

CHIPOTLE MEXICAN GRILL INC  
Form 10-Q  
October 31, 2007  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

\_\_\_\_\_  
**FORM 10-Q**  
\_\_\_\_\_

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended September 30, 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**  
(State or other jurisdiction of  
incorporation or organization)

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

**1543 Wazee Street, Suite 200 Denver, CO**  
(Address of Principal Executive Offices)

**80202**  
(Zip Code)

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

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

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Indicate by check mark whether the registrant is a large accelerated filer, accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer       Accelerated filer       Non-accelerated filer

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

As of October 26, 2007 there were 14,481,773 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.

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**Table of Contents****PART I****ITEM 1. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA****Chipotle Mexican Grill, Inc.****Consolidated Balance Sheet****(in thousands, except per share data)**

|   | September 30,<br>2007<br>(unaudited) | December 31,<br>2006 |
|---|--------------------------------------|----------------------|
| <b>Assets</b>   |                                      |                      |
| Current assets:   |                                      |                      |
| Cash and cash equivalents   | \$ 167,657                           | \$ 153,642           |
| Accounts receivable, net of allowance for doubtful accounts of \$237 and \$344 as of September 30, 2007 and December 31, 2006, respectively | 5,869                                | 4,865                |
| Notes receivable - McDonald's Corporation   | 48                                   | 8,783                |
| Inventory   | 4,404                                | 3,505                |
| Current deferred tax asset  | 1,644                                | 930                  |
| Income tax receivable   | 394                                  |                      |
| Prepaid expenses  | 8,633                                | 7,112                |
| <b>Total current assets</b>   | <b>188,649</b>                       | <b>178,837</b>       |
| Leasehold improvements, property and equipment, net   | 469,295                              | 404,740              |
| Other assets  | 3,484                                | 2,893                |
| Goodwill  | 21,939                               | 17,738               |
| <b>Total assets</b>   | <b>\$ 683,367</b>                    | <b>\$ 604,208</b>    |
| <b>Liabilities and shareholders' equity</b>   |                                      |                      |
| Current liabilities:  |                                      |                      |
| Accounts payable  | \$ 24,958                            | \$ 19,567            |
| Accrued payroll and benefits  | 25,618                               | 16,764               |
| Accrued liabilities   | 19,605                               | 23,277               |
| Current portion of deemed landlord financing  | 75                                   | 71                   |
| Income tax payable  |                                      | 1,522                |
| <b>Total current liabilities</b>  | <b>70,256</b>                        | <b>61,201</b>        |
| Deferred rent   | 58,185                               | 46,222               |
| Deemed landlord financing   | 3,979                                | 4,036                |
| Deferred income tax liability   | 10,513                               | 18,681               |
| Other liabilities   | 3,667                                | 111                  |
| <b>Total liabilities</b>  | <b>146,600</b>                       | <b>130,251</b>       |
| Shareholders' equity:   |                                      |                      |
| Preferred stock, \$0.01 par value, 600,000 shares authorized, no shares outstanding as of September 30, 2007 and December 31, 2006          | 144                                  | 142                  |

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Class A common stock, \$0.01 par value, 200,000 shares authorized, 14,359 and 14,222 shares outstanding as of September 30, 2007 and December 31, 2006, respectively

Class B common stock, \$0.01 par value, 30,000 shares authorized, 18,374 and 18,322 shares outstanding as of September 30, 2007 and December 31, 2006, respectively

|  |                |                |
|--|----------------|----------------|
|  | 184            | 183            |
| Additional paid-in capital                 | 483,035        | 470,653        |
| Accumulated other comprehensive income     | 7              | 7              |
| Retained earnings                          | 53,397         | 2,972          |
| <b>Total shareholders' equity</b>          | <b>536,767</b> | <b>473,957</b> |
| <br>                                       |                |                |
| Total liabilities and shareholders' equity | \$ 683,367     | \$ 604,208     |

*See accompanying notes to consolidated financial statements.*

**Table of Contents****Chipotle Mexican Grill, Inc.****Consolidated Statement of Income****(unaudited)****(in thousands, except per share data)**

