering, sold an additional portion of its interest in us in a secondary offering of class A common stock in May 2006, and disposed of its remaining interest in us in an exchange offer to its shareholders that was completed in October 2006. As a result of the completion of the McDonald s exchange offer, we now have two publicly-traded classes of common stock, class A and class B, and McDonald s no longer owns any interest in us.

### Our Menu and Food Preparation

*A Few Things, Thousands of Ways.* We serve only a few things: burritos, burrito bowls, tacos and salads. But because customers can choose from four different meats, two types of beans and a variety of extras such as salsas, guacamole, cheese and lettuce, there s enough variety to extend our menu to provide countless choices. We plan to keep a focused menu, but we ll consider additions that we think make sense. For example, in 2005 we rolled out a salad that uses the same ingredients as our burritos and tacos, with the addition of chipotle-honey vinaigrette that we make in the restaurant daily. And if you can t find something on the menu that s quite what you re after, let us know. If we can make it from the ingredients we have, we ll do it.

In preparing our food, we use gas stoves and grills, pots and pans, cutting knives, wire whisks and other kitchen utensils, walk-in refrigerators stocked with a variety of fresh ingredients, herbs and spices and dry goods such as rice. Ingredients we use include chicken and steak that is marinated in our restaurants, carnitas (seasoned and braised pork), barbacoa (spicy shredded beef) and pinto and vegetarian black beans. We add our rice, which is tossed with lime juice and freshly chopped cilantro, as well as freshly shredded cheese, sour cream, lettuce, tomatoes, peppers and onions, depending on each customer s request. We use various herbs, spices and seasonings to prepare our meats and vegetables. We also provide a variety of extras such as guacamole, salsas and tortilla chips seasoned with fresh lime and kosher salt. In addition to sodas and fruit drinks, most of our restaurants also offer a selection of beer and margaritas. All of our food is prepared from scratch, with the majority prepared in our restaurants while some is prepared with the same fresh ingredients in commissaries.

*Food Served Fast ...So That Customers Can Enjoy It Slowly.* Our employees spend hours preparing our food on-site, but each customer order can be ready in seconds. Customers select exactly what they want and how they want it by speaking directly to the employees that have prepared the food. While we think that our customers return because of the great-tasting food, we also think that they like getting food served fast without having a fast-food experience, even when they re not in a hurry. And while our restaurants often have lines, we try to serve customers as quickly as possible; we ve even been able to serve more than 300 customers an hour at some locations. The natural flow of our restaurant layout, including the floor plan and the design of our serving line, are designed to make the food ordering process intuitive and, we believe, more efficient. And we re focused on further improving the speed of service in all of our restaurants, so that we can accommodate more customers and larger orders without disrupting restaurant traffic. For instance, our restaurants accept orders by fax or over the internet in order to allow customers in a hurry or with large orders to avoid standing in line to wait for their food. We installed change machines at the cashier station in virtually all of our restaurants. We ve also began testing a hand-held point-of-sale terminal in a small number of our restaurants which allows customers to pay with a credit card while waiting in line. We continue to review other equipment and kitchen design modifications to improve the speed of service. By emphasizing speed of service without compromising the genuine interactions between our customers and our crews, and by continually making improvements to our restaurants to keep pace at even our highest-volume restaurants, we believe that we can provide the Chipotle experience to more and more customers.

*Food With Integrity.* More than anything, serving high quality food is what motivates us. And we re always looking to make the food we serve better. As part of our Food With Integrity strategy, we believe that using fresh ingredients is not enough, so we spend time on farms and in the field to understand where our ingredients come from and how the animals are raised. This includes working with experts in the areas of animal ethics to try to support more humane farming practices. Because our menu is so focused, we can concentrate on where we obtain each ingredient, and this has become a cornerstone of our continuous effort to improve our food. All of our pork, for example, is naturally raised, coming from animals that are fed a pure vegetarian diet, never given antibiotics or hormones, and raised in open pastures or deeply bedded barns. We also serve naturally raised chicken in about 84% of our restaurants and naturally raised beef in about 53% of our restaurants. We re also investigating the use of more sustainably grown produce, meaning produce grown by suppliers who we believe respect the environment and their employees, while still charging reasonable prices for our food. Today, about 30% of all of the beans we buy are organically grown- that is, they meet U.S. Food and Drug Administration standards for organic - up from 25% during 2007. All of the sour cream and cheese we buy is made from milk that comes from cows that are not given rBGH, or recombinant bovine growth hormone, to stimulate milk production.

We do, however, face challenges in pursuing our Food With Integrity strategy, including the length of time it takes to identify and secure relationships with suppliers, and the costs and risks associated with purchasing naturally raised or sustainably grown ingredients. Naturally raised meat and sustainably grown vegetables are more costly and the growth process is longer. Herd losses can also be greater when animals aren t treated with antibiotics and hormones. Given the costs associated with natural and sustainable farming practices, many large suppliers have not found it economical to pursue business in this area. We believe that consumers increasing concern about where and how food is raised, and in the environmental management, animal husbandry and labor practices of food suppliers, will foster demand for these foods. We believe that increased demand for naturally

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raised meat and produce will continue to attract the interest and capital investment of larger farms and suppliers. That said, we understand that we ll continue to be at the forefront of this trend and must balance our interest in advancing Food With Integrity with our desire to provide great food at reasonable prices. If our focus resonates with consumers, it should improve our sourcing flexibility, although we would expect that these ingredients and other raw materials will remain more expensive than commodity-priced equivalents for some time to come.

*Quality Assurance and Food Safety.* Chipotle is committed to serving safe, high quality food to our customers. Quality and food safety is integrated throughout our supply chain and everything we do; from the farms that supply our food all the way through to our front line. We have established close relationships with some of the top suppliers in the industry, and we actively maintain a limited list of approved suppliers from whom our distributors must purchase. Our quality assurance department establishes and monitors our quality and food safety programs, including farm, supplier and distributor audits. Our training department develops and implements operating standards for food quality, preparation and safety in the restaurants. Our food safety programs are also designed to ensure that we comply with applicable state and local food safety regulations.

**Restaurant Management And Operations**

*Culture of High Performers.* We value the individuality of our company, our employees and our customers, which we believe results in a management, operations and training philosophy distinct from that of our competitors. We make an effort to hire employees who share a passion for food, and who will operate our restaurants in a way that is consistent with our high standards but that allows each of their unique personalities and strengths to contribute to our success. We provide attractive career opportunities to crew and managers who are committed to work hard, provide great customer service and have the ability to lead and empower others. We provide hands on, shoulder to shoulder training to develop the full potential of our restaurant employees. Our best restaurant managers who run great restaurants and develop strong restaurant teams are promoted to *Restaurateur*, and can earn bonuses for developing people and building sales. Through our culture, diversity and language programs that we provide in all of our markets, we teach English to Spanish-speaking workers, which helps our crew provide better customer service and provides greater career opportunities. This program helps encourage our staff members to develop skills that will enhance their work experience and enrich their personal lives.

*Importance of Methods and Culture.* Although we have many restaurants, we believe that our departure from the automated cooking techniques used by many traditional fast-food and fast-casual restaurants helps to set us apart. Our crews use classic cooking methods: they marinate and grill meats, hand-chop produce and herbs, make fresh salsa and guacamole, and steam rice in small batches throughout the day. They work in kitchens that more closely resemble those of high-end restaurants than they do a typical fast-food place. Despite our more labor-intensive method of food preparation our focused menu creates efficiencies which allow us to serve high quality food, made from ingredients typically found in fine dining restaurants.

*The Front Line is Key.* Our restaurant and kitchen designs intentionally place crew members up front with customers to reinforce our focus on service. All of our restaurant employees are encouraged to have genuine interactions with customers no matter their specific job, whether preparing food or serving customers during our busiest period. We focus on attracting and keeping people who can deliver that experience for each customer one burrito at a time . We provide each customer with individual attention and make every effort to respond to customer suggestions and concerns in a personal and hospitable way. We believe our focus on creating a positive and interactive experience helps build loyalty and enthusiasm for our brand among restaurant managers, crew members and customers alike.

*The Basics.* Each restaurant typically has a restaurant manager (a position we ve characterized as the most important in the company), an assistant manager, one or two hourly service managers, one or two hourly kitchen managers and an average of approximately 19 to 23 full and part-time crew members. We generally have two shifts at our restaurants, which simplifies scheduling and provides stability for our employees. We tend to have more employees in our busier restaurants. We cross-train our people, so that each can work a variety of stations, allowing us to work efficiently during our busiest times, while giving our people greater variety and the opportunity to develop a wider array of skills. Consistent with our emphasis on customer service, we encourage our restaurant managers and crew members to welcome and interact with customers throughout the day. And although they may increase our labor costs, we believe that the benefits we provide to our employees, which include language training and our company car program for longer-term restaurant managers, help us to attract and keep top performing restaurant managers and crew members.

In addition to the employees serving our customers at each restaurant, we also have a field support system that includes area managers, operations directors and regional directors. We are reviewing the field support structure to ensure it is effective and efficient as we grow, and are in the process of reorganizing from three regions to five.

**Provisions and Supplies**

*Close Relationships With Suppliers.* Maintaining the high quality levels we expect in our restaurants depends in part on our ability to acquire fresh ingredients and other necessary supplies that meet our specifications from reliable suppliers. We purchase from various suppliers, carefully selected based on quality and their understanding of our brand, and we seek to develop mutually beneficial long-term relationships with them. We work closely with our suppliers and use a mix of forward, fixed and formula pricing protocols. 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, weather, crises and other world events that may affect supply prices.

We do not purchase raw materials directly from farmers or other suppliers, but have approved all of the suppliers from whom ingredients are purchased for our restaurants. Distribution centers purchase ingredients and other supplies from suppliers we select based on our quality specifications within the pricing guidelines and protocols we have established.

*Distribution Arrangements.* We deliver ingredients and other supplies to our restaurants from 21 independently owned and operated regional distribution centers. As we continue to expand geographically, we expect to add additional regional distribution centers.

**Marketing**

We believe the best and most recognizable brands aren t built through advertising or promotional campaigns alone, but also through deeply held beliefs that are evident in how the company is run. All of the ways that we project ourselves beginning with each customer s experience in our restaurants, the look and feel of our restaurants, our advertising and promotional programs, and the design items that carry our name or logo influence how people think about us. By adhering to this principle, we believe that Chipotle is well on its way to becoming a highly recognized brand.

When we open a new restaurant, we plan a range of activities to introduce Chipotle to the local community to help create interest in the restaurant from the start. Our advertising primarily includes print, outdoor, transit and radio ads. In addition, we continue to generate considerable media coverage, with scores of publications writing favorably about our food, restaurant concept and business, and our food and restaurants have been featured in a number of television news programs.

Although our marketing program has many components, we believe the single greatest contributor to our success has been word-of-mouth, with our customers learning about us and telling others. Some of our customers have gone so far as to develop websites about Chipotle, providing a way for Chipotle customers to share their stories. This kind of support helps promote our business without requiring additional advertising expenditures.

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**Competition**

The fast-casual segment of the restaurant industry is highly competitive and fragmented. In addition, fast-casual restaurants compete against other segments of the restaurant industry, including quick-service restaurants and casual dining restaurants. The number, size and strength of competitors vary by region. All of these restaurants compete based on a number of factors, including taste, quality, speed of service, value, name recognition, restaurant location, customer service and the ambience and condition of each restaurant.

We compete with national and regional fast-casual, quick-service and casual dining restaurants. Our competition also includes a variety of locally owned restaurants and the deli sections and in-restaurant cafés of several major grocery store chains. Many of our competitors have greater financial and other resources, have been in business longer, and have greater name recognition than we have, and are better established than we are in the markets where our restaurants are located or are planned to be located.

