News Article

Chipotle Mexican Grill Earnings Q4 2014 Earnings Call

February 03, 2015 05:48PM ET

Event Date: 02/03/2015

Company Name: Chipotle Mexican Grill

Event Description:Q4 2014 Earnings Call

Source: Chipotle Mexican Grill

MANAGEMENT DISCUSSION SECTION

Operator: Good day everyone and welcome to the Chipotle Mexican Grill's fourth quarter 2014 earnings conference call. All participants are now in a listen-only mode. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] As a reminder, this conference is being recorded. Thank you. I would now like to introduce Chipotle's Director of Investor Relations, Mark Alexee. You may begin your conference.

Mark Alexee: Good afternoon, everyone, and welcome to our call today. By now you should have access to our earnings announcement released this afternoon for the fourth quarter and year end 2014. It may also be found on our website at chipotle.com in the Investor Relations section. Before we begin our presentation, I will remind everyone that parts of our discussion today will include forward-looking statements as defined in the securities laws. These forward-looking statements will include projections of number of restaurants we intend to open, the new restaurant development cost, and new restaurant volume. Statements about potential shareholder returns, projections of comparable restaurant sales increases or comps, trends in food, labor and G&A costs, our expected effective tax rate, statements about stock repurchases, as well as other statements of our expectations and plans. These statements are based on information available to us today and we are not assuming any obligation to update them. Forward-looking statements are subject to risks and uncertainties that could cause our actual results to differ materially from the forward-looking statements. We refer you to the risk factors in our Annual Report on Form 10-K as updated on our subsequent Form 10-Q for a discussion of these risks. Our discussion today will also include non-GAAP financial measures, a reconciliation of which will be found on the presentation page of the Investor Relations section of our website. I'd like to remind everyone that we've adopted a self-imposed quiet period, restricting communications with investors during that period. The quiet period begins on the first day of the last month of each fiscal quarter and continues until the next earnings conference call. For the first quarter, it will begin March 1 and will continue through our Q1 earnings release on April 21, 2015. On the call with us today are

Steve Ells, our Chairman and Co-Chief Executive Officer; Monty Moran, Co-Chief Executive Officer; Jack Hartung, Chief Financial Officer; and Mark Crumpacker, Chief Marketing and Development Officer. With that, I will now turn the call over to Steve.