|  | <b>Three months ended<br/>September 30,</b> |                  | <b>Nine months ended<br/>September 30,</b> |                  |
|--|---|------------------|--|------------------|
|  | <b>2007</b>                                 | <b>2006</b>      | <b>2007</b>                                | <b>2006</b>      |
| <b>Revenue:</b>                                    |   |                  |  |                  |
| Restaurant sales                                   | \$ 286,431                                  | \$ 210,381       | \$ 796,137                                 | \$ 601,028       |
| Franchise royalties and fees                       |   | 879              | 735  | 2,183            |
| <b>Total revenue</b>                               | <b>286,431</b>                              | <b>211,260</b>   | <b>796,872</b>                             | <b>603,211</b>   |
| <b>Restaurant operating costs:</b>                 |   |                  |  |                  |
| Food, beverage and packaging                       | 92,075                                      | 65,436           | 254,209                                    | 188,009          |
| Labor  | 75,395                                      | 59,629           | 211,965                                    | 169,507          |
| Occupancy  | 19,745                                      | 15,040           | 55,355                                     | 43,250           |
| Other operating costs                              | 33,240                                      | 25,744           | 96,663                                     | 74,855           |
| General and administrative expenses                | 19,279                                      | 15,723           | 54,397                                     | 48,633           |
| Depreciation and amortization                      | 11,167                                      | 8,676            | 31,907                                     | 24,988           |
| Pre-opening costs                                  | 2,350                                       | 2,053            | 6,730                                      | 4,668            |
| Loss on disposal of assets                         | 1,784                                       | 1,106            | 4,919                                      | 2,845            |
|  | 255,035                                     | 193,407          | 716,145                                    | 556,755          |
| <b>Income from operations</b>                      | <b>31,396</b>                               | <b>17,853</b>    | <b>80,727</b>                              | <b>46,456</b>    |
| Interest income                                    | 1,597                                       | 2,015            | 4,617                                      | 4,607            |
| Interest expense                                   | (74)  | (68)             | (223)                                      | (197)            |
| <b>Income before income taxes</b>                  | <b>32,919</b>                               | <b>19,800</b>    | <b>85,121</b>                              | <b>50,866</b>    |
| Provision for income taxes                         | (12,315)                                    | (7,998)          | (32,096)                                   | (20,284)         |
| <b>Net income</b>                                  | <b>\$ 20,604</b>                            | <b>\$ 11,802</b> | <b>\$ 53,025</b>                           | <b>\$ 30,582</b> |
| <b>Earnings per common share:</b>                  |   |                  |  |                  |
| Basic  | \$ 0.63                                     | \$ 0.36          | \$ 1.63                                    | \$ 0.96          |
| Diluted  | \$ 0.62                                     | \$ 0.36          | \$ 1.60                                    | \$ 0.95          |
| <b>Weighted average common shares outstanding:</b> |   |                  |  |                  |
| Basic  | 32,706                                      | 32,499           | 32,622                                     | 31,888           |
| Diluted  | 33,171                                      | 32,885           | 33,049                                     | 32,295           |

*See accompanying notes to consolidated financial statements.*

**Table of Contents****Chipotle Mexican Grill, Inc.****Consolidated Statement of Cash Flows****(unaudited)****(in thousands)**

|   | <b>Nine months ended</b> |             |
|---|--------------------------|-------------|
|   | <b>September 30,</b>     |             |
|   | <b>2007</b>              | <b>2006</b> |
| <b>Operating activities</b>   |                          |             |
| Net income  | \$ 53,025                | \$ 30,582   |
| Adjustments to reconcile net income to net cash provided by operating activities: |                          |             |
| Depreciation and amortization   | 31,907                   | 24,988      |
| Current income tax provision  |                          | 1,832       |
| Deferred income tax benefit   | (8,882)                  | (5,558)     |
| Loss on disposal of assets  | 4,919                    | 2,845       |
| Bad debt allowance  |                          | 363         |
| Stock-based compensation  | 6,137                    | 3,811       |
| Other   | 47                       | (97)        |
| Changes in operating assets and liabilities:                                      |                          |             |
| Accounts receivable   | (1,004)                  | (1,489)     |
| Inventory   | (843)                    | (768)       |
| Prepaid expenses  | (1,521)                  | 1,576       |
| Other assets  | (592)                    | (226)       |
| Accounts payable  | 3,414                    | (529)       |
| Accrued liabilities   | 5,177                    | 6,185       |
| Income tax receivable   | 420                      | 3,755       |
| Due to McDonald's Corp.   |                          | (336)       |
| Deferred rent   | 12,413                   | 6,555       |
| Other long term liabilities   | 956                      |             |
| Net cash provided by operating activities   | 105,573                  | 73,489      |
| <b>Investing activities</b>   |                          |             |
| Purchases of leasehold improvements, property and equipment, net                  | (98,186)                 | (62,499)    |
| Franchise acquisitions  | (5,668)                  |             |
| Net cash used in investing activities   | (103,854)                | (62,499)    |
| <b>Financing activities</b>   |                          |             |
| Proceeds from sale of common stock  |                          | 133,333     |
| Costs of issuing common stock   |                          | (12,436)    |
| Proceeds from option exercises  | 2,280                    | 2,325       |
| Excess tax benefit on stock-based compensation                                    | 3,669                    | 983         |
| Proceeds from deemed landlord financing   |                          | 635         |
| Payments on deemed landlord financing   | (53)                     | (42)        |
| Proceeds from McDonald's tax sharing agreement                                    | 6,400                    | 19,468      |
| Proceeds from McDonald's intercompany notes                                       |                          | 2,248       |
| Net cash provided by financing activities   | 12,296                   | 146,514     |

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|   |            |            |
|---|------------|------------|
| Net change in cash and cash equivalents   | 14,015     | 157,504    |
| Cash and cash equivalents at beginning of period  | 153,642    | 61         |
| Cash and cash equivalents at end of period  | \$ 167,657 | \$ 157,565 |
| <b>Supplemental disclosures of cash flow information</b>                                    |            |            |
| Net purchases of leasehold improvements, property and equipment accrued in accounts payable | \$ 1,977   | \$ 4,981   |