We believe we re well-positioned to continue to grow our market position in existing and new markets given current consumer trends, including the increasing impact of Hispanic culture on food, the growth of the Mexican food segment and increasing awareness and concern among consumers about what they eat and how it is prepared. Some of our competitors have formats similar to ours. We believe, however, that Chipotle has become one of the most recognized fast-casual restaurants and is known for its focus on using a variety of fresh ingredients and commitment to Food With Integrity, which we think represents a significant competitive advantage in the segment in which we operate.

**Seasonality**

Seasonal factors cause our profitability to fluctuate from quarter to quarter. Historically, our average daily restaurant sales and profits 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.

**Our Intellectual Property and Trademarks**

Chipotle, Chipotle Mexican Grill, Chipotle Mexican Grill (in stylized font), Unburritable, Food With Integrity, Fresh Is Not Enough, Anyr
The Gourmet Restaurant Where You Eat With Your Hands, the Chili Pepper Logo design, the Foil Burrito design and the Chipotle Medallion design are U.S. registered trademarks of Chipotle. We have filed trademark applications for a number of other marks in the U.S. In addition to our U.S. registrations, we own the trademarks for Chipotle Mexican Grill in Australia, Brazil and Mexico and for Chipotle in Australia and the European Union, among other countries. We have filed trademark applications for Chipotle and related marks in a number of additional countries, including Canada.

We also believe that the design of our restaurant is our proprietary trade dress. From time to time we have taken action against other restaurants that we believe are misappropriating our trademarks, restaurant designs or advertising. Although our policy is to protect and defend vigorously our rights to our intellectual property, we may not be able to adequately protect our intellectual property, which could harm the value of our brands and adversely affect our business.

**Information Systems**

Chipotle uses an integrated information system to manage the flow of information within each restaurant and between the restaurants and the corporate office. This system includes a point-of-sales local area network that helps facilitate the operations of the restaurant by recording sales transactions and printing orders in the

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appropriate locations within the restaurant. Additionally, the point-of-sales system is used to authorize, batch and transmit credit card transactions, to record employee time clock information, and to produce a variety of management reports. Select information that is captured from this system is transmitted to the corporate office on a daily basis, which enables management to continually monitor operating results. We believe that our current point-of-sales systems will be an adequate platform to support our continued expansion.

**Employees**

As of December 31, 2007, we had about 18,800 employees, including 1,800 salaried employees and 17,000 hourly employees. None of our employees are unionized or covered by a collective bargaining agreement.

**Available Information**

We maintain a website at www.chipotle.com. The information on or available through our website is not, and should not be considered, a part of this report. You may access our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports, as well as other reports relating to us that are filed with or furnished to the SEC, free of charge at our website as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC.

## ITEM 1A. RISK FACTORS

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

This report includes statements of our expectations, intentions, plans and beliefs that constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 and are intended to come within the safe harbor protection provided by those sections. These statements, which involve risks and uncertainties, relate to the discussion of our business strategies and our expectations concerning future operations, margins, profitability, liquidity and capital resources and to analyses and other information that are based on forecasts of future results and estimates of amounts not yet determinable. Forward-looking statements include our estimates of the amount of certain expected expenses for 2008, as well as the number of restaurants that we expect to open in 2008 and potential changes in our comparable restaurant sales during 2008. We have used words such as may, will, should, expects, intends, plans, anticipa believes, thinks, estimates, seeks, expects, predicts, could, projects, potential and other similar terms and phrases, including refe assumptions, in this report to identify forward-looking statements. These forward-looking statements are made based on expectations and beliefs concerning future events affecting us and are subject to uncertainties, risks and factors relating to our operations and business environments, all of which are difficult to predict and many of which are beyond our control, that could cause our actual results to differ materially from those matters expressed or implied by these forward-looking statements. These risks and other factors include those listed in this Item 1A. Risk Factors, and elsewhere in this report.

When considering these forward-looking statements, you should keep in mind the cautionary statements in this report and the documents incorporated by reference. New risks and uncertainties arise from time to time, and we cannot predict those events or how they may affect us. We assume no obligation to update any forward-looking statements after the date of this report as a result of new information, future events or developments, except as required by the federal securities laws.

***Increasing our sales and profitability depends substantially on our ability to open new restaurants and is subject to many unpredictable factors.***

There were 704 Chipotle restaurants as of December 31, 2007. We plan to increase the number of our restaurants significantly in the next three years. We may not be able to open new restaurants as quickly as planned. We have experienced delays in opening some restaurants and that could happen again. Delays or

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failures in opening new restaurants could materially and adversely affect our growth strategy and our expected results. As we operate more restaurants, our rate of expansion relative to the size of our restaurant base will decline. In addition, one of our biggest challenges is locating and securing an adequate supply of suitable new restaurant sites. Competition for those sites in our target markets is intense, and lease costs are increasing (particularly for urban locations). Our ability to open new restaurants also depends on other factors, including:

- obtaining and negotiating leases with acceptable terms;
- hiring and training qualified operating personnel in the local market;
- managing construction and development costs of new restaurants at affordable levels, particularly in competitive markets;
- the availability of construction materials and labor;
- the availability of, and our ability to obtain, adequate supplies of ingredients that meet our quality standards;
- securing required governmental approvals (including construction, parking and other permits) in a timely manner; and
- the impact of inclement weather, natural disasters and other calamities, such as hurricanes Katrina and Rita in 2005.

Although we plan to open a total of between 130 and 140 restaurants in 2008, we may not be able to do so for the reasons described in this risk factor. In addition, our progress in opening new restaurants from quarter to quarter may occur at an uneven rate, which may result in quarterly sales and profit growth falling short of market expectations in some periods. In addition, this growth strategy and the substantial investment associated with the development of each new restaurant (as well as the impact of our new restaurants on the sales of our existing restaurants) may cause our operating results to fluctuate and be unpredictable or adversely affect our profits.

***Our sales and profit growth could be adversely affected if comparable restaurant sales are less than we expect.***

While future sales growth will depend substantially on our plans for new restaurant openings, the level of comparable restaurant sales (which include company-operated restaurants only and represent the change in period-over-period sales for restaurants beginning in their 13th full month of operations) will also affect our sales growth and will continue to be a critical factor affecting profit growth. This is because the profit margin on comparable restaurant sales is generally higher, as comparable restaurant sales increases enable fixed costs to be spread over a higher sales base. While we do not expect comparable restaurant sales growth to continue at historical levels and expect comparable restaurant sales increases in 2008 in the low to mid single digits due to difficult prior year comparisons and the potential impact of weaker consumer spending, our plans do incorporate increases in comparable restaurant sales. Our ability to increase comparable restaurant sales depends in part on our ability to successfully implement our initiatives to increase the speed at which our crew serves each customer, and expanded use of fax service lines and online ordering, which we may not be able to do. It is possible that we will not achieve our targeted comparable restaurant sales growth or that the change in comparable restaurant sales could be negative. If this were to happen, sales and profit growth would be adversely affected.

***Our failure to manage our growth effectively could harm our business and operating results.***

Our plans call for a significant number of new restaurants. Our existing restaurant management systems, financial and management controls and information systems may be inadequate to support our expansion. Managing our growth effectively will require us to continue to enhance these systems, procedures and controls and to hire, train and retain restaurant managers and crew. We also are restructuring our field management structure, in part due to our recent rapid growth. We may not respond quickly enough to the changing demands

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that our expansion will impose on management, crew and existing infrastructure, and changes to our operating structure may result in increased costs or inefficiencies that we cannot currently anticipate. Changes as we grow may have a negative impact on the operation of our restaurants, and cost increases resulting from our inability to effectively manage our growth could adversely impact our profitability. We also place a lot of importance on our culture, which we believe has been an important contributor to our success. As we grow, however, we may have difficulty maintaining our culture or adapting it sufficiently to meet the needs of our operations. Our failure to foster and maintain our corporate culture could also harm our business and operating results.

***New restaurants, once opened, may not be profitable, and the increases in average restaurant sales and comparable restaurant sales that we have experienced in the past may not be indicative of future results.***

Historically, many of our new restaurants have opened with an initial ramp-up period typically lasting 24 months or more, during which they generated sales and income below the levels at which we expect them to normalize. This is in part due to the time it takes to build a customer base in a new area, higher fixed costs relating to increased occupancy costs and other start-up inefficiencies that are typical of new restaurants. New restaurants may neither be profitable nor have similar results as our existing restaurants. In addition, our average restaurant sales and comparable restaurant sales likely will not continue to increase at the rates achieved over the past several years. Our ability to operate new restaurants profitably and increase average restaurant sales and comparable restaurant sales will depend on many factors, some of which are beyond our control, including:

- executing our strategies effectively;
- initial sales performance of new restaurants;
- competition, either from our competitors in the restaurant industry or our own restaurants;
- changes in consumer preferences and discretionary spending;
- consumer understanding and acceptance of the Chipotle experience;
- road construction and other factors limiting access to new restaurants;
- general economic conditions, which can affect restaurant traffic, local labor costs and prices we pay for the ingredients and other supplies we use, and
- changes in government regulation.

If we fail to open restaurants as quickly as planned or if new restaurants do not perform as planned, our business and future prospects could be harmed. In addition, changes in our average restaurant sales or comparable restaurant sales could cause our operating results to vary adversely from expectations, which could cause the price of our common stock to decline.

***Our expansion into new markets may present increased risks due to our unfamiliarity with those areas.***

Some of our new restaurants are planned for markets where we have little or no operating experience. For instance we have announced plans to open a restaurant in Toronto in 2008, which will be our first restaurant outside of the United States. New markets may have different competitive conditions, consumer tastes and discretionary spending patterns than our existing markets. As a result, new restaurants in those markets may be less successful than restaurants in our existing markets. Consumers in a new market may not be familiar with the Chipotle brand, and we may need to build brand awareness in that market through greater investments in advertising and promotional activity than we originally planned. We may find it more difficult in new markets to hire, motivate and keep qualified employees who can project our vision, passion and culture. Restaurants opened in new markets may also have lower average restaurant sales than restaurants opened in existing markets, and may have higher construction, occupancy or operating costs than restaurants in existing markets. We may also have difficulty finding reliable suppliers or distributors or ones that can provide us, either initially or over time, with adequate supplies of ingredients meeting our quality standards. Sales at restaurants opened in new markets may take longer to ramp up and reach expected sales and profit levels, and may never do so, thereby affecting

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our overall profitability. Some or all of these factors may be more pronounced in markets outside the United States due to cultural, regulatory or economic differences with which we are not familiar, which may have a particularly adverse impact on our sales or profitability in those markets and could thereby adversely impact our overall results.

***Changes in food and supply costs could adversely affect our results of operations.***

Our profitability depends in part on our ability to anticipate and react to changes in food and supply costs. Like all restaurant companies, we are susceptible to increases in food costs as a result of factors beyond our control, such as general economic conditions, seasonal fluctuations, weather conditions, demand, food safety concerns, generalized infectious diseases, product recalls and government regulations. Due to increased demand for ethanol the cost of corn has increased substantially, which has increased the cost of corn-sourced ingredients as well as wheat, soybeans and rice. This has led to upward pricing pressures on many of our other raw ingredients including chicken, beef, tortillas and rice, and we expect that pressure to continue throughout 2008. Furthermore, our pricing protocols for cheese expired at the end of 2007, which has resulted in pricing increases on cheese that we expect to continue throughout 2008. As a result of freezes in California and Chile, and potentially as a result of wildfires in California, we expect price pressure on avocados to continue in 2008 as well. Any increase in the prices of the ingredients most critical to our menu, such as beef, chicken, cheese, avocados, beans, tomatoes and pork, could adversely affect our operating results. Alternatively, in the event of cost increases with respect to one or more of our raw ingredients, we may choose to suspend serving menu items, such as guacamole, rather than paying the increased cost for the ingredients. Any such changes to our available menu may negatively impact our restaurant traffic and comparable restaurant sales.