Steve Ells: Thanks, Mark. I'm extremely pleased with our performance during the fourth quarter and throughout 2014. During the quarter, we generated revenue of $1.1 billion, an increase of 26.7% on comparable restaurant sales growth of 16.1%, and the opening of 60 new restaurants. This produced diluted earnings per share of $3.84, an increase of 51.8%. For the full year, we generated revenue of $4.1 billion on comparable restaurant sales growth of 16.8%, and the opening of 192 new restaurants. While those results would be strong for a company of any size, I think they are particularly impressive considering how we now have nearly 1,800 restaurants averaging nearly $2.5 million each. Quite simply, I do not think that we would be able to deliver these results without such compelling and relevant vision. We have made it our mission to change the way people think about any fast food, and we have created an extraordinary food and people culture. And a very strong unit economic model that is allowing us to do that. Recently we've seen strong evidence that our commitment to sourcing sustainably raised ingredients is resonating with many consumers. In January, we decided to suspend one of our pork suppliers after a routine audit revealed that they were not following all of our animal welfare protocols. Choosing to suspend the supplier meant that we would not be able to supply carnitas to about one-third of our restaurants. While we could have chosen to replace this supply with pork from conventionally raised pigs, we decided not to because most conventionally raised pigs are subjected to conditions that we find unacceptable. Conventionally raised pigs are typically raised indoors with no outdoor or access to bedding and are typically given antibiotics non-therapeutically to stimulate growth and to prevent illness from spreading due to harsh crowded living conditions. These conventional practices are unacceptable to us and we refuse to serve pork from animals raised in that manner. Since we made this decision, the majority of sentiment from our customers has been very supportive in email and web comments, along with social media posts, customers are applauding our commitment to our vision. Thanking us for standing on principle, commending us for taking action against the inhumane treatment of animals and congratulating us for standing by our business values. We certainly appreciate what we are hearing from our customers and are grateful for their continued loyalty. We're also pleased to see this response as it shows that our vision and our commitment to sourcing responsibly raised ingredients, including respecting animal welfare are resonating with people in a very real and powerful way. People care about where their food comes from and how it is raised. And we are proud of the tremendous progress we have made over the years. Last year, we served more than 165 million pounds of responsibly raised meat, more than a 20% increase from 2013. All of our responsibly raised meats come from animals that are raised in more humane ways and without the use of antibiotics or added hormones. Meat from animals raised to these higher welfare of standards still accounts for a small percentage of the total meat production in this country, yet we continue to find ways to increase our supply year-after-year. Because meat raised in this way is such a small portion of the overall supply system, we will be disruptions from time-to-time. But these disruptions just reinforce the strength and strengthen our commitment to continue to look for ways to increase the supply that is available to us, whether from existing suppliers who can grow with us exploring additional cuts to add to our supply while enhancing the quality and flavor or finding new suppliers that meet our high standards. Our commitment to sourcing food that is raised responsibly is not limited to pork, chicken and beef. During the year we continued our use of no-till and organically grown beans, and we eclipsed our 2014 goal of serving 20 million pounds of locally grown produce. In a food system that is so heavily dominated by relatively few large producers, it's extraordinary progress and our teams have encountered and overcome numerous hurdles to reach each of these milestones. I'm certain that we will continue to face challenges in this area, but our commitment rate remains as strong as ever and we will find ways to keep making progress, simply because we believe that serving food from these great ingredients is the right thing to do. While the customer response to how we handle our pork situation is encouraging, it's not the only sign that more and more people are becoming more curious and more discerning about where their food comes from. For example, our vision is really resonating with teens, millennials, and Generation X. According to industry research, Chipotle is one of the most popular restaurant chains among teens and has been growing in popularity among this demographic. This report from 2014 ranks Chipotle as the third most popular brand among teens, up from number eight in 2013. Gen X consumers were 33% more likely than average to choose Chipotle. With millennials, Chipotle was even more popular, with customers in this group 75% more likely than average to choose Chipotle over other restaurants. We believe that our popularity among these younger consumers is tied to our vision and the growing interest in issues related to food and how it is raised. Our own research shows that these issues are clearly becoming more relevant and important when customers choose where they will dine. Based on our ongoing tracking research, 87% of fast casual diners say they prefer to eat foods that are grown locally, up from 70% in 2011. Eighty-six percent believe ingredients raised or grown in a more responsible way taste better. That's up from 76% in 2011. Seventy-three percent feel it's important to buy organic for certain food items, up from 61% in 2011. And 69% try to eat meat that has been raised responsibly, and that's up 53% in 2011. From the very first Chipotle restaurant nearly 22 years ago, we have chartered our own path for how a restaurant company should be run in every single way. We have shown that you can own and operate all of your restaurants rather than franchise and still grow at a rapid rate; that you can spend more on ingredients, not less, still serve high-quality food at reasonable prices, and have industry-leading margins and returns; that you can build teams of top performers, empower them to deliver high standards, while still maintaining an efficient labor model; and that you can remain focused on doing just a few things extremely well rather than trying to be all things to all people or engaging in the kind of marketing gimmicks that have become the hallmarks of traditional fast food and still continue to attract new customers and profitably grow the business over the long term. We believe this is the new fast food model. But this model is not limited to just burritos and tacos. And as you know, we are in the early stages of developing two new concepts, ShopHouse Southeast Asian Kitchen and Pizzeria Locale, that embrace the principles that have made Chipotle successful over the years. We believe offering these cuisines following the Chipotle model is a great way to offer variety to our customers, elevating the dining experience for pizza and Asian cuisine, just as we have done with Chipotle. And we believe this is a much better way to create additional compelling shareholder value as compared to the traditional restaurant model of flooding the menu with so many items that it's impossible to serve anything that is extraordinary. During the quarter, we opened the newest ShopHouse in Washington DC's Union Station, the ninth ShopHouse so far. And in January, we finalized a deal to open the first Pizzeria Locale outside of Denver, this one in Kansas City's Waldo neighborhood. While we are pursuing additional sites for each of these concepts, I will remind you that most of our growth for the foreseeable future will continue to be driven by opening Chipotle restaurants in the United States. Chipotle has created the new fast food model, and it's the underlying principles of that model that continue to drive our financial success. Increasingly, our vision of changing the way people think about and eat fast food is resonating with consumers, many of whom want a better, more responsible alternative to traditional fast food. I'll now turn the call over to Monty.