*See accompanying notes to consolidated financial statements.*



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**Chipotle Mexican Grill, Inc.**

**Notes to Consolidated Financial Statements**

**(unaudited)**

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

**1. Basis of Presentation and New Accounting Principles**

*Basis of Presentation*

Chipotle Mexican Grill, Inc. (the Company), a Delaware corporation, develops and operates fresh Mexican food restaurants with a focused menu of burritos, tacos, burrito bowls and salads in 30 states throughout the United States and in the District of Columbia. Through its vision of Food With Integrity, the Company is seeking better food not only from using fresh ingredients, but ingredients that are sustainably grown and naturally raised with respect for the animals, the land and the farmers who produce the food. As of September 30, 2007, the Company operated 668 restaurants. The Company manages its operations based on three regions and has aggregated its operations to one reportable segment.

The accompanying unaudited consolidated financial statements of the Company have been prepared in accordance with U.S. generally accepted accounting principles for interim financial statements and pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of management, the accompanying unaudited consolidated financial statements reflect all adjustments consisting of normal recurring adjustments necessary for a fair presentation of its financial position and results of operations. Interim results of operations are not necessarily indicative of the results that may be achieved for the full year. The financial statements and related notes do not include all information and footnotes required by U.S. generally accepted accounting principles for annual reports. This quarterly report should be read in conjunction with the consolidated financial statements included in the Company's annual report on Form 10-K for the year ended December 31, 2006.

*Adoption of New Accounting Principles*

Effective January 1, 2007, the Company adopted Emerging Issue Task Force (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 (SFAS) No. 43, *Accounting for Compensated Absences* (FAS 43) and therefore the benefit should be accrued if the remaining criteria of FAS 43 are met. The Company offers sabbatical leave to employees who have provided ten years of service. The actuarially determined accrued sabbatical balance as of December 31, 2006 was \$2,600, which the Company recognized as a cumulative-effect accounting adjustment to beginning retained earnings on January 1, 2007. During the three months and nine months ended September 30, 2007, the Company accrued sabbatical expense of \$152 and \$441, respectively.

Effective January 1, 2007, the Company 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 the Company's consolidated financial statements.

The Company's policy is to recognize interest to be paid on an underpayment of income taxes in interest expense and any related statutory penalties in provision for income taxes in the consolidated statement of income. The Company is open to federal and state tax audits until the applicable statute of limitations expire. Tax audits by their very nature are often complex and can require several years to complete. The Company is no longer subject to U.S. federal tax examinations by tax authorities for tax years before 2003. For the majority of states where the Company has a significant presence, it is no longer subject to tax examinations by tax authorities for tax years before 2002.

*Recent Accounting Pronouncements*

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, (SFAS 159). SFAS 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. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company does not expect the adoption of SFAS 159 to have a material impact on its consolidated financial statements.



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In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements*, ( SFAS 157 ). SFAS 157 defines fair value, establishes a framework for using fair value to measure assets and liabilities, and expands disclosure about fair value measurements. SFAS 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. The Company does not expect the adoption of SFAS 157 to have a material impact on its consolidated financial statements.

**2. Franchise Acquisitions**

On March 7, March 31, and April 30, 2007, the Company acquired two, two and four franchised restaurants, respectively. The results of operations have been included in the Company's financial results from the dates of acquisition. These acquisitions resulted from the franchisees obligation under their franchise agreement with McDonald's Corporation ( McDonald's ) to dispose of either their Chipotle franchise or their McDonald's franchise within 24 months after McDonald's ceased to own a majority of the outstanding common stock of the Company, which occurred on October 12, 2006. The acquisitions were accounted for using the purchase method as defined in SFAS No. 141, *Business Combinations*. Goodwill represents the excess of the purchase price over the fair value of the net tangible and intangible assets acquired. Goodwill will not be amortized, but instead will be tested for impairment at least annually. The aggregate purchase price of \$5,668 for the eight restaurants acquired has been allocated as follows:

|  |          |
|--|----------|
| Net current assets                             | \$ 51    |
| Leasehold improvements, property and equipment | 1,416    |
| Goodwill                                       | 4,201    |
| Total  | \$ 5,668 |

**3. Stock-based Compensation**

In February 2007, the Company issued 275 options to purchase shares of its class A common stock to eligible employees with a grant date fair value of \$24.80 per share and an exercise price of \$63.89 per share which vest on the third anniversary of the grant date. Compensation expense is generally recognized equally over the three year vesting period. Compensation expense related to employees eligible to retire and retain rights to the awards is recognized over six months which coincides with the notice period. The Company also granted to executive officers 120 shares of non-vested class A common stock with a grant date fair value of \$63.89 which vests in two equal installments on the second and third anniversary of the grant. Compensation expense is recognized on a straight-line basis for each separate vesting portion (graded vesting).

In August 2007, the Company granted 3 shares of non-vested class A common stock with a grant date fair value of \$99.19 which vests in two equal installments on the second and third anniversary of the grant. Compensation expense is recognized on a straight-line basis for each separate vesting portion.