***Additional instances of e. coli, avian flu, mad cow disease or other food-borne illnesses could adversely affect the price and availability of the meat or produce we use to prepare our food, cause the temporary closure of some restaurants and result in negative publicity, thereby resulting in a decline in our sales.***

In 2006, outbreaks of e. coli relating to certain food items caused consumers to avoid certain products and restaurant chains. Asian and European countries have also experienced outbreaks of avian flu, and incidents of mad cow disease have occurred in Canadian and U.S. cattle herds. These problems, other food-borne illnesses (such as hepatitis A, trichinosis or salmonella) and injuries caused by food tampering have in the past, and could in the future, adversely affect the price and availability of affected ingredients and cause customers to shift their preferences, particularly if we choose to pass any higher ingredient costs along to consumers. As a result, our sales may decline.

Instances of food-borne illnesses, real or perceived, whether at our restaurants or those of our competitors, could also result in negative publicity about us or the restaurant industry, which could adversely affect sales. If we react to negative publicity by changing our menu or other key aspects of the Chipotle experience, we may lose customers who do not accept those changes, and may not be able to attract enough new customers to produce the revenue needed to make our restaurants profitable. In addition, we may have different or additional competitors for our intended customers as a result of making these changes and may not be able to compete successfully against those competitors. If our customers become ill from food-borne illnesses, we could be forced to temporarily close some restaurants. A decrease in customer traffic as a result of these health concerns or negative publicity, or as a result of a change in our menu or dining experience or a temporary closure of any of our restaurants, could materially harm our business.

***Our business could be adversely affected by increased labor costs or difficulties in finding the right employees for our restaurants.***

Labor is a primary component of our operating costs, and we believe good managers and crew are a key part of our success. We devote significant resources to recruiting and training our restaurant managers and crew. Increased labor costs due to factors like competition, increased minimum wage requirements, employee benefits and changes due to our new restaurant staffing structure would adversely impact our operating costs. Our success also depends in part on the energy and skills of our employees and our ability to hire, motivate and keep qualified employees, including especially restaurant managers and crew members. Our failure to find and keep enough employees who are a good fit with our culture could delay planned restaurant openings, result in higher employee turnover or require us to change our culture, any of which could have a material adverse effect on our business and results of operations. Restaurant operators have traditionally experienced relatively high employee turnover rates. Any increase in our turnover rates for managers or crew could be costly.

Various states in which we operate are considering or have already adopted new immigration laws, and the U.S. Congress has recently been considering changes to Federal immigration laws as well. Some of these new laws may increase our obligations for compliance and oversight, which could subject us to additional costs and make our hiring process more cumbersome, or reduce the availability of potential employees. Although we require all workers to provide us with government-specified documentation evidencing their employment eligibility, some of our employees may, without our knowledge, be unauthorized workers. Unauthorized workers are subject to deportation and may subject us to fines or penalties, and if any of our workers are found to be unauthorized we could experience adverse publicity that negatively impacts our brand.

***Our insurance coverage and self-insurance reserves may not cover future claims.***

We maintain various insurance policies for employee health, worker s compensation, general liability and property damage. In conjunction with our separation from McDonald s, we entered into certain new insurance policies with modified coverage. Prior to entering into the new policies, we were covered by fixed cost policies for health insurance and worker s compensation. We are now self-insured for our health plans, and have purchased a fully-insured stop loss policy to help offset our liability for both individual and aggregate claim costs. We are also responsible for losses up to a certain limit for worker s compensation, general liability and property damage insurance.

For policies under which we are responsible for losses, we record a liability that represents our estimated cost of claims incurred and unpaid as of the balance sheet date. Our estimated liability is not discounted and is based on a number of assumptions and factors, including historical trends, actuarial assumptions and economic conditions, and is closely monitored and adjusted when warranted by changing circumstances. Our history of claims experience is short and our significant growth rate could affect the accuracy of estimates based on historical experience. Should a greater amount of claims occur compared to what was estimated or medical costs increase beyond what was expected, our accrued liabilities might not be sufficient and we may be required to record additional expense. Unanticipated changes may produce materially different amounts of expense than that reported under these programs, which could adversely impact our results of operations.

***We may not persuade customers of the benefits of paying our prices for higher-quality food.***

Our success depends in large part on our ability to persuade customers that food made with higher-quality ingredients is worth the prices they will pay at our restaurants relative to prices offered by some of our competitors, particularly those in the quick-service segment. We may not successfully educate customers about the quality of our food, and customers may not care even if they do understand our approach. That could require us to change our pricing, advertising or promotional strategies, which could materially and adversely affect our results or the brand identity that we have tried to create.

***Changes in customer tastes and preferences, spending patterns and demographic trends could cause sales to decline.***

Changes in customer preferences, general economic conditions, discretionary spending priorities, demographic trends, traffic patterns and the type, number and location of competing restaurants affect the restaurant industry. Our sales could be impacted by changes in consumer preferences in response to health or dietary concerns, including preferences regarding items such as calories, carbohydrates, fat or sodium. These changes could result in consumers avoiding our burritos and other menu items in favor of other foods. Our success also depends to a significant extent on consumer confidence, which is influenced by general economic conditions and discretionary income levels. Negative consumer sentiment, in particular relating to difficulties in the housing and credit markets, has been widely reported in late 2007 and early 2008. Our sales may decline during economic downturns, which can be caused by various economic factors such as high gasoline prices, or during periods of uncertainty, such as those that followed the terrorist attacks on the United States in 2001. Any material decline in consumer confidence or a decline in family food away from home spending could cause our sales, operating results, profits, business or financial condition to decline. If we fail to adapt to changes in customer preferences and trends, we may lose customers and our sales may deteriorate.

***Competition from other restaurant companies could adversely affect us.***

The fast-casual, quick-service and casual dining segments of the restaurant industry are highly competitive with respect to, among other things, taste, price, food quality and presentation, service, location and the ambience and condition of each restaurant. Our competition includes a variety of restaurants in each of these segments, including locally owned restaurants and national and regional chains. Our competitors offer dine-in, carry-out and delivery services. Many of our competitors have existed longer and often have a more established market presence with substantially greater financial, marketing, personnel and other resources than we have. Among our main competitors are a number of multi-unit, multi-market Mexican food or burrito restaurant concepts, some of which are expanding nationally. As we expand further in existing markets, our existing restaurants may face competition from our new restaurants that begin operating in those markets.

Several of our competitors compete by offering menu items that are specifically identified as low in carbohydrates, better for customers or otherwise targeted at particular consumer preferences. Many of our competitors in the fast-casual and quick-service segments of the restaurant industry also emphasize lower-cost, value meal menu options, a strategy we do not pursue. Our sales may be adversely affected by these products and price competition.

Moreover, new companies may enter our markets and target our customers. For example, additional competitive pressures have come more recently from the deli sections and in-store cafés of several major grocery store chains, including those targeted at customers who want higher-quality food, as well as from convenience stores and casual dining outlets. These competitors may have, among other things, lower operating costs, better locations, better facilities, better management, more effective marketing and more efficient operations than we have.

All of these competitive factors may adversely affect us and reduce our sales and profits.

***We may have experienced a security breach with respect to certain customer credit and debit card data, and we have incurred and may continue to incur substantial costs as a result of this matter. We may also incur costs resulting from other security risks we may face in connection with our electronic processing and transmission of confidential customer information.***

In August 2004, the merchant bank that processes our credit and debit card transactions, which we refer to as the acquiring bank, informed us that we may have been the victim of a possible theft of credit and debit card data. Together with two forensic auditing firms, we investigated the alleged theft and reviewed our information systems and information security procedures. We also reported the problem to federal law enforcement authorities and cooperated in their investigation. While to date we have not discovered conclusive evidence that a theft occurred, we identified some restaurant practices that may have made information systems at our restaurants vulnerable during periods before August 2004. As a result, outside parties may have gained access to stored information. It is possible that all of the cards we processed since we began accepting them in 1999 may have been vulnerable. In the three months prior to being notified of the problem, we processed between 1.3 million and 1.5 million credit and debit card charges each month.

We may in the future become subject to additional claims for purportedly fraudulent transactions arising out of this matter. As long as a credit or debit card is active, fraudulent charges may be made using that card until the card s expiration date. We may also be subject to lawsuits or other proceedings by various interested parties, including banks and credit unions that issue cards, cardholders (either individually or as part of a class action lawsuit) and federal and state regulators. The statutes of limitation for pursuing some of these potential claims may extend for six years or more in some cases, depending on the circumstances. Moreover, the application of the law and the rules and procedures of the major card associations in these circumstances is generally untested. Any lawsuit or other proceeding will likely be complex, costly and protracted, which could in turn divert financial and management resources from execution of our business plan. We have no way to predict the level of claims or the number or nature of proceedings that may be asserted against us, nor can we quantify the costs that we may incur in connection with investigating, responding to and defending any of them. If we litigate these matters, we may not be able to defend against penalties successfully. The ultimate outcome of this matter could have a material adverse effect on our financial results and condition. Consumer perception of our brand could also be negatively affected by these events, which could further adversely affect our results and prospects.

Despite the changes we have made to our information systems as a result of this matter, we still need to periodically upgrade our software. We rely on commercially available software and other technologies to provide security for processing and transmission of customer credit card data. During 2007 and 2006, approximately half of our sales were attributable to credit card transactions, and we expect credit card usage to increase. Our systems could be compromised in the future, which could result in the misappropriation of customer information or the disruption of our systems. Either of those consequences could have a material adverse effect on our reputation and business or subject us to additional liabilities.

***Failure to receive frequent deliveries of higher-quality food ingredients and other supplies could harm our operations.***

Our ability to maintain our menu depends in part on our ability to acquire ingredients that meet our specifications from reliable suppliers. We do not have long-term contracts with any of our suppliers. Shortages or interruptions in the supply of ingredients caused by unanticipated demand, problems in production or distribution, food contamination, inclement weather or other conditions could adversely affect the availability, quality and cost of our ingredients, which could harm our operations. If any of our distributors or suppliers performs inadequately, or our distribution or supply relationships are disrupted for any reason, our business, financial condition, results of operations or cash flows could be adversely affected. We currently depend on multiple suppliers for our pork, chicken and beef supplies. Due to the unique nature of the products we receive from our pork suppliers, these suppliers could be more difficult to replace if we were no longer able to rely on them. In addition, we have relied on the same third party distribution network as McDonald s. We may have to seek new suppliers and service providers with pricing or other terms less favorable than those we currently enjoy. If we cannot replace or engage distributors or suppliers who meet our specifications in a short period of time, that could increase our expenses and cause shortages of food and other items at our restaurants, which could cause a restaurant to remove items from its menu. If that were to happen, affected restaurants could experience significant reductions in sales during the shortage or thereafter, if our customers change their dining habits as a result. Our focus on a limited menu would make the consequences of a shortage of a key ingredient more severe.

In addition, our approach to competing in the restaurant industry depends in large part on our continued ability to adhere to the principle of Food With Integrity. We use a substantial amount of naturally raised and sustainably grown ingredients, and try to make our food as fresh as we can, in light of pricing considerations. As we increase our use of these ingredients, the ability of our suppliers to expand output or otherwise increase their supplies to meet our needs may be constrained. Our inability to obtain a sufficient and consistent supply of these ingredients on a cost-effective basis, or at all, could cause us difficulties in aligning our brand with the principle of Food With Integrity. That could make us less popular among our customers and cause sales to decline.

***Governmental regulation may adversely affect our ability to open new restaurants or otherwise adversely affect our existing and future operations and results.***

We are subject to various federal, state and local regulations. Each of our restaurants is subject to state and local licensing and regulation by health, alcoholic beverage, sanitation, food and workplace safety and other agencies. We may experience material difficulties or failures in obtaining the necessary licenses or approvals for new restaurants, which could delay planned restaurant openings. In addition, stringent and varied requirements of local regulators with respect to zoning, land use and environmental factors could delay or prevent development of new restaurants in particular locations.

We are subject to the U.S. Americans with Disabilities Act and similar state laws that give civil rights protections to individuals with disabilities in the context of employment, public accommodations and other areas. We may in the future have to modify restaurants, for example by adding access ramps or redesigning certain architectural fixtures, to provide service to or make reasonable accommodations for disabled persons. The expenses associated with these modifications could be material.