Montgomery F. Moran: Thanks, Steve. Our ongoing ability to deliver impressive financial results arises from a special culture that we have built at Chipotle that has led to the development of strong leaders. These leaders are able to attract very talented people to our company and to develop those people to be at their best. Because of this, we are able to do things most of our competitors can't do. For instance, other restaurants rely heavily on automated systems to reduce the amount of training and skill that is necessary to do their work in an effort to simplify training and make operations foolproof. On the other hand, at Chipotle we hire energetic and ambitious people who have a desire to learn classic cooking skills, how to be a successful leader, and the business acumen necessary to run a highly successful business. But we ask even more of our people. We ask them to elevate the people around them, and we judge all of our leaders based on how positively they do that. By rewarding this behavior, we elevate the dining experience our customers enjoy each time they visit, which leads to excellent operations. One of the rewards of this kind of enlightened leadership is the rapid promotion of our talented leaders into positions within the restaurant where they can have a greater effect on more of our crew people. Over 90% of our general managers come from crew positions. So people are really starting to understand the kind of opportunity that awaits them at Chipotle. The extraordinary culture that we have created with the Restaurateur program as the cornerstone is one of the areas where we are unique within the restaurant industry. And it's one of the key drivers of our business, and this culture is growing stronger. We have made important investments over the past year or so to further strengthen this culture and our ability to develop restaurateurs at a faster rate and across more restaurants. First, we have reduced the field leadership ratios from a high of around 15 restaurants per field leader just a few years ago to about eight restaurants per field leader today. Secondly, we created the Restaurateur diagnostic and plan tool, which helps our field leaders properly diagnose inadequacies and weaknesses in the culture of each restaurant they supervise. Also, this tool generates a clear and actionable plan, which helps the GM address the underlying causes that are preventing that restaurant team from becoming a restaurateur. The combination of these two investments is just now beginning to pay off. While we promoted a similar number of restaurateurs during the past two years, we are currently approaching the largest backlog of GMs ready to be interviewed to become a restaurateur that we've ever had at one time. This gives me great confidence that 2015 will be a breakout year for us in terms of restaurateur development, which means that even more of our restaurants will be better than they are today, with better throughput, better food, and a better overall customer experience. I'm confident about this because our restaurateurs show us time and time again that the special cultures they create lead to better restaurants in every way. Better field leadership ratios alone might not accelerate restaurateur development. But with the development and plan tool in place and better ratios that allow our field leaders to dive deep into and better understand each restaurant's culture, we feel that we're in a position to accelerate the proliferation of this powerful culture quickly into more restaurants. So I'm excited to see the dividends from this combined investment pay off this year and in the coming years. One of the benefits of having great teams and great cultures is the ability to deliver superior throughput. When done well, throughput isn't simply about moving people through the restaurant as quickly as possible. Instead, it's about outstanding customer service with clear authentic communication with customers as they efficiently move down our serving line. During the quarter, we continued to make progress in terms of throughput, on top of the outstanding throughput we drove in the fourth quarter of 2013. We increased our average peak lunch hour transactions by three, and had an average of five more transactions during the peak dinner hour. We attribute this to our continued emphasis on the four pillars and the effectiveness of our auditing of and reporting to our field teams who get frequent feedback on how well they're executing these four pillars. Since beginning the four pillars reporting effort, we've seen significant improvement and we recently expanded our reporting to include peak dinner hours in addition to peak lunch hours. With this expanded reporting we continue to get better at executing the four pillars of both lunch and dinner, which we expect will pay off as we head into our busiest season in just a few months. Finally, I would like to provide an update on development. During the quarter we opened 60 new restaurants, bringing our total to 192 restaurants opened during the year, coming in at the higher end of our guided range of 180 restaurants to 195 restaurants. Nearly 80% of these new restaurants opened in proven or established markets, while the remainder opened in developing or new markets. This mix allowed us to expand our footprint in markets where we have strong presence and strong teams while also introducing our unique dining experience to customers in new markets, For 2015, we expect to open 190 to 205 new restaurants, with a similar distribution between proven, established, developing, and new markets, and a small number of growth seed restaurants as well. Overall, we're seeing more competition for sites given the relative health of the economy, but Chipotle remains a very desirable tenant and so we continue to have success in obtaining great real estate locations. In 2014, our total average development cost, including international, ShopHouse and Pizzeria Locale locations was about $849,000, net of landlord reimbursements. The increase in our development costs this year was driven by opening more freestanding restaurants along with higher cost locations in the Northeast, an improving commercial real estate and construction market has also contributed to an increase in development costs. In 2015, we expect our average restaurant development cost to decrease based on opening more traditional end-cap and in-line restaurants, which are generally easier to build and cost less than the freestanding restaurants. I'm more confident now that we have the right pieces in place, a strong food culture, a strong and empowering people culture and an industry leading unit economic model to continue on our path to change the way people think about and eat fast-food. I know that our success in doing that will allow us to generate outstanding returns for our shareholders. I will now turn the call over to Jack.