Stock-based compensation, including options and non-vested stock, was \$2,169 and \$6,389 (\$1,321 and \$3,891 net of income tax) for the three months and nine months ended September 30, 2007 respectively, and was \$783 and \$3,811 (\$471 and \$2,294 net of income tax) for the three months and nine months ended September 30, 2006, respectively. For the three months and nine months ended September 30, 2007, \$84 and \$252 of stock-based compensation was recognized as capitalized development and is included in leasehold improvements, property and equipment in the consolidated balance sheet. During the nine months ended September 30, 2007, 135 options to purchase class A common stock were exercised, 2 shares of class A common stock were granted to non-employee board members, 31 options were forfeited and 52 shares of class B common stock vested.

**4. Earnings Per Share**

Basic earnings per share is calculated by dividing income available to common shareholders by the weighted-average number of shares of common stock outstanding during each period. Diluted earnings per share is calculated using income available to common shareholders divided by diluted weighted-average shares of common stock outstanding during each period. Potentially dilutive securities include potential common shares related to stock options and non-vested stock.



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

|  | Three months ended September 30, 2007 |           | Nine months ended September 30, 2006 |           |
|--|---------------------------------------|-----------|--------------------------------------|-----------|
|  | 2007                                  | 2006      | 2007                                 | 2006      |
| Net income   | \$ 20,604                             | \$ 11,802 | \$ 53,025                            | \$ 30,582 |
| Shares:  |                                       |           |                                      |           |
| Weighted average number of common shares outstanding         | 32,706                                | 32,499    | 32,622                               | 31,888    |
| Dilutive stock options                                       | 376                                   | 299       | 360                                  | 311       |
| Dilutive non-vested stock                                    | 89                                    | 87        | 67                                   | 96        |
| Diluted weighted average number of common shares outstanding | 33,171                                | 32,885    | 33,049                               | 32,295    |
| Basic earnings per share                                     | \$ 0.63                               | \$ 0.36   | \$ 1.63                              | \$ 0.96   |
| Diluted earnings per share                                   | \$ 0.62                               | \$ 0.36   | \$ 1.60                              | \$ 0.95   |

**5. Commitments and Contingencies**

In August 2004, the merchant bank that processes the Company's credit and debit card transactions informed the Company it may have been the victim of a possible theft of credit and debit card data. During 2004, the Company recorded a reserve for the potential exposure for losses and fines of \$4,000. Through June 30, 2007, the Company utilized \$2,789 of the reserve to cover fines and losses. In June 2007, the Company determined more than 90% of the possibly-affected cards had expired and the Company had incurred minimal losses from related claims in the last year. Accordingly, the Company concluded that any remaining exposure was remote and reversed the remaining reserve of \$1,211 (\$737 net of income tax and \$0.02 impact on basic and diluted earnings per share for the nine months ended September 30, 2007) in general and administrative expenses in the consolidated statement of income. To the extent the Company receives additional claims or incurs fines or legal or other expenses related to this matter, such amounts will be recognized as expense in the consolidated statement of income when incurred.

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

In the normal course of business, the Company is subject to other proceedings, lawsuits and claims. Such matters are subject to many uncertainties, and outcomes are not predictable with assurance. Consequently, the Company is unable to ascertain the ultimate aggregate amount of monetary liability or financial impact with respect to these matters as of September 30, 2007. These matters could affect the operating results of any one quarter when resolved in future periods. Management does not believe that any monetary liability or financial impact to the Company as a result of these proceedings or claims will be material to the Company's annual consolidated financial statements. However, a significant increase in the number of these claims, or one or more successful claims resulting in greater liabilities than the Company currently anticipates, could materially and adversely affect the Company's business, financial condition, results of operation or cash flows.

**Table of Contents****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS*****Cautionary Note Regarding Forward-Looking Statements***

*Certain statements in this report, including our estimates of the number of restaurants we intend to open and potential changes in comparable restaurant sales increases and average restaurant sales, as well as projections regarding food costs and labor expenses, are forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. We use words such as anticipate, believe, could, should, estimate, expect, intend, may, predict, project, target, and similar terms and phrases, including references to assumptions, to identify forward-looking statements. These forward-looking statements are based on information available to us as of the date any such statements are made, and we assume no obligation to update these forward-looking statements. These statements are subject to risks and uncertainties that could cause actual results to differ materially from those described in the statements. These risks and uncertainties include, but are not limited to, the risk factors described in our annual report on Form 10-K for the year ended December 31, 2006 as updated in subsequent quarterly reports on Form 10-Q, including Item 1A of Part II of this report.*

**Overview**

Chipotle develops and 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, we're working 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 vision called Food With Integrity. Our objective is to find the very best 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 September 30, 2007, we had 668 restaurants in 30 states throughout the United States and in the District of Columbia. New restaurants have contributed substantially to our restaurant sales growth. We opened 28 and 88 restaurants during the three months and nine months ended September 30, 2007. We expect to open between 110 and 120 total restaurants in 2007.