Our operations are also subject to the U.S. Fair Labor Standards Act, which governs such matters as minimum wages, overtime and other working conditions, along with the U.S. Americans with Disabilities Act, family leave mandates and a variety of similar laws enacted by the states that govern these and other employment law matters. A lawsuit has been filed against us in California alleging violations of state laws regarding employee record-keeping, meal and rest breaks, payment of overtime and related practices with respect to our employees. We could suffer losses in this case or similar cases, and any such losses could be significant. In addition, several states in which we operate and the federal government have recently enacted minimum wage increases, and these increases could increase our labor costs.

In recent years, there has been an increased legislative, regulatory and consumer focus at the federal, state and municipal levels on the food industry including nutrition and advertising practices. Restaurants operating in the quick-service and fast-casual segments have been a particular focus. For example, New York City and King County, Washington have adopted regulations requiring that chain restaurants include calorie information on their menu boards, and make other nutritional information available on printed menus which must be plainly visible to consumers at the point of ordering. We may in the future become subject to other initiatives in the area of nutrition disclosure or advertising, such as requirements to provide information about the nutritional content of our food, which could increase our expenses or slow customers as they move through the line, decreasing our throughput.

We are subject to federal, state and local environmental laws and regulations concerning the discharge, storage, handling, release and disposal of hazardous or toxic substances, as well as local ordinances restricting the types of packaging we can use in our restaurants. Many environmental laws applicable to us provide for significant fines, penalties and liabilities, sometimes without regard to whether we knew of, or were responsible for, the release or presence of hazardous or toxic substances. Third parties may also make claims against owners or operators of properties for personal injuries and property damage associated with releases of, or actual or alleged exposure to, such substances. We cannot predict what environmental laws will be enacted in the future, how existing or future environmental laws will be administered or interpreted, or the amount of future expenditures that we may need to make to comply with, or to satisfy claims relating to, environmental laws. We have not conducted a comprehensive environmental review of our properties or operations. We have, however, conducted investigations of some of our properties and identified contamination caused by third-party operations. We believe any such contamination has been or should be addressed by the third party. If the relevant third party does not address or has not addressed the identified contamination properly or completely, then under certain environmental laws, we could be held liable as an owner and operator to address any remaining contamination. Any such liability could be material. Further, we may not have identified all of the potential environmental liabilities at our properties, and any such liabilities could have a material adverse effect on our operations or results of operations.

***We may not be able to adequately protect our intellectual property, which could harm the value of our brands and adversely affect our business.***

Our intellectual property is material to the conduct of our business. Our ability to implement our business plan successfully depends in part on our ability to further build brand recognition using our trademarks, service marks, trade dress and other proprietary intellectual property, including our name and logos and the unique ambience of our restaurants. If our efforts to protect our intellectual property are inadequate, or if any third party misappropriates or infringes on our intellectual property, either in print or on the internet, the value of our brands may be harmed, which could have a material adverse effect on our business and might prevent our brands from achieving or maintaining market acceptance. We may also encounter claims from prior users of similar intellectual property in areas where we operate or intend to conduct operations. This could harm our image, brand or competitive position and cause us to incur significant penalties and costs.

***We may face difficulties transitioning services McDonald s provided to us and entering into new or modified arrangements with existing or new suppliers or service providers.***

Prior to our separation from McDonald s in October 2006, we benefited from our relationship with McDonald s in a number of ways. McDonald s provided us, directly or through McDonald s own vendor relationships, with a variety of services and benefits and we also benefited from our relationship with McDonald s when we bought supplies or distribution or other services. For example, McDonald s relationships helped us obtain beneficial pricing on some supplies and services, and we have relied on some of the same third-party distribution networks as McDonald s. In light of our separation from McDonald s and the resulting termination of services and benefits we received from them, we have implemented or obtained accounting functions, information technology systems, employee benefits plans, insurance policies and administrative services to replace services or benefits previously provided by McDonald s. We have limited experience providing or administering these services on our own and we may encounter difficulties with some or all of these arrangements. In addition, as a result of our separation from McDonald s we may not receive the volume pricing benefits or favorable service levels we received from suppliers, vendors and distribution centers as a McDonald s affiliate. We may also need to replace additional suppliers, vendors or distribution centers as a result of our separation from McDonald s, which could adversely affect our business.

***Our quarterly operating results may fluctuate significantly and could fall below the expectations of securities analysts and investors due to various factors.***

Our quarterly operating results may fluctuate significantly because of various factors, including:

- the impact of inclement weather, natural disasters and other calamities, such as snow storms in many of our primary markets in 2006 and 2007 and hurricanes Katrina and Rita in 2005;

- the timing of new restaurant openings and related revenues and expenses;

- operating costs at newly opened restaurants, which are often materially greater during the first several months of operation;

- labor availability and wages of restaurant management and crew;

- profitability of our restaurants, especially in new markets;

- changes in comparable restaurant sales and customer visits, including as a result of the introduction of new menu items;

- variations in general economic conditions, including the impact of declining interest rates on our interest income;

- negative publicity about the ingredients we use or the occurrence of food-borne illnesses or other problems at our restaurants;

changes in consumer preferences and discretionary spending;

increases in infrastructure costs;

fluctuations in supply prices; and

tax expenses, impairment charges and other non-operating costs.

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Seasonal factors also cause our operating results to fluctuate from quarter to quarter. Our restaurant sales are typically lower during the winter months and the holiday season and during periods of inclement weather (because fewer people are eating out) and higher during the spring, summer and fall months (for the opposite reason). Our revenue will also vary as a result of the number of trading days, that is, the number of days in a quarter when a restaurant is open.

As a result of these factors, results for any one quarter are not necessarily indicative of results to be expected for any other quarter or for any year. Average restaurant sales or comparable restaurant sales in any particular future period may decrease. In the future, operating results may fall below the expectations of securities analysts and investors, which could cause our stock prices to fall. We believe the market prices of our class A and class B common stock reflect high market expectations for our future operating results, and as a result , if we fail to meet market expectations for our operating results in the future, any resulting decline in the price of our common stock could be significant.

***The prices of our class A and class B common stock may continue to differ.***

Our class B common stock has historically traded at lower prices than our class A common stock. For instance, on February 15, 2008, our class A common stock closed at $105.25 per share and our class B common stock closed at $90.59 per share. The trading prices of our class A and class B common stock may continue to differ due to factors outside of our control, including differences in market awareness of the two classes, trading liquidity of the two classes or other factors. In the separation agreement we entered into with McDonald s in connection with our separation from them, we agreed not to take any action to combine the class A and class B common stock or otherwise eliminate the two-class capital structure until at least the second anniversary of the separation, and for a period of three years thereafter only under certain conditions. We may incur a large indemnity obligation to McDonald s if the exchange offer is determined to be taxable as a result of our breach of this agreement or any action we take to combine the class A and class B common stock or otherwise eliminate the two-class structure. See Restrictions and indemnities in connection with the tax treatment of McDonald s exchange offer could adversely affect us below. Therefore, we are not currently considering any such action and we do not plan to consider any such action for the foreseeable future. If in the future we do choose to combine the class A and class B common stock or otherwise take action to eliminate the two-class structure, there may be significant costs associated with any such action as a result of the restrictions or indemnities under the separation agreement. Moreover, even if we propose to combine the class A and class B common stock or otherwise eliminate the two-class structure we can not anticipate how the prices of the class A and class B common stock may react to such an action.

***Restrictions and indemnities in connection with the tax treatment of McDonald s exchange offer could adversely affect us.***

We understand that the exchange offer McDonald s completed in October 2006 to dispose of its interest in us should generally be tax-free to McDonald s and its shareholders. Current U.S. tax law generally creates a presumption that a tax-free exchange of the type used by McDonald s would be taxable to McDonald s, but not to its shareholders, if we or our shareholders were to engage in a transaction that would result in a 50% or greater change by vote or by value in our stock ownership during the four-year period beginning two years before the date of the exchange, unless it is established that the exchange and the transaction are not part of a plan or series of related transactions to effect such a change in ownership. As a consequence of the foregoing, in the separation agreement we entered into with McDonald s in connection with the separation, we have:

- undertaken to maintain our current business as an active business for a period of two years following the separation;

- undertaken not to take any action affecting the relative voting rights of any separate classes of our stock on or before the second anniversary of the separation, and for a period thereafter to only take such action under certain conditions;

generally agreed to be restricted, for a period of two years following the separation, from (i) consenting to certain acquisitions of significant amounts of our stock; (ii) transferring significant amounts of our assets; (iii) merging or consolidating with any other person; (iv) liquidating or partially liquidating; (v) reacquiring our stock; or (vi) taking any other action that would be reasonably likely to jeopardize the tax-free status of the exchange, except in specified circumstances; and

agreed to indemnify McDonald s for taxes and related losses it incurs as a result of the exchange failing to qualify as a tax-free transaction, if the taxes and related losses are attributable to (i) direct or indirect acquisitions of our stock or assets (regardless of whether we consent to such acquisitions); (ii) negotiations, understandings, agreements or arrangements in respect of such acquisitions; or (iii) our failure to comply with applicable representations and undertakings and the restrictions placed on our actions under the separation agreement.

The indemnity described above covers corporate level taxes and related losses suffered by McDonald s in the event of a 50% or greater change in our stock ownership, as well as taxes and related losses suffered by McDonald s if, due to any of our representations or undertakings being incorrect or violated, the exchange is determined to be taxable for other reasons. We currently estimate that the indemnification obligation to McDonald s for taxes due in the event of a 50% or greater change in our stock ownership could exceed $450 million. This estimate, which does not take into account related losses, depends upon several factors that are beyond our control. As a consequence, the indemnity to McDonald s could vary substantially from the estimate. Furthermore, the estimate does not address the potential indemnification obligation to McDonald s in the event that, due to any of our representations or undertakings being incorrect or violated, the exchange is determined to be taxable for other reasons. In that event, the total indemnification could extend to tax-related losses suffered by McDonald s shareholders, and therefore would likely be much greater.

***Our anti-takeover provisions may delay or prevent a change in control of us, which could adversely affect the price of our common stock.***

Certain provisions in our corporate documents and Delaware law may delay or prevent a change in control of us, which could adversely affect the price of our class A or class B common stock. Our restated certificate of incorporation and restated bylaws contain some provisions that may make the acquisition of control of us without the approval of our board of directors more difficult, including provisions relating to the nomination, election and removal of directors, the structure of the board of directors and limitations on actions by our shareholders. In addition, Delaware law also imposes some restrictions on mergers and other business combinations between us and any holder of 15% or more of our outstanding class A or class B common stock. Any of these provisions, as well as the provisions of our separation agreement with McDonald s described above under Restrictions and indemnities in connection with the tax treatment of McDonald s exchange offer could adversely affect us, may discourage a potential acquirer from proposing or completing a transaction that may have otherwise presented a premium to our shareholders.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

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**ITEM 2. PROPERTIES**

As of December 31, 2007, we operated 704 restaurants. The table below sets forth the locations (by state) of Chipotle restaurants in operation.

| | |
|---|---|
| Alabama | 2 |
| Arizona | 28 |
| California | 99 |
| Colorado | 66 |
| District of Columbia | 6 |
| Florida | 30 |
| Georgia | 12 |
| Illinois | 55 |
| Indiana | 10 |
| Iowa | 1 |
| Kansas | 15 |
| Kentucky | 5 |
| Maryland | 26 |
| Massachusetts | 3 |
| Michigan | 8 |
| Minnesota | 44 |
| Missouri | 16 |
| Nebraska | 7 |
| Nevada | 7 |
| New Hampshire | 1 |
| New Jersey | 4 |
| New York | 24 |
| North Carolina | 10 |
| Ohio | 86 |
| Oklahoma | 1 |
| Oregon | 7 |
| Pennsylvania | 5 |
| Rhode Island | 1 |
| Texas | 71 |
| Utah | 3 |
| Virginia | 31 |
| Washington | 9 |
| Wisconsin | 10 |
| Wyoming | 1 |
| Total | 704 |

We categorize our restaurants as either end-caps (at the end of a line of retail outlets), in-lines (in a line of retail outlets), free-standing or other. Of our restaurants in operation as of December 31, 2007, we had 159 free-standing units, 413 end-cap locations, 115 in-line locations and 17 other. The average free-standing restaurant seats about 63 customers while the average in-line or end-cap restaurant seats about 61 customers. Our average restaurant size is about 2,650 square feet. Most of our restaurants also feature outdoor patio space.