John R. Hartung: Thanks, Monty. We're extremely proud of the results we achieved during the fourth quarter and for the entire year of 2014, as our empowered restaurant teams continued to delight our customers with great service, while preparing and serving a delicious meal made from responsibly raised ingredients to each and every customer. In the fourth quarter, we compared against 2013's highest quarterly comp at 9.3%, and we're delighted to be able to serve many more customers and deliver a fourth quarter comp of 16.1% on top of that 9.3% comp in 2013. This 16.1% comp helped drive our total quarterly revenue to $1.1 billion, an increase of 26.7%. And our full-year revenue totaled $4.1 billion, an increase of 27.8% on a full-year comp of 16.8%. These increased sales are driven primarily by increased customer visits along with an average check increase of 8.3%. The increase in average check was primarily driven by the menu price increase we took mid-year of 6.3%, and to a lesser extent by continued growth in catering and in group size. We're maintaining our full year 2015 same-store sales guidance in the low-to-mid single-digit range. While we're bullish about the strong sales trends and a growing consumer awareness and appreciation for our sustainably raised ingredients, in 2015 we will compare against the toughest comps we've ever had as a public company. We expect our comps will be the highest in the first quarter and then become more difficult as we begin to lap the menu price increase starting in the second quarter and then begin to flatten out as we compare it to the 19.8% comp in Q3 and the 16.1% in the fourth quarter. As a result of this strong comp, our average sales volume for restaurants that have been opened for at least 12 months is now $2.472 million, the highest we've ever achieved. This average volume along with our industry-leading restaurant level margins help us deliver among the highest restaurant level returns in the industry and nearly double the very attractive returns we earned when we first became a public company. Our new restaurants also continue to perform exceptionally well opening above our communicative sales range of $1.7 million to $1.8 million. And in fact, we now expect our new restaurants to open in the range of $1.8 million to $1.9 million and grow from this initial opening level. We opened 60 new restaurants in the quarter bringing our year-to-date openings to 192, which is at the high end of our guidance range for 2014 and we ended the year with 1,783 restaurants, including 17 Chipotle restaurants outside the U.S., nine ShopHouses and two Pizzeria Locales. As Monty mentioned earlier, we plan to open between 190 new restaurants to 205 new restaurants in 2015, which we expect will be reasonably level loaded throughout the year. Diluted earnings per share for the quarter was $3.84, an increase of 51.8%. Restaurant level margins increased in the quarter by a 100 basis points to 26.6%. Margins were impacted by strong transaction trends and the menu price increase from the middle of last year. Diluted EPS was $14.13 for the full year 2014, an increase of 35% over 2013. EPS growth outpaced our sales growth as the higher comps including the menu price increase allowed us to leverage labor and occupancy lines at the restaurant level. Margins for the year increased 60 basis points to 27.2% in 2014. The full year margin impact included underlying food inflation of about 7.5%, and because we increased prices around midyear, our effective price increase for the full year was only about 3.8%, which did not fully cover all of this food inflation. Food costs were 35% in the quarter, up a 110 basis points from 2013, and sequentially higher by 70 basis points from the third quarter, while avocado cost declined in the quarter as we shifted away from buying California avocados, that benefit was more than offset by higher beef and dairy costs during the quarter. Beef prices are expected to remain elevated throughout the year and into 2016 due to continued supply constraints, and avocado prices are expected to be slightly higher in 2015 as increased demand is projected to exceed the higher yields we expect from California and Mexico during the year. We expect dairy prices to come down during Q1 from record highs for cheese and sour cream from late 2014, and remain at normalized level throughout the remainder of 2015. We also expect about a $2 million charge in the first quarter on our food line related to the suspension of one of our pork suppliers. As Steve mentioned, the decision to stop serving this pork was driven by our commitment to the principles underlying Food with Integrity including animal welfare protocols, and the response from our loyal customers has been very supportive. So, all things considered, we expect our food cost in 2015 to remain at about the 35% level we saw in the fourth quarter as the continued pressure in the prices of beef and avocadoes will be roughly offset by lower prices for dairy with full year food cost to remain in that 35% range. We don't have any plans for an across the board menu price increase in 2015, since we just increased prices and because we're currently earning at or near record margins and returns. In addition, it's important to us that remain - we remain accessible or affordable to our customers as this is the core to our ability to change the way people think about any fast food. But had we known earlier last year that beef prices would continue to rise, we may have increased the prices for our steak and barbacoa more than we did. We did increase the price of these two items much higher than any other entre in an effort to charge the fair going price for our steak and barbacoa. And we expected to see some tradeoff from steak and barbacoa as a result of the higher relative price, though we saw virtually no trade down. The continued rise in beef prices has resulted in the upcharge for these entres not covering the higher ingredient cost, so we're open to considering a targeted price increase later in 2015 on our steak and perhaps barbacoa to help cover the rising cost of beef. Because steak and barbacoa account for less than one-third of the entres we sell, we expect any increase we might consider to have a relatively modest impact on our overall