*Sales Growth.* In addition to growing our number of restaurants, we have experienced increases in our average restaurant sales from \$1.584 million as of September 30, 2006 to \$1.708 million as of September 30, 2007, driven primarily by strong comparable restaurant sales increases. Our comparable restaurant sales increases for the first nine months of 2007 were 10.9%. 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 calendar month of operation. Comparable restaurant sales increases were due mainly to an increase in the number of transactions processed at our registers, menu price increases and improved restaurant level controls. We expect our average restaurant sales to continue to increase for the remainder of 2007, driven by comparable restaurant sales increases in the low double digits for the full year.

*Food Costs.* As a result of freezes in California and Chile, and potentially as a result of recent wildfires in California, we expect price pressure on avocados for the remainder of 2007 and into 2008. We also expect an increase in cheese prices in 2008. Additionally, 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 raw ingredients including chicken, beef, tortillas and rice and we expect that pressure to continue for the remainder of 2007 and into 2008.

*Labor.* Labor costs as a percentage of revenue decreased in the first nine months of 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 experience 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 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 the remainder of 2007 and 2008.

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We continue to focus on ensuring our employee practices are as exceptional as our food. In order to achieve this, we initiated the Restaurateur program in early 2006. The Restaurateur program is designed to encourage the restaurant manager position as a career opportunity for our top performing managers. In addition to excelling in providing quality food and customer service, restaurant managers are expected to contribute substantially to the development of their crew. We also launched a new restaurant management structure in the second quarter of 2006 to facilitate the development of crew members into restaurant managers. Our primary goal with the new restaurant structure is to increase the number of restaurant managers hired from within our company and lower restaurant turnover. We continue to see positive results through increased internal promotions and decreased turnover.

*Food With Integrity.* In addition to continuing to serve naturally raised pork in all of our restaurants, during the first nine months of 2007, we made progress on delivering Food With Integrity by increasing the number of our restaurants serving naturally raised beef and chicken. We now serve naturally raised chicken in 79% of our restaurants and naturally raised beef in 46%. We define naturally raised as coming from animals that are fed a pure vegetarian diet, never given antibiotics or hormones, and raised in open pastures or deeply bedded pens. We have been working with suppliers to buy cheese made with milk that comes from cows that are not given rBGH, or recombinant bovine growth hormone, to stimulate milk production. We now serve this cheese in 90% of our restaurants. All of the sour cream we buy comes from cows that have not been treated with rBGH. We continue to investigate the use of more sustainably grown produce and performed a limited test of the use of locally grown green peppers and lettuce during the quarter.

*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. In addition by the first quarter of 2007, change machines had been installed in virtually all of our restaurants, and we continue to review other equipment and kitchen design modifications to improve the speed of service.

*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 5 to the Consolidated Financial Statements included in Part I, Item 1.

**Restaurant Activity**

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

|   | For the three months<br>ended<br>September 30 |            | For the nine months<br>ended September 30 |            |
|---|---|------------|---|------------|
|   | 2007  | 2006       | 2007                                      | 2006       |
| <b>Company-operated</b>                   |   |            |   |            |
| Beginning of period                       | 640   | 510        | 573                                       | 481        |
| Openings                                  | 28  | 30         | 88  | 59         |
| Closures                                  |   | (1)        | (1)                                       | (1)        |
| Franchise acquisitions                    |   |            | 8   |            |
| End of period                             | 668   | 539        | 668                                       | 539        |
| <b>Franchises</b>                         |   |            |   |            |
| Beginning of period                       |   | 8          | 8   | 8          |
| Franchise acquisitions                    |   |            | (8)                                       |            |
| End of period                             |   | 8          |   | 8          |
| <b>Total restaurants at end of period</b> | <b>668</b>                                    | <b>547</b> | <b>668</b>                                | <b>547</b> |

**Results of Operations**

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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.



**Table of Contents****Restaurant Sales**

|  | For the three months ended September 30 |            | %        | For the nine months ended September 30 |            | %        |
|--|---|------------|----------|--|------------|----------|
|  | 2007                                    | 2006       | increase | 2007                                   | 2006       | increase |
|  | (dollars in thousands)                  |            |          |  |            |          |
| Restaurant sales   | \$ 286,431                              | \$ 210,381 | 36.1%    | \$ 796,137                             | \$ 601,028 | 32.5%    |
| Average restaurant sales   | \$ 1,708                                | \$ 1,584   | 7.8%     | \$ 1,708                               | \$ 1,584   | 7.8%     |
| Comparable restaurant sales increases                              | 12.4%                                   | 11.6%      |          | 10.9%                                  | 15.0%      |          |
| Number of company-operated restaurants as of the end of the period | 668                                     | 539        | 23.9%    | 668                                    | 539        | 23.9%    |
| Number of company-operated restaurants opened in the period        | 28                                      | 30         |          | 88                                     | 59         |          |

The significant factors contributing to our increase in sales for the three and nine months ended September 30, 2007 were restaurant openings and strong comparable restaurant sales performance. Restaurant sales for the three and nine months ended September 30, 2007 for restaurants not in the comparable restaurant base contributed to \$46.3 million and \$123.7 million of the increase in sales, respectively, of which \$25.9 million and \$47.6 million was attributable to restaurants opened in 2007. Comparable restaurant sales increases contributed to \$29.8 million of the increase in restaurant sales for the third quarter of 2007, and \$71.4 million of the increase in restaurant sales for the first nine months of 2007. 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 number of transactions, and the remainder was driven primarily by menu price increases in selected markets in conjunction with the introduction of naturally raised beef or chicken, as well as improved restaurant-level controls.