Our main office is located at 1543 Wazee Street, Suite 200, Denver, Colorado, 80202 and our telephone number is (303) 595-4000. We lease our main office and substantially all of the properties on which we operate restaurants. For additional information regarding the lease terms and provisions, see Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations *Contractual Obligations*.

We own twelve properties and operate restaurants on all of them.

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## ITEM 3. LEGAL PROCEEDINGS

During the second quarter of 2007, we reversed the remaining $1.2 million reserve we had established relating to the possible theft of our customers credit and debit card data. See Note 13 to the Consolidated Financial Statements included in Item 8, Financial Statements and Supplementary Data.

A lawsuit has been filed against us in California alleging violations of state laws regarding employee record-keeping, meal and rest breaks, payment of overtime and related practices with respect to our employees. The case seeks damages, penalties and attorney s fees on behalf of a purported class of our present and former employees. We are currently investigating these claims, and although we have various defenses, it is not possible at this time to reasonably estimate the outcome of or any potential liability from this case.

We re 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 operation and cash flows.

## ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

There were no matters submitted to a vote of our security holders through solicitation of proxies or otherwise, during the fourth quarter of our fiscal year ended December 31, 2007.

# PART II

## ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The following table describes the per share range of high and low sales prices for shares of each class of our common stock for the quarterly periods indicated, as reported by the New York Stock Exchange ( NYSE ). Our class A common stock, which trades under the symbol CMG, began trading on the NYSE on January 26, 2006, and our class B common stock, which trades under the symbol CMG.B, began trading on the NYSE on October 5, 2006.

| | Chipotle Class A Common Stock | | Chipotle Class B Common Stock | |
|---|---|---|---|---|
| | **High** | **Low** | **High** | **Low** |
| 2007 | | | | |
| First Quarter | $ 65.25 | $ 54.61 | $ 61.17 | $ 50.40 |
| Second Quarter | $ 88.70 | $ 61.94 | $ 81.95 | $ 57.19 |
| Third Quarter | $ 119.97 | $ 77.51 | $ 109.20 | $ 70.65 |
| Fourth Quarter | $ 155.49 | $ 113.51 | $ 129.64 | $ 102.28 |

| | Chipotle Class A Common Stock | | Chipotle Class B Common Stock | |
|---|---|---|---|---|
| | **High** | **Low** | **High** | **Low** |
| 2006 | | | | |
| First Quarter | $ 56.75 | $ 39.99 | n/a | n/a |
| Second Quarter | $ 67.76 | $ 48.30 | n/a | n/a |
| Third Quarter | $ 60.77 | $ 45.86 | n/a | n/a |
| Fourth Quarter | $ 62.36 | $ 48.30 | $ 59.07 | $ 48.50 |

As of February 21, 2008, there were approximately 389 holders of our class A common stock and approximately 1,169 holders of our class B common stock, in each case as determined by counting our record holders and the number of participants reflected in a security position listing provided to us by the Depository Trust Company. We estimate that there are approximately 56,000 beneficial owners of our class A common stock and approximately 11,000 beneficial owners of our class B common stock.

***Dividend Policy***

We are not required to pay any dividends and have not declared or paid any cash dividends on either class of our common stock. We intend to continue to retain earnings for use in the operation and expansion of our business and therefore do not anticipate paying any cash dividends on our common stock in the foreseeable future.

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**COMPARISON OF CUMULATIVE TOTAL RETURN**

The following graph compares the cumulative annual stockholders return on our classes of common stock from the dates trading began on the NYSE (January 26, 2006 for class A and October 5, 2006 for class B) through December 31, 2007 to that of the total return index for the Russell 2000 and the S&P SmallCap 600 Restaurants Index assuming an investment of $100 on January 26, 2006. In calculating total annual stockholder return, reinvestment of dividends, if any, is assumed. The indices are included for comparative purpose only. They do not necessarily reflect management s opinion that such indices are an appropriate measure of the relative performance of the class A or class B common stock. This graph is not soliciting material, is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference in any of our filings under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date hereof and irrespective of any general incorporation language in any such filing.

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**ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA**

Our selected consolidated financial data shown below should be read together with our Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and respective notes included in Item 8. Financial Statements and Supplementary Data . The selected consolidated statements of income data for the years ended December 31, 2007, 2006 and 2005 and the consolidated balance sheet data as of December 31, 2007 and 2006 have been derived from our audited consolidated financial statements included in Item 8. Financial Statements and Supplementary Data . Our consolidated financial statements for the years ended December 31, 2007, 2006 and 2005 have been audited and reported upon by Ernst & Young LLP, an independent registered public accounting firm. The selected consolidated statements of income data for the year ended December 31, 2004 and 2003 and the consolidated balance sheet data as of December 31, 2005, 2004 and 2003 have been derived from audited financial statements not included in this report. The data shown below are not necessarily indicative of results to be expected for any future period (in thousands, except per share data).

| | For the years ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2007 | 2006 | 2005 | 2004 | 2003 |
| **Statements of Income:** | | | | | |
| Revenue | | | | | |
| Restaurant sales | $ 1,085,047 | $ 819,787 | $ 625,077 | $ 468,579 | $ 314,027 |
| Franchise royalties and fees | 735 | 3,143 | 2,618 | 2,142 | 1,493 |
| Total revenue | 1,085,782 | 822,930 | 627,695 | 470,721 | 315,520 |
| Food, beverage and packaging costs | 346,393 | 257,998 | 202,288 | 154,148 | 104,921 |
| Labor costs | 289,417 | 231,134 | 178,721 | 139,494 | 94,023 |
| Occupancy costs | 75,891 | 58,804 | 47,636 | 36,190 | 25,570 |
| Other operating costs | 131,512 | 102,745 | 82,976 | 64,274 | 43,527 |
| General and administrative expenses | 75,038 | 65,284 | 51,964 | 44,837 | 34,189 |
| Depreciation and amortization | 43,595 | 34,253 | 28,026 | 21,802 | 15,090 |
| Pre-opening costs | 9,585 | 6,778 | 1,971 | 2,192 | 1,631 |
| Loss on disposal of assets | 6,168 | 3,982 | 3,119 | 1,678 | 4,504 |
| Total costs and expenses | 977,599 | 760,978 | 596,701 | 464,615 | 323,455 |
| Income (loss) from operations | 108,183 | 61,952 | 30,994 | 6,106 | (7,935) |
| Interest income | 6,115 | 6,574 | 36 | 211 | 249 |
| Interest expense | (296) | (271) | (790) | (191) | (28) |
| Income (loss) before income taxes | 114,002 | 68,255 | 30,240 | 6,126 | (7,714) |
| (Provision) benefit for income taxes[(1)] | (43,439) | (26,832) | 7,456 | | |
| Net income (loss) | $ 70,563 | $ 41,423 | $ 37,696 | $ 6,126 | $ (7,714) |
| Earnings (loss) per share | | | | | |
| Basic | $ 2.16 | $ 1.29 | $ 1.43 | $ 0.24 | $ (0.34) |
| Diluted | $ 2.13 | $ 1.28 | $ 1.43 | $ 0.24 | $ (0.34) |
| Shares used in computing earnings (loss) per share | | | | | |
| Basic | 32,672 | 32,051 | 26,281 | 25,454 | 22,384 |
| Diluted | 33,146 | 32,465 | 26,374 | 25,520 | 22,384 |

| | As of December 31, | | | | |
|---|---|---|---|---|---|
| | 2007 | 2006 | 2005 | 2004 | 2003 |
| **Balance Sheet Data:** | | | | | |
| Total current assets | $ 201,844 | $ 178,837 | $ 17,824 | $ 10,332 | $ 7,833 |
| Total assets | $ 722,115 | $ 604,208 | $ 392,495 | $ 329,653 | $ 249,014 |
| Total current liabilities | $ 73,301 | $ 61,201 | $ 41,982 | $ 38,663 | $ 38,266 |

| | | | | | |
|---|---|---|---|---|---|
| Total liabilities | $ 160,005 | $ 130,251 | $ 83,141 | $ 67,087 | $ 57,506 |
| Total shareholders equity | $ 562,110 | $ 473,957 | $ 309,354 | $ 262,566 | $ 191,508 |

(1) During the year ended December 31, 2005, we determined that it was more likely than not that we would realize our deferred tax assets and we reversed our valuation allowance of $20.3 million, resulting in a non-recurring tax benefit.

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**ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*You should read the following discussion together with Item 6. Selected Consolidated Financial Data and our consolidated financial statements and related notes included in Item 8. Financial Statements and Supplementary Data . The discussion contains forward-looking statements involving risks, uncertainties and assumptions that could cause our results to differ materially from expectations. Factors that might cause such differences include those described in Item 1A. Risk Factors and elsewhere in 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. Over the years, that vision has evolved. Today, our vision is to change the way people think about and eat fast food. 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 a 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.

**2007 Highlights**

*Restaurant Development*. As of December 31, 2007, we had 704 restaurants in 33 states throughout the United States and in the District of Columbia. New restaurants have contributed substantially to our restaurant sales. We opened 125 company-operated restaurants during 2007, including 10 restaurants in 5 new markets. We define a new market as one in which no restaurant was open as of the end of the prior year. We expect to open between 130 and 140 restaurants in 2008, including one in Toronto, Canada.

*Sales Growth.* In addition to growing our number of restaurants, we have experienced increases in our average restaurant sales of 7.6% in 2007 and 11.9% in 2006, driven primarily by strong comparable restaurant sales increases. We define average restaurant sales as the average trailing 12-month sales for company-operated restaurants in operation for at least 12 full calendar months. Comparable restaurant sales include company-operated restaurants only and represent the change in period-over-period sales for restaurants beginning in their 13th full month of operation. Comparable restaurant sales increases were due mainly to an increase in the number of transactions processed at our registers and menu price increases.

We expect our average restaurant sales to continue to increase in 2008, driven by comparable restaurant sales increases in the low to mid single digits. However, as a result of several years of double-digit comparable restaurant sales increases and the potential impact of weaker consumer spending, we believe that comparable restaurant sales will not continue to increase at the rates we have achieved over the past several years.

*Food Costs.* As a result of freezes in California and Chile, we experienced increased costs for avocados during 2007 and we expect the pricing pressures for avocados to continue through 2008. Additionally, the cost of many basic foods for humans and animals, including corn, wheat, rice and oil has increased. This has resulted in upward pricing pressures on almost all of our raw ingredients including chicken, beef, tortillas and rice, and we expect that pressure to continue through 2008 as well. We also will have a significant increase in cheese prices for 2008 as a result of the expiration of the pricing protocols under which we operated during 2007.

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*Labor.* Labor costs as a percentage of revenue decreased in 2007 primarily due to more effective management of staffing through the implementation of a national labor matrix, improved employee efficiency as average restaurant sales increased faster than our need to add labor and lower insurance claims experience benefiting us as we became self-insured in the fourth quarter of 2006. The national labor matrix prescribes labor hours based on projected sales volumes. The decrease was partially offset by an increase in hourly employee wages in part from the restaurant structure introduced in 2006. Although we have not been directly impacted by recent minimum wage increases, we anticipate some upward pressure on our restaurant wages in 2008. In addition, because we have now operated a full year with the national labor matrix and self-insurance structures in place, we do not expect to see the same level of labor improvements during 2008 as 2007.