results. But our Food with Integrity mission depends on our ability to charge a fair price for the ingredients we serve and we're not quite doing that with our beef right now. So while we're open to the possibility, we've not made a decision to raise beef prices at this time and we'll keep you updated if and when we decide to do so. Labor costs were 22% of sales - 22.2% of sales in the quarter, a decrease of 80 basis points from 2013, and for the full year labor costs were down a 100 basis points from 2013. These decreases were mainly due to leverage from the higher full year comp including the menu price increase, partially offset by increased wage inflation and higher manager and crew staffing. But Chipotle has always offered a simple streamlined health insurance option to all of our hourly employees. On January 1, 2015, we began to offer medical coverage that qualifies under the Affordable Care Act to full-time hourly employees; that is, those employees working 30 or more hours per week and with at least 12 months of service. Over 10,000 hourly employees were eligible for this plan based on service length and actual hours worked, and more than 1,000 employees have enrolled so far. The enrollment number is likely to increase going forward as additional employees will qualify each month as they hit the full time status and as they hit their one year anniversary. And based on the over 1,000 enrolled so far, our estimate of expected and the estimate of expected additional enrollees going forward, we expect the additional cost of this health insurance in 2015 to be in the $4 million to $8 million range, and all of that will hit our labor line. Other operating costs were 10.5% for the quarter, which is down 80 basis points from 2013 due to leverage from the higher comp in the quarter and slightly lower marketing costs. For the full year, other operating costs were 10.6% or down 20 basis point from 2013. Marketing was 1% of sales for the quarter compared to 1.2% in the fourth quarter of 2013. Our marketing expenses dropped sequentially by 30 basis points, as our Skillfully Made advertising campaign ended for most markets in October. For the full year, marketing was 1.4% of sales in 2014, in line with 2013, and we expect it to increase slightly to around 1.5% to 1.6% in 2015. G&A was 5.7% in the quarter or 90 basis points lower than 2013, due primarily to the timing of the accrual for our annual bonus program and the increased acceleration of stock compensation expense entered the first three quarters of the year as another one of our officers achieved retiree status. For the full year, G&A was 6.7% or 40 basis points higher than 2013, primarily driven by higher non-cash, non-economic stock comp and from our biennial All Manager Conference held in September, where nearly 3,000 Chipotle employees and suppliers were in attendance. The non-cash, non-economic stock comp expense was $15 million in the quarter and $98 million for the full year, which is about $33 million higher than in 2013 due to options granted in 2014 being issued at a much higher share price and as a result of more of the senior amendment team qualifying for retirement, which accelerates the non-cash charges. These items accounted for about 50 basis points of increase in G&A. So without these items, underlying G&A would have been lower for the full year 2014. In 2015, we will hold our biennial field leadership conference in the third quarter and we expect that will cost around $2 million. The Compensation Committee of our Board is actively evaluating our executive comp for 2015 and so until that - till that is finalized and approved, we're unable to project and communicate the stock comp expense expected for 2015. Our Comp Committee expects to finalize the plan in the next week or so, and we'll communicate the impact when we're able to. Our 2014 effective tax rate was 37.6% and this was lower than the rate projected at Q3 because of an adjustment in our state tax rate due to a change in estimate of usable employer credits and the renewal of the work opportunity and R&D credits in the fourth quarter. Unfortunately, the renewal was only approved for 2014, so without the state tax adjustment and without the work opportunity and R&D credits we expect our 2015 tax rate to return to about 39%. If these federal credits are renewed the effective tax rate would benefit by about 40 basis points in 2015. During the quarter we purchased about $25 million worth of our stock, or over 37,500 shares, at an average share price of $650. For the year we purchased about $88 million worth of stock and over 153,000 shares at an average share price of $572. At the end of 2014, we still had about $102 million remaining on our previously announced share buyback program. And we are announcing today that our board is authorizing an additional share repurchase program of another $100 million. Overall, since 2008 we've invested more than $700 million to purchase more than 4.2 million shares at an average price of $166 per share. Capital expenditures net of landlord reimbursements totaled about $240 million in 2014, primarily related to new restaurants along with continued reinvestment in existing restaurants and other company initiatives, including a significant upgrade of our restaurant network infrastructure. For 2015 we anticipate CapEx will be around $220 million, the majority of which relates to new restaurant construction. In 2014 we increased our total cash and investments by $362 million to $1.250 billion, even after funding the opening of 192 restaurants and repurchasing $88 million of stock through our share buyback agreements, and we still have no debt on our balance sheet. We continue to believe that investing in our high- returning new restaurants remains the best use of our cash. And we're confident that the growth options we're developing today, including ShopHouse, Chipotle in international markets, and Pizzeria Locale will provide value-enhancing growth opportunities in the future. And in the meantime, we'll continue to invest in our high returning domestic restaurants and we'll opportunistically repurchase our stock to enhance shareholder value. Thanks for your time today. And at this time, we'd be happy to answer any questions you may have. Operator, please open the lines.