**Food, Beverage and Packaging Costs**

|                              | For the three months ended September 30 |           | %        | For the nine months ended September 30 |            | %        |
|------------------------------|---|-----------|----------|--|------------|----------|
|                              | 2007                                    | 2006      | increase | 2007                                   | 2006       | increase |
|                              | (dollars in thousands)                  |           |          |  |            |          |
| Food, beverage and packaging | \$ 92,075                               | \$ 65,436 | 40.7%    | \$ 254,209                             | \$ 188,009 | 35.2%    |
| As a percentage of revenue   | 32.1%                                   | 31.0%     |          | 31.9%                                  | 31.2%      |          |

As a percentage of revenue, food, beverage and packaging costs increased due to increased product costs, 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.

**Labor Costs**

|                            | For the three months ended September 30 |           | %        | For the nine months ended September 30 |            | %        |
|----------------------------|---|-----------|----------|--|------------|----------|
|                            | 2007                                    | 2006      | increase | 2007                                   | 2006       | increase |
|                            | (dollars in thousands)                  |           |          |  |            |          |
| Labor costs                | \$ 75,395                               | \$ 59,629 | 26.4%    | \$ 211,965                             | \$ 169,507 | 25.0%    |
| As a percentage of revenue | 26.3%                                   | 28.2%     |          | 26.6%                                  | 28.1%      |          |

Labor costs as a percentage of revenue decreased 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 experience 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.

**Table of Contents****Occupancy Costs**

|                            | For the three months ended September 30 |           | %        | For the nine months ended September 30 |           | %        |
|----------------------------|---|-----------|----------|--|-----------|----------|
|                            | 2007                                    | 2006      | increase | 2007                                   | 2006      | increase |
| Occupancy costs            | \$ 19,745                               | \$ 15,040 | 31.3%    | \$ 55,355                              | \$ 43,250 | 28.0%    |
| As a percentage of revenue | 6.9%                                    | 7.1%      |          | 6.9%                                   | 7.2%      |          |

In 2007, 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.

**Other Operating Costs**

|                            | For the three months ended September 30 |           | %        | For the nine months ended September 30 |           | %        |
|----------------------------|---|-----------|----------|--|-----------|----------|
|                            | 2007                                    | 2006      | increase | 2007                                   | 2006      | increase |
| Other operating costs      | \$ 33,240                               | \$ 25,744 | 29.1%    | \$ 96,663                              | \$ 74,855 | 29.1%    |
| As a percentage of revenue | 11.6%                                   | 12.2%     |          | 12.1%                                  | 12.4%     |          |

Other operating costs as a percentage of revenue decreased in the third quarter of 2007 primarily due to higher average restaurant sales on a partially fixed cost base and decreased marketing and promotion spend. We expect the marketing spend as a percentage of revenue for the full year 2007 will remain consistent with 2006.

For the nine months ended September 30, 2007 the decrease as a percentage of revenue was primarily due to the effect of higher average restaurant sales on a partially fixed cost base.

**General and Administrative Expenses**

|                                    | For the three months ended September 30 |           | %        | For the nine months ended September 30 |           | %        |
|------------------------------------|---|-----------|----------|--|-----------|----------|
|                                    | 2007                                    | 2006      | increase | 2007                                   | 2006      | increase |
| General and administrative expense | \$ 19,279                               | \$ 15,723 | 22.6%    | \$ 54,397                              | \$ 48,633 | 11.9%    |
| As a percentage of revenue         | 6.7%                                    | 7.4%      |          | 6.8%                                   | 8.1%      |          |

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. The 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.

As a percentage of revenue, general and administrative expenses decreased due 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 offerings and severance negatively impacting 2006.

**Table of Contents****Depreciation and Amortization**

|                               | For the three months<br>ended September 30 |          | %        | For the nine months<br>ended September 30 |           | %        |
|-------------------------------|--|----------|----------|---|-----------|----------|
|                               | 2007                                       | 2006     | increase | 2007                                      | 2006      | increase |
|                               | (dollars in thousands)                     |          |          |   |           |          |
| Depreciation and amortization | \$ 11,167                                  | \$ 8,676 | 28.7%    | \$ 31,907                                 | \$ 24,988 | 27.7%    |
| As a percentage of revenue    | 3.9%                                       | 4.1%     |          | 4.0%                                      | 4.1%      |          |

Depreciation and amortization increased in 2007 primarily due to restaurants opened in 2006 and 2007. As a percentage of revenue, depreciation and amortization decreased as a result of higher average restaurant sales on a partially fixed-cost base, offset by accelerated depreciation on our corporate office and certain restaurants.