We continue to focus on ensuring our employee practices are as exceptional as our food. In an effort to achieve this, we continue to develop the Restaurateur program which is designed to encourage the restaurant manager position as a career opportunity for our top performing restaurant managers. During 2008, we plan to leverage our Restaurateurs leadership in neighboring restaurants with opportunities for improvement. In addition to excelling in providing quality food and customer service, restaurant managers are expected to contribute substantially to the development of their crew. Our restaurant management structure is designed to facilitate the development of crew members into restaurant managers. During 2008, these efforts will continue, ensuring we have an effective and efficient field support system for restaurant managers that supports our efforts to identify people with potential, develops crew into managers and ensures high operating standards of our restaurants.

*Throughput.* We deliver our best customer service and hottest food when the line moves efficiently. Through effective restaurant staffing and training, we continue to increase the number of customers we serve during our busiest hours. By the first quarter of 2007, change machines had been installed at the cashier station in virtually all of our restaurants. We also began testing a hand-held point-of-sale terminal in a small number of our restaurants which allows customers to pay with credit cards while waiting in line. We continue to review other equipment and kitchen design innovations to improve the speed of service.

*Food With Integrity.* In addition to continuing to serve naturally raised pork in all our restaurants, we made progress with our Food With Integrity initiative by increasing the number of our restaurants that serve naturally raised beef and chicken. We now serve naturally raised chicken in about 84% of our restaurants and naturally raised beef in about 53%. We define naturally raised as coming from animals that are fed a pure vegetarian diet, never given antibiotics or hormones, and raised humanely in open pastures or deeply bedded pens. All of the sour cream and cheese we serve is made from milk that comes from cows that are not given rBGH, or recombinant bovine growth hormone, to stimulate milk production. In 2008, 30% of all the beans we buy will be organically grown, up from 25% in 2007. We continue to investigate the use of more sustainably grown produce and performed a limited test of the use of locally grown green peppers, onions, and lettuce during 2007. We expect to increase the amount of locally grown produce purchased during 2008.

*Franchise Acquisitions.* In March 2007, we completed the acquisition of four franchised restaurants from two franchisees for an aggregate purchase price of $2.5 million. The remaining four franchised restaurants were acquired on April 30, 2007 for a purchase price of $3.2 million.

*Commitments and Contingencies.* In June 2007, after determining the reserve for claims seeking reimbursement for purportedly fraudulent credit and debit card transactions and related costs was no longer needed, we reversed the remaining $1.2 million reserve into income. See Note 13 to the Consolidated Financial Statements included in Item 8, Financial Statements and Supplementary Data .

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**Restaurant Openings, Relocations and Closures**

The following table details restaurant unit data for our company-operated and franchised locations for the years indicated.

| | For the years ended December 31, | | |
|---|---|---|---|
| | **2007** | **2006** | **2005** |
| **Company-operated** | | | |
| Beginning of year | 573 | 481 | 401 |
| Openings | 125 | 94 | 80 |
| Relocations and closures | (2) | (2) | |
| Franchise acquisitions | 8 | | |
| End of year | 704 | 573 | 481 |
| **Franchises** | | | |
| Beginning of year | 8 | 8 | 8 |
| Franchise acquisitions | (8) | | |
| End of year | | 8 | 8 |
| **Total restaurants at end of year** | 704 | 581 | 489 |

**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, as we open more restaurants and hire more employees, our restaurant operating costs increase.

***Restaurant Sales***

| | For the years ended December 31, | | | % increase 2007 over 2006 | % increase 2006 over 2005 |
|---|---|---|---|---|---|
| | **2007** | **2006** | **2005** | | |
| | | | (dollars in millions) | | |
| Restaurant sales | $ 1,085.0 | $ 819.8 | $ 625.1 | 32.4% | 31.1% |
| Average restaurant sales | $ 1.734 | $ 1.611 | $ 1.440 | 7.6% | 11.9% |
| Comparable restaurant sales increase | 10.8% | 13.7% | 10.2% | | |
| Number of company operated restaurants as of the end of the year | 704 | 573 | 481 | 22.9% | 19.1% |
| Number of company operated restaurants opened in the year, net of closures and relocations | 123 | 92 | 80 | | |

The significant factors contributing to our increases in sales were new restaurant openings and strong comparable restaurant sales performance. Restaurant sales from restaurants not yet in the comparable base contributed to $167.2 million of the increase in sales in 2007, of which $83.8 million was attributable to restaurants opened during the year. In 2006, restaurant sales from restaurants not yet in the comparable restaurant base contributed to $110.8 million of the increase in sales, of which $46.5 million was attributable to restaurants opened in 2006.

Comparable restaurant sales increases contributed to $98.1 million and $84.1 million of the increase in restaurant sales in 2007 and 2006, respectively. We believe comparable restaurant sales increases were driven primarily by an increasing awareness of our brand, increased customer loyalty and our focus on improving service time. The substantial majority of our comparable restaurant sales growth was due to an increase in the

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number of transactions, and the remainder was driven primarily by menu price increases in markets in conjunction with the introduction of naturally raised beef or chicken.

***Food, Beverage and Packaging Costs***

| | For the years ended December 31, | | | % increase 2007 over 2006 | % increase 2006 over 2005 |
|---|---|---|---|---|---|
| | 2007 | 2006 | 2005 | | |
| | | | (dollars in millions) | | |
| Food, beverage and packaging | $ 346.4 | $258.0 | $ 202.3 | 34.3% | 27.5% |
| As a percentage of revenue | 31.9% | 31.4% | 32.2% | | |

Food, beverage and packaging costs increased as a percentage of revenue in 2007 due to increased product cost, primarily avocados, chicken and steak, partially offset by menu price increases in selected markets in conjunction with the introduction of naturally raised beef or chicken, as well as an improvement in food controls. We have seen cost pressures as a result of freezes in California and Chile, which impacted citrus and avocado crops and we expect these cost pressures, along with pressure from significantly higher food costs for items such as wheat and corn, to continue into 2008.

In 2006, food costs decreased as a percentage of revenue due primarily to menu price increases and favorable commodity costs, partially offset by increased food costs associated with our Food With Integrity initiative.

***Labor Costs***

| | For the years ended December 31, | | | % increase 2007 over 2006 | % increase 2006 over 2005 |
|---|---|---|---|---|---|
| | 2007 | 2006 | 2005 | | |
| | | | (dollars in millions) | | |
| Labor costs | $ 289.4 | $ 231.1 | $ 178.7 | 25.2% | 29.3% |
| As a percentage of revenue | 26.7% | 28.1% | 28.5% | | |

Labor costs decreased as a percentage of revenue in 2007 primarily due to more effective management of staffing, improved employee efficiency as average restaurant sales increased faster than our need to add labor and lower insurance claims benefiting us as we became self-insured in the fourth quarter of 2006. The decrease was partially offset by an increase in hourly employee wages.

In 2006, labor costs as a percentage of revenue decreased primarily due to higher average restaurant sales, partially offset by additional staffing costs as we transitioned to our enhanced restaurant structure. We launched the enhanced restaurant management structure in the second quarter of 2006 focusing on developing a defined path for crew to become restaurant managers. This has enabled more promotions from within our existing crew, which has lowered turnover and decreased training costs in 2007.

***Occupancy Costs***

| | For the years ended December 31, | | | % increase 2007 over 2006 | % increase 2006 over 2005 |
|---|---|---|---|---|---|
| | 2007 | 2006 | 2005 | | |
| | | | (dollars in millions) | | |
| Occupancy costs | $ 75.9 | $ 58.8 | $ 47.6 | 29.1% | 23.4% |
| As a percentage of revenue | 7.0% | 7.1% | 7.6% | | |

In 2007 and 2006, occupancy costs decreased as a percentage of revenue due to higher average restaurant sales on a partially fixed-cost base, partially offset by higher rents for new locations.

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*Other Operating Costs*

| | For the years ended December 31, | | | % increase 2007 over 2006 | % increase 2006 over 2005 |
|---|---|---|---|---|---|
| | 2007 | 2006 | 2005 | | |
| | | | (dollars in millions) | | |
| Other operating costs | $ 131.5 | $ 102.7 | $ 83.0 | 28.0% | 23.8% |
| As a percentage of revenue | 12.1% | 12.5% | 13.2% | | |

Other operating costs as a percentage of revenue declined in 2007 and 2006 primarily due to the effect of higher average restaurant sales on a partially fixed-cost base and operating efficiencies that are realized as we both grow in size and become more experienced. We also realized a benefit in 2007 and 2006 related to our promote from within strategy which reduced the dollars we spent on training external hires.

*General and Administrative Expenses*

| | For the years ended December 31, | | | % increase 2007 over 2006 | % increase 2006 over 2005 |
|---|---|---|---|---|---|
| | 2007 | 2006 | 2005 | | |
| | | | (dollars in millions) | | |
| General and administrative expense | $ 75.0 | $ 65.3 | $ 52.0 | 14.9% | 25.6% |
| As a percentage of revenue | 6.9% | 7.9% | 8.3% | | |

The increase in general and administrative expenses in 2007 primarily resulted from hiring more employees as we grew and an increase in stock-based compensation expense resulting from the stock-based compensation awards granted in 2007 and the one-time broad based option award granted in 2006 in conjunction with our initial public offering. The 2007 increase was partially offset by the reversal of the credit card contingency reserve in the second quarter of 2007 and costs incurred for the exchange offer conducted by McDonald s in the third quarter of 2006, a secondary offering of our common stock in the second quarter of 2006 and severance costs incurred in the first and second quarters of 2006.

The increase in general and administrative expenses in 2006 primarily resulted from increased employee related expenses driven by hiring more employees, increase in stock-based compensation expense resulting from the one-time broad based option grant in conjunction with our initial public offering, incremental legal and audit costs due to growth and becoming a public company, costs incurred in conjunction with the secondary and exchange offers related to McDonald s disposition of its interest in us, and increases in severance expense.

As a percentage of revenue, general and administrative expenses decreased in 2007 and 2006 due primarily to the effect of higher restaurant sales on a partially fixed-cost base, the reversal of the credit card contingency in the second quarter of 2007 and the costs incurred for the secondary and exchange offers and severance negatively impacting 2006.

*Depreciation and Amortization*

| | For the years ended December 31, | | | % increase 2007 over 2006 | % increase 2006 over 2005 |
|---|---|---|---|---|---|
| | 2007 | 2006 | 2005 | | |
| | | | (dollars in millions) | | |
| Depreciation and amortization | $ 43.6 | $ 34.3 | $ 28.0 | 27.3% | 22.2% |
| As a percentage of revenue | 4.0% | 4.2% | 4.5% | | |

Depreciation and amortization increased in 2007 and 2006 primarily due to the increase of 303 restaurants from January 1, 2005 to December 31, 2007. In addition, in 2007 and 2006 we accelerated depreciation on

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certain restaurant and office locations as a result of relocations or closures which have occurred or will occur. As a percentage of total revenue, depreciation and amortization has decreased as a result of higher average restaurant sales on a partially fixed-cost base.

***Pre-opening Costs***

| | For the years ended December 31, | | | % increase 2007 over 2006 | % increase 2006 over 2005 |
|---|---|---|---|---|---|
| | 2007 | 2006 | 2005 | | |
| | (dollars in millions) | | | | |
| Pre-opening costs | $ 9.6 | $ 6.8 | $ 2.0 | 41.4% | * |
| As a percentage of revenue | 0.9% | 0.8% | 0.3% | | |
| Restaurant openings | 125 | 94 | 80 | | |

* not meaningful

Pre-opening costs increased in 2007 primarily due to an increase in restaurant openings in 2007. Pre-opening costs increased in 2006 primarily as a result of the adoption of FASB Staff Position No. FAS 13-1, *Accounting for Rental Costs Incurred during a Construction Period* ( FSP 13-1 ). FSP 13-1 requires rental costs associated with ground or building operating leases incurred during a construction period to be recognized as expense. Had FSP 13-1 been effective prior to 2006, we would have recognized additional pre-opening costs of approximately $4.2 million in 2005.