**Pre-opening Costs**

|                            | For the three months<br>ended<br>September 30 |          | %        | For the nine<br>months ended<br>September 30 |          | %        |
|----------------------------|---|----------|----------|--|----------|----------|
|                            | 2007  | 2006     | increase | 2007   | 2006     | increase |
|                            | (dollars in thousands)                        |          |          |  |          |          |
| Pre-opening costs          | \$ 2,350                                      | \$ 2,053 | 14.5%    | \$ 6,730                                     | \$ 4,668 | 44.2%    |
| As a percentage of revenue | 0.8%  | 1.0%     |          | 0.8%   | 0.8%     |          |
| Restaurant openings        | 28  | 30       |          | 88   | 59       |          |

For the third quarter of 2007, the increase in pre-opening costs compared to the third quarter of 2006 is due to an increase in the number of restaurants under construction as these restaurants incur pre-opening rent.

For the nine months ended September 30, 2007, the increase in pre-opening costs is a result of an increase in the number of restaurant openings in 2007.

**Loss on Disposal of Assets**

|                            | For the three months<br>ended<br>September 30 |          | %        | For the nine<br>months ended<br>September 30 |          | %        |
|----------------------------|---|----------|----------|--|----------|----------|
|                            | 2007  | 2006     | increase | 2007   | 2006     | increase |
|                            | (dollars in thousands)                        |          |          |  |          |          |
| Loss on disposal of assets | \$ 1,784                                      | \$ 1,106 | 61.3%    | \$ 4,919                                     | \$ 2,845 | 72.9%    |
| As a percentage of revenue | 0.6%  | 0.5%     |          | 0.6%   | 0.5%     |          |

The increase 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.

**Interest Income**

|                            | For the three months<br>ended<br>September 30 |          | %        | For the nine<br>months ended<br>September 30 |          | %        |
|----------------------------|---|----------|----------|--|----------|----------|
|                            | 2007  | 2006     | decrease | 2007   | 2006     | increase |
|                            | (dollars in thousands)                        |          |          |  |          |          |
| Interest income            | \$ 1,597                                      | \$ 2,015 | (20.7)%  | \$ 4,617                                     | \$ 4,607 | 0.2%     |
| As a percentage of revenue | 0.6%  | 1.0%     |          | 0.6%   | 0.8%     |          |

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Interest income resulted from investing our incremental cash and cash equivalents in short-term investments with maturities of three months or less. For the three months ended September 30, 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.

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For the nine months ended September 30, 2007 interest income increased due to a higher daily average cash equivalent balance in the first nine months of 2007 compared to the same period in 2006 partially offset by an increase in investments in tax-exempt securities.

**Provision for Income Taxes**

|                            | For the three months<br>ended September 30 |          | %        | For the nine months<br>ended September 30 |           | %        |
|----------------------------|--|----------|----------|---|-----------|----------|
|                            | 2007                                       | 2006     | increase | 2007                                      | 2006      | increase |
|                            | (dollars in thousands)                     |          |          |   |           |          |
| Provision for income taxes | \$ 12,315                                  | \$ 7,998 | 54.0%    | \$ 32,096                                 | \$ 20,284 | 58.2%    |
| As a percentage of revenue | 4.3%                                       | 3.8%     |          | 4.0%                                      | 3.4%      |          |
| Effective tax rate         | 37.4%                                      | 40.4%    |          | 37.7%                                     | 39.9%     |          |

The decrease in the effective tax rate from 2006 to 2007 was primarily due to increased investments in tax-exempt securities and a decrease in the estimated statutory state tax rate. The changes in state tax laws enacted in 2007 had no measurable impact on the effective tax rate.

**Seasonality**

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

Our quarterly results are also affected by other factors such as the number and timing of new restaurants opened in a quarter and unanticipated events. New restaurants 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. Our fourth quarter net income has historically been lower than other quarters, in part, as we have opened more new restaurants later in the fiscal year. In addition, unanticipated events also impact our results. For example, in the second quarter of 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. 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 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 growth.

*Operating Activities.* Net cash provided by operating activities was \$105.6 million for the nine months ended September 30, 2007 compared to \$73.5 million for the same period in 2006. The \$32.1 million increase was primarily attributable to a \$22.4 million improvement in net income and a change in operating assets and liabilities.

*Investing Activities.* Net cash used in investing activities was \$103.9 million for the nine months ended September 30, 2007 compared to \$62.5 million for the same period in 2006. The \$41.4 million increase over the comparable nine month period was primarily attributable to higher capital expenditures in 2007 as we opened 88 restaurants, compared with 59 restaurants in 2006, and to increased reinvestment costs as the number of our restaurants and the average restaurant age increases.

*Financing Activities.* Net cash provided by financing activities was \$12.3 million for the nine months ended September 30, 2007 compared to \$146.5 million for the same period in 2006. The \$134.2 million decrease was primarily attributable to the net proceeds received from our initial public offering in 2006.



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*Liquidity and Capital Expenditures.* We will continue to use our available cash balances to provide additional long-term 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 the cash and cash equivalents on hand will be enough to meet ongoing capital expenditures, working capital requirements and other cash needs over at least the next 24 months.

### **Off-Balance Sheet Arrangements**

As of September 30, 2007 and December 31, 2006, we had no off-balance sheet arrangements or obligations.

### **Recent Accounting Pronouncements**

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, ( SFAS 159 ). SFAS 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. SFAS 159 is effective for fiscal years beginning after November 15, 2007. We do not expect the adoption of SFAS 159 to have a material impact on our consolidated financial statements.

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements*, ( SFAS 157 ). SFAS 157 defines fair value, establishes a framework for using fair value to measure assets and liabilities, and expands disclosure about fair value measurements. SFAS 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 SFAS 157 to have a material impact on our consolidated financial statements.

### **Critical Accounting Estimates**

Critical accounting estimates are those that we believe are both significant and that require us to make difficult, subjective or complex judgments, often because we need to estimate the effect of inherently uncertain matters. We base our estimates and judgments on historical experiences and various other factors that we believe to be appropriate under the circumstances. Actual results may differ from these estimates, and we might obtain different estimates if we used different assumptions or conditions. We had no significant changes in our critical accounting estimates since our last annual report, except for the release of the remaining \$1.2 million reserve we had established relating to the possible theft of customers' credit and debt card data. Our critical accounting estimates are contained in our annual report on Form 10-K for the year ended December 31, 2006.

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

### **Changing Interest Rates**

We are exposed to interest rate risk through the investment of our cash and cash equivalents. Since the completion of our initial public offering we have invested our cash in short-term investments with maturities of three months or less. Changes in interest rates affect the interest income we earn, and therefore impact our cash flows and results of operations. As of September 30, 2007, we had \$157.0 million deposited in short-term investments bearing a weighted-average interest rate of 3.7% (approximately 5.6% tax equivalent).

### **Commodity Price Risks**

We are 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 demand, weather, seasonality, production, availability and other factors outside our control. We work closely with our suppliers and use a mix of forward pricing protocols under which we agree with our supplier on fixed prices for deliveries at 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 pricing protocols under which the prices we pay are based on a specified formula related to the prices of the goods, such as spot prices. Though we generally do not have written 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





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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.

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

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

As of September 30, 2007, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer, President and Chief Operating Officer and Chief Finance and Development Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on the foregoing, our Chief Executive Officer, President and Chief Operating Officer and Chief Finance and Development Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this quarterly report.

There were no changes during the three months ended September 30, 2007 in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

## **PART II**

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

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 5 to the Consolidated Financial Statements included in Part I, Item 1.

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 believe 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 1A. RISK FACTORS**

The following discusses significant changes in our risk factors since our last annual report. You should read this in conjunction with our risk factors in Item 1A in our annual report on Form 10-K for the year ended December 31, 2006

#### ***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. As a result of recent freezes in California and Chile, and potentially as a result of recent wildfires in California, we expect price increases on avocados for the

remainder of 2007 and into 2008.

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Additionally, 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 for the remainder of 2007 and into 2008 as well. Furthermore, our recent pricing protocols for cheese are set to expire at the end of 2007, which we expect will result in pricing increases on cheese during 2008. 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.

***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 October 26, 2007, our class A common stock closed at \$133.95 per share and our class B common stock closed at \$117.57 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. 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 a transaction.

***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, King County, Washington has 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.

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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.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

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

None.

**ITEM 5. OTHER INFORMATION**

None.

**ITEM 6. EXHIBITS**

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

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CHIPOTLE MEXICAN GRILL, INC.

By: /s/ JOHN R. HARTUNG

Name: John R. Hartung

Title: Chief Finance and Development Officer

Date: October 31, 2007

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**Exhibit Index**

| <b>Exhibit Number</b> | <b>Description of Exhibit</b>  |
|-----------------------|--|
| 3.1                   | Restated Certificate of Incorporation of Chipotle Mexican Grill, Inc.*   |
| 3.2                   | Restated Bylaws of Chipotle Mexican Grill, Inc.*   |
| 4.1                   | Form of Stock Certificate for Class A Common Stock.*   |
| 4.2                   | Form of Stock Certificate for Class B Common Stock.**  |
| 10.1                  | Amendment No. 2 to Chipotle Mexican Grill, Inc. Supplemental Deferred Investment Plan.   |
| 31.1                  | Certification of Chief Executive Officer of Chipotle Mexican Grill, Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 31.2                  | Certification of President and Chief Operating Officer of Chipotle Mexican Grill, Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 31.3                  | Certification of Chief Finance and Development Officer of Chipotle Mexican Grill, Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 32.1                  | Certification of Chief Executive Officer, Chief Finance and Development Officer and President and Chief Operating Officer of Chipotle Mexican Grill, Inc. pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

\* Incorporated by reference to Chipotle Mexican Grill, Inc.'s annual report on Form 10-K for the year ended December 31, 2005 (File No. 001-32731).

\*\* Incorporated by reference to Chipotle Mexican Grill, Inc.'s quarterly report on Form 10-Q for the three months ended September 30, 2006 (File No. 001-32731).