***Loss on Disposal of Assets***

| | For the years ended December 31, | | | % increase 2007 over 2006 | % increase 2006 over 2005 |
|---|---|---|---|---|---|
| | 2007 | 2006 | 2005 | | |
| | (dollars in millions) | | | | |
| Loss on disposal of assets | $ 6.2 | $ 4.0 | $ 3.1 | 54.9% | 27.7% |
| As a percentage of revenue | 0.6% | 0.5% | 0.5% | | |

The increase in 2007 in loss on disposal of assets was due to an increase in both the age and number of restaurants, the upgrade of restaurant security systems and an increase in the write-offs associated with investigating potential restaurant sites that we considered but subsequently rejected. The increase in 2006 in loss on disposal of assets was due to a pending closure of one restaurant at the landlord s request, the closure of one restaurant due to structural damage in the leased space and the write-off of obsolete or unused equipment.

***Interest Income***

| | For the years ended December 31, | | | % decrease 2007 over 2006 | % increase 2006 over 2005 |
|---|---|---|---|---|---|
| | 2007 | 2006 | 2005 | | |
| | (dollars in millions) | | | | |
| Interest income | $ 6.1 | $ 6.6 | | 7.0% | * |
| As a percentage of revenue | 0.6% | 0.8% | | | |

* not meaningful

In 2007 interest income decreased primarily due to an increase in investments in tax-exempt securities which have lower interest rates but are exempt from federal income taxes. In 2006 interest income increased as a result of investing our incremental cash and cash equivalents in short-term investments with maturities of three months or less. Our incremental cash and cash equivalents resulted from our initial public offering proceeds and cash from operations.

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***Income Tax (Provision) Benefit***

| | For the years ended December 31, 2007 | 2006 | 2005 | % increase 2007 over 2006 | % increase 2006 over 2005 |
|---|---|---|---|---|---|
| | (dollars in millions) | | | | |
| Income tax (provision) benefit | $ (43.4) | $ (26.8) | $ 7.5 | 61.9% | * |
| As a percentage of revenue | (4.0)% | (3.3)% | 1.2% | | |
| Effective tax rate | 38.1% | 39.3% | (24.7)% | | |

* not meaningful

The 2007 effective tax rate decreased primarily due to increased investments in tax-exempt securities and a decrease in our estimated statutory state tax rate. The improvement was partially offset by a $0.5 million tax effect from non-deductible costs associated with the secondary offering and split-off transaction in 2006.

The total tax provision for 2006 of $26.8 million represents a 39.3% effective tax rate. During 2005, we determined that it was more likely than not we would realize our deferred tax assets and we reversed our valuation allowance of $20.3 million resulting in a $7.5 million tax benefit and an effective tax rate benefit of 24.7%. Excluding the $20.3 million non-recurring tax benefit, the effective tax rate for 2005 would have been 42.6%. The decrease in the effective tax rate is largely due to a decrease in the estimated statutory state rate for enacted changes in state tax laws, the favorable impact of changes in our state tax footprint due to growth, the declining impact of meals and entertainment disallowance as taxable income increases, our investing in tax-exempt securities and a permanent difference related to stock-based compensation in 2005.

**Quarterly Financial Data/Seasonality**

The following table presents consolidated statement of income data for each of the eight quarters in the period ended December 31, 2007. The operating results for any quarter are not necessarily indicative of the results for any subsequent quarter.

| | 2007 Quarters Ended Mar. 31 | June 30 | Sept. 30 | Dec. 31 |
|---|---|---|---|---|
| | (dollars in millions) | | | |
| Revenue | $ 236.1 | $ 274.3 | $ 286.4 | $ 289.0 |
| Operating income | $ 18.6 | $ 30.7 | $ 31.4 | $ 27.5 |
| Net income | $ 12.4 | $ 20.0 | $ 20.6 | $ 17.6 |
| Number of restaurants opened in quarter | 28 | 32 | 28 | 37 |
| Comparable restaurant sales increase | 8.3% | 11.6% | 12.4% | 10.6% |

| | 2006 Quarters Ended Mar. 31 | June 30 | Sept. 30 | Dec. 31 |
|---|---|---|---|---|
| | (dollars in millions) | | | |
| Revenue | $ 187.0 | $ 204.9 | $ 211.3 | $ 219.7 |
| Operating income | $ 12.7 | $ 15.9 | $ 17.9 | $ 15.5 |
| Net income | $ 8.0 | $ 10.8 | $ 11.8 | $ 10.8 |
| Number of restaurants opened in quarter | 15 | 14 | 30 | 35 |
| Comparable restaurant sales increase | 19.7% | 14.5% | 11.6% | 10.1% |

Seasonal factors cause our profitability to fluctuate from quarter to quarter. Historically, our 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

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number of trading days in a quarter can also affect our results. Overall, on an annual basis, changes in trading dates do not have a significant impact on our results.

Our quarterly results are also affected by other factors such as the number of new restaurants opened in a quarter 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. In addition, unanticipated events also impact our results. 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, cash equivalent, and short-term investment balance of $171.2 million 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), and to continue to maintain our existing restaurants and for general corporate purposes. We believe that cash from operations, together with our cash balance, will be enough to meet ongoing capital expenditures, working capital requirements and other cash needs over at least the next 24 months.

In August 2007, we entered into a revolving line of credit with a principal amount of $15 million which expires in August 2008. The line of credit is for support of letters of credit we issue in the normal course of business and normal short-term working capital needs. The line of credit bears interest at our option at the prime rate, a fixed rate determined by the bank or an adjusted LIBOR rate. As of December 31, 2007, no amounts were outstanding.

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 some time after the receipt of those items, generally within ten days, thereby reducing the need for incremental working capital to support our growth.

While operations continue to provide cash, our primary use of cash is in new restaurant development. As we expand into more urban areas, our average costs to open new restaurants will increase due to more significant reconstruction work that often needs to be done on those sites. Our total capital expenditures for 2007 were $141 million, and we expect to incur capital expenditures of about $150 million in 2008, relating primarily to our construction of new restaurants in both periods. In 2007, we spent on average about $880,000 in development and construction costs per restaurant, with end-caps costing about $740,000, in-lines costing about $930,000, free-standing costing about $1.1 million and urban costing about $1.4 million (in each case, reduced for landlord reimbursements). The average development and construction costs per restaurant increased from $860,000 in 2006 due to opening a larger portion of our restaurants in urban locations being partially offset by a decline in the percentage of free-standing restaurant openings and decreasing our average restaurant size. In 2008, we expect average development and construction costs to be approximately $900,000 per restaurant as a result of developing in higher cost markets as well as inflation in construction costs.

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**Contractual Obligations**

Our contractual obligations as of December 31, 2007 were as follows:

| | Payments Due by Period | | | | |
|---|---|---|---|---|---|
| | Total | 1 year | 2-3 years (in thousands) | 4-5 years | After 5 years |
| Operating leases | $ 1,410,566 | $ 76,469 | $ 155,795 | $ 157,452 | $ 1,020,850 |
| Deemed landlord financing | 7,395 | 366 | 740 | 785 | 5,504 |
| Other contractual obligations[1] | 12,271 | 12,271 | | | |
| Total contractual cash obligations | $ 1,430,232 | $ 89,106 | $ 156,535 | $ 158,237 | $ 1,026,354 |

(1) We enter into various purchase obligations in the ordinary course of business. Those that are binding primarily relate to amounts owed under contractor and subcontractor agreements, orders submitted for equipment for restaurants under construction, and corporate sponsorships.

We re obligated under non-cancelable leases for our restaurants and administrative offices. Our leases generally have initial terms of either five to ten years with two or more five-year extensions, for end-cap and in-line restaurants, or 15 to 20 years with several five-year extensions, for free-standing restaurants. Our leases generally require us to pay a proportionate share of real estate taxes, insurance, common charges and other operating costs. Some restaurant leases provide for contingent rental payments based on sales thresholds, although we generally do not expect to pay significant contingent rent on these properties based on the thresholds in those leases.

**Off-Balance Sheet Arrangements**

As of December 31, 2007 and 2006, we had no off-balance sheet arrangements or obligations.

**Inflation**

The primary areas of our operations affected by inflation are food, labor, fuel, insurance, utility costs and materials used in the construction of our restaurants. Although almost all of our crew members make more than the minimum wage, increases in the applicable federal or state minimum wage will have an impact on our labor costs. Additionally, many of our leases require us to pay taxes, maintenance, utilities and insurance, all of which are generally subject to inflationary increases.

**Critical Accounting Estimates**

We describe our significant accounting policies in Note 1 of our consolidated financial statements. 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 believe the following critical accounting estimates affect our more significant judgments and estimates used in the preparation of our financial statements:

***Leases***

We lease most of our restaurant locations. Our leases contain escalating rentals over the lease term as well as optional renewal periods. We account for our leases under FASB Statement No. 13, *Accounting for Leases* ( FAS 13 ) which requires rent to be recognized on a straight-line basis over the lease term including reasonably

assured renewal periods. We have estimated that our lease term, including reasonably assured renewal periods, is the lesser of the lease term or 20 years. If the estimate of our reasonably assured lease terms were changed our depreciation and rent expense could differ materially.

***Stock-based Compensation***

We recognize compensation expense for equity awards over the vesting period based on the award s fair value. We use the Black-Scholes valuation model to determine the fair value of our stock options, which requires assumptions to be made regarding our stock price volatility, the expected life of the option and expected dividend rates. The volatility assumptions were derived primarily from historical volatilities of competitors whose shares are traded in the public markets and are adjusted to reflect anticipated behavior specific to us and our volatility while a public company. Had we arrived at different assumptions of stock price volatility or expected lives of our options, our stock-based compensation expense and result of operations could have been different.

***Insurance Liability***

We maintain various insurance policies for employee health, workers compensation, general liability and property damage. Pursuant to these policies we are either responsible for losses up to certain limits or are self insured but have third party insurance coverage to limit exposure to these claims. We record a liability that represents our estimated cost of claims incurred and unpaid as of the balance sheet date. Our estimated liability is not discounted and is based on a number of assumptions and factors, including historical trends, actuarial assumptions and economic conditions, and is closely monitored and adjusted when warranted by changing circumstances. In addition, our history of claims experience is short and our significant growth rate could affect the accuracy of estimates based on historical experience. Should a greater amount of claims occur compared to what was estimated or medical costs increase beyond what was expected, our accrued liabilities might not be sufficient and additional expenses may be recorded. Actual claims experience could also be more favorable than estimated resulting in expense reductions. Unanticipated changes may produce materially different amounts of expense than that reported under these programs.

***Reserves/Contingencies for Litigation and Other Matters***

We are involved in various claims and legal actions that arise in the ordinary course of business. These actions are subject to many uncertainties, and we cannot predict the outcomes with any degree of certainty. Consequently, we were unable to ascertain the ultimate aggregate amount of monetary liability or financial impact with respect to these matters as of December 31, 2007 and 2006. Once resolved, however, these actions may affect our operating results and cash flows.

***Sabbatical Liability***

We offer our employees a sabbatical leave after each ten years of service they complete. We record a liability for our estimate of the accumulated sabbatical expense as of the balance sheet date. Our estimated liability is based on a number of factors including actuarial assumptions and historical trends. Changes in assumptions and trends could result in a materially different liability and expense.

**Adoption of New Accounting Standards**

In September 2006, the Emerging Issues Task Force ( EITF ) issued EITF Issue No. 06-2, *Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43 Accounting for Compensated Absences* ( EITF 06-2 ). The EITF concluded that sabbatical leave accumulates pursuant to the criteria of Statement of Accounting Standard No. 43 *Accounting for Compensated Absences* ( FAS 43 ) and therefore the benefit should be accrued if the remaining criteria of FAS 43 are met. EITF 06-2 is effective for fiscal years beginning after December 15, 2006. EITF 06-2 can be applied as a change in accounting principle either as a cumulative-effect adjustment to beginning retained earnings in the year of adoption or as retrospective application to all prior periods. We offer sabbatical leave to employees who have provided ten years of services. Previously, we expensed sabbatical costs as incurred.

We determined an estimated accrued sabbatical balance as of December 31, 2006 of $2.6 million which we recognized as a cumulative-effect adjustment to beginning retained earnings in the first quarter of 2007. During 2007, the assumptions used were changed to estimate the accrual for only the sabbatical currently being earned. In addition, the tax impact of the cumulative effect adjustment had been excluded. As a result, we adjusted the amount of the cumulative-effect adjustment that was recorded to retained earnings effective January 1, 2007 to $1.0 million (net of taxes of $675,000). We have deemed the impact of the adjustment to be immaterial to the consolidated balance sheet for each of the 2007 quarterly reports. During the year ended December 31, 2007, we accrued sabbatical expense of $331,000 (net of taxes of $212,000).

Effective January 1, 2007, we adopted Financial Accounting Standards Board ( FASB ) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ( FIN 48 ). FIN 48 prescribes a recognition threshold and measurement attribute for recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. Adoption of FIN 48 did not have an impact on our consolidated financial statements.

**Recent Accounting Pronouncements**

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities,* ( FAS 159 ). FAS 159 allows entities the option to measure eligible financial instruments at fair value as of specified dates. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. FAS 159 is effective for fiscal years beginning after November 15, 2007. We do not expect to elect the option to measure any existing financial instruments at fair value, therefore, we do not expect the adoption of FAS 159 to have an impact on our consolidated financial statements.

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements,* ( FAS 157 ). FAS 157 defines fair value, establishes a framework for using fair value to measure assets and liabilities, and expands disclosure about fair value measurements. FAS 157 applies whenever other statements require or permit assets or liabilities to be measured at fair value and is effective for fiscal years beginning after November 15, 2007. We do not expect the adoption of FAS 157 to have a material impact on our consolidated financial statements.

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

**Changing Interest Rates**

We re exposed to interest rate risk through the investment of our cash, cash equivalents, and available-for-sale securities. Changes in interest rates affect the interest income we earn, and therefore impact our cash flows and results of operations. As of December 31, 2007, we had $163.5 million deposited in short-term investments and available-for-sale securities bearing a weighted-average interest rate of 3.6% (approximately 5.2% tax equivalent).

**Commodity Price Risks**

We re also exposed to commodity price risks. Many of the ingredients we use to prepare our food, as well as our packaging materials, are commodities that are affected by 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 sometime 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

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pricing protocols under which the prices we pay are based on specified formula related to the prices of the goods, such as spot prices. Though we do not have long-term supply contracts or guaranteed purchase amounts, our pricing protocols with suppliers can remain in effect for periods ranging from one month to a year, depending on the outlook for prices of the particular ingredient. We also sometimes buy supplies at current market or spot prices. 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, weather, crises and other world events that may affect supply prices. Long-term increases in ingredient prices could adversely affect our future results if we could not increase menu prices at the same pace for competitive or other reasons. Similarly, if we believe the ingredient price increase to be short in duration we may choose not to pass on the cost increases, which could adversely affect our short-term financial results.

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**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

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## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

**The Board of Directors and Shareholders of**

**Chipotle Mexican Grill, Inc.**

We have audited the accompanying consolidated balance sheets of Chipotle Mexican Grill, Inc. (the Company ) as of December 31, 2007 and 2006, and the related consolidated statements of income, shareholders equity and comprehensive income, and cash flows for each of the three years in the period ended December 31, 2007. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Chipotle Mexican Grill, Inc. at December 31, 2007 and 2006, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles.

As discussed in the Notes to the consolidated financial statements, effective January 1, 2006, the Company changed its method for accounting for pre-opening rental costs to conform with FASB Staff Position No. FAS 13-1, *Accounting for Rental Costs Incurred during a Construction Period*, effective January 1, 2007, the Company changed its method for accounting for income taxes to conform with FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, and effective January 1, 2007, the Company changed its method for accounting for sabbatical leave to conform with Emerging Issues Task Force Issue No. 06-2, *Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43 Accounting for Compensated Absences*.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Chipotle Mexican Grill, Inc. s internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 25, 2008, expressed an unqualified opinion thereon.

Ernst & Young LLP

Denver, Colorado

February 25, 2008

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**CHIPOTLE MEXICAN GRILL, INC.**

**CONSOLIDATED BALANCE SHEET**

**(in thousands, except per share data)**

| | December 31 2007 | December 31 2006 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 151,176 | $ 153,642 |
| Accounts receivable, net of allowance for doubtful accounts of $237 and $344 as of December 31, 2007 and 2006, respectively | 5,373 | 4,865 |
| Receivable McDonald s Corp. | | 8,783 |
| Inventory | 4,332 | 3,505 |
| Current deferred tax assets | 2,431 | 930 |
| Prepaid expenses | 8,997 | 7,112 |
| Income tax receivable | 9,535 | |
| Available-for-sale securities | 20,000 | |
| Total current assets | 201,844 | 178,837 |
| Leasehold improvements, property and equipment, net | 494,930 | 404,740 |
| Other assets | 3,402 | 2,893 |
| Goodwill | 21,939 | 17,738 |
| Total assets | $ 722,115 | $ 604,208 |
| **Liabilities and shareholders equity** | | |
| Current liabilities: | | |
| Accounts payable | $ 19,880 | $ 19,567 |
| Accrued payroll and benefits | 26,210 | 16,764 |
| Accrued liabilities | 27,135 | 23,277 |
| Current portion of deemed landlord financing | 76 | 71 |
| Income tax payable | | 1,522 |
| Total current liabilities | 73,301 | 61,201 |
| Deferred rent | 63,192 | 46,222 |
| Deemed landlord financing | 3,960 | 4,036 |
| Deferred income tax liability | 16,483 | 18,681 |
| Other liabilities | 3,069 | 111 |
| Total liabilities | 160,005 | 130,251 |
| Shareholders equity: | | |
| Preferred stock, $0.01 par value, 600,000 shares authorized, no shares outstanding as of December 31, 2007 and 2006 | | |
| Class A common stock, $0.01 par value, 200,000 shares authorized, 14,431 and 14,222 shares outstanding as of December 31, 2007 and 2006, respectively | 144 | 142 |
| Class B common stock, $0.01 par value, 30,000 shares authorized, 18,374 and 18,322 shares outstanding as of December 31, 2007 and 2006, respectively | 184 | 183 |
| Additional paid-in capital | 489,296 | 470,653 |
| Accumulated other comprehensive income | | 7 |
| Retained earnings | 72,486 | 2,972 |
| Total shareholders equity | 562,110 | 473,957 |

| | | |
|---|---|---|
| Total liabilities and shareholders equity | $ 722,115 | $ 604,208 |

See accompanying notes to consolidated financial statements.

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**CHIPOTLE MEXICAN GRILL, INC.**

**CONSOLIDATED STATEMENT OF INCOME**

**(in thousands, except per share data)**

| | Years ended December 31 | | |
|---|---|---|---|
| | **2007** | **2006** | **2005** |
| Revenue: | | | |
| Restaurant sales | $ 1,085,047 | $ 819,787 | $ 625,077 |
| Franchise royalties and fees | 735 | 3,143 | 2,618 |
| Total revenue | 1,085,782 | 822,930 | 627,695 |
| Restaurant operating costs (exclusive of depreciation and amortization shown separately below): | | | |
| Food, beverage and packaging | 346,393 | 257,998 | 202,288 |
| Labor | 289,417 | 231,134 | 178,721 |
| Occupancy | 75,891 | 58,804 | 47,636 |
| Other operating costs | 131,512 | 102,745 | 82,976 |
| General and administrative expenses | 75,038 | 65,284 | 51,964 |
| Depreciation and amortization | 43,595 | 34,253 | 28,026 |
| Pre-opening costs | 9,585 | 6,778 | 1,971 |
| Loss on disposal of assets | 6,168 | 3,982 | 3,119 |
| | 977,599 | 760,978 | 596,701 |
| Income from operations | 108,183 | 61,952 | 30,994 |
| Interest income | 6,115 | 6,574 | 36 |
| Interest expense | (296) | (271) | (790) |
| Income before income taxes | 114,002 | 68,255 | 30,240 |
| (Provision) benefit for income taxes | (43,439) | (26,832) | 7,456 |
| Net income | $ 70,563 | $ 41,423 | $ 37,696 |
| Earnings per share | | | |
| Basic | $ 2.16 | $ 1.29 | $ 1.43 |
| Diluted | $ 2.13 | $ 1.28 | $ 1.43 |
| Weighted average common shares outstanding | | | |
| Basic | 32,672 | 32,051 | 26,281 |
| Diluted | 33,146 | 32,465 | 26,374 |

See accompanying notes to consolidated financial statements.

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**CHIPOTLE MEXICAN GRILL, INC.**

**CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY AND COMPREHENSIVE INCOME**

**(in thousands)**

| | Class A Common Stock | | Class B Common Stock | | | | Retained Earnings | Accumulated Other | |
|---|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | Shares | Amount | Additional Paid in Capital | Tax Receivable McDonald s Corp | (Accumulated Deficit) | Comprehensive Income | Total |
| Balance, December 31, 2004 | | $ | 26,281 | $ 263 | $ 384,426 | $ (45,985) | $ (76,147) | $ 9 | $ 262,566 |
| Tax sharing arrangement | | | | | (10,417) | 17,790 | | | 7,373 |
| Stock-based compensation | | | | | 1,719 | | | | 1,719 |
| Net income | | | | | | | 37,696 | | 37,696 |
| Balance, December 31, 2005 | | | 26,281 | 263 | 375,728 | (28,195) | (38,451) | 9 | 309,354 |
| Issuance of common stock | 6,061 | 61 | | | 133,272 | | | | 133,333 |
| Costs to issue common stock | | | | | (12,436) | | | | (12,436) |
| Grant of common stock | 1 | | | | 100 | | | | 100 |
| Conversion of common stock | 8,010 | 80 | (8,010) | (80) | | | | | |
| Stock-based compensation | | | 51 | | 5,870 | | | | 5,870 |
| Stock option exercises | 150 | 1 | | | 2,751 | | | | 2,752 |
| Excess tax benefit on option exercises, net of utilization of $423 | | | | | 934 | | | | 934 |
| Tax sharing arrangement | | | | | (35,566) | 19,412 | | | (16,154) |
| Separation from McDonald s | | | | | | 8,783 | | | 8,783 |
| Comprehensive income: | | | | | | | | | |
| Net income | | | | | | | 41,423 | | 41,423 |
| Foreign currency translation adjustment | | | | | | | | (2) | (2) |
| Total comprehensive income | | | | | | | | | 41,421 |
| Balance, December 31, 2006 | 14,222 | 142 | 18,322 | 183 | 470,653 | | 2,972 | 7 | 473,957 |
| Grant of common stock | 2 | | | | 192 | | | | 192 |
| Stock-based compensation | | | 52 | 1 | 8,135 | | | | 8,136 |
| Stock option exercises | 207 | 2 | | | 3,861 | | | | 3,863 |
| Excess tax benefit on option exercises, net of utilization of $177 | | | | | 6,455 | | | | 6,455 |
| Cumulative affect of change in accounting principle, net of income tax of $675 | | | | | | | (1,049) | | (1,049) |
| Comprehensive income: | | | | | | | | | |
| Net income | | | | | | | 70,563 | | 70,563 |
| Foreign currency translation adjustment | | | | | | | | (7) | (7) |
| Total comprehensive income | | | | | | | | | 70,556 |
| Balance, December 31, 2007 | 14,431 | $ 144 | 18,374 | $ 184 | $ 489,296 | $ | $ 72,486 | $ | $ 562,110 |

See accompanying notes to consolidated financial statements.

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**CHIPOTLE MEXICAN GRILL, INC.**

**CONSOLIDATED STATEMENT OF CASH FLOWS**

**(in thousands)**