Q&A

Operator: Thank you very much. [Operator Instructions] We'll take our first question from John Glass from Morgan Stanley.

<Q - John Glass>: Thanks. First, Jack, could you just clarify your comments around food cost, particularly that you're not going to take pricing, but you might take some pricing and that pricing is I guess targeted? When would you make that decision if not now because it sounds like beef is going to stay elevated? And maybe you can just frame, if you did cover that cost increase, what the implications for overall COGS inflation might be in that scenario.

<A - John R. Hartung>: John, I don't know that I can be that precise because we haven't made a decision. But when we raised our prices in the middle of last year, we doubled the increase or the difference between our chicken burrito, for example, and our steak and barbacoa burrito. Historically, we've had about a $0.30 or $0.35 upcharge for that, and we doubled that to about

$0.70. And that at the time came close to or was in the ballpark of covering our additional ingredient cost for serving a steak burrito, for example. Now it costs us an extra dollar or so to serve steak versus chicken, and so we're actually not covering that upcharge. And so it's that situation that causes us to think that we're subsidizing steak and barbacoa with other items on the menu, and that doesn't make sense to us. So recognizing that kind of a shortfall, we're at least considering raising prices on right now our steak and our barbacoa. We don't expect to do anything before midyear John. We don't want to have a second increase, even though it would be just on a few menu items. We'd rather not do that within a 12-month period. We don't want to double up on price increases. We think in order for us to remain accessible, we want to hold off as long as we can. So we'll look and see, watch what happens to beef prices throughout the next quarter or two. And then around the middle of the year, we'll decide whether it makes sense to go ahead and do some kind of a targeted price increase as I just described. In terms of the impact, John, if we did a $0.30 or $0.40 impact or increase, that would be roughly a 5% or so increase. As an order of magnitude, steak and barbacoa, since they account for less than a third of our menu, that would be somewhere between maybe 100 to 150 basis point menu price increase across all of our menu. So it's not a huge impact to our overall menu, not a huge impact to our margins, but it just gets our individual margins for the entrees that we serve a little bit more in line.

<Q - John Glass>: And just to follow up on the food question, you removed pork from about a third of your restaurants, and you said the customers received it well. Did it have an impact therefore on sales or no impact on sales, and is that also in any way feeding into your view on food cost for 2015?

<A - Steve Ells>: John, at this point, it seems to have mostly just - people are just trading off for chicken or beef, or in a few cases our other offerings, and it doesn't seem to have hit sales at all. But it's early yet and we'll have more time to analyze that.

<Q - John Glass>: Thank you.

Operator: We'll take our next question from David Tarantino from Robert W. Baird.

<Q - David E. Tarantino>: Hi, good afternoon and congratulations on a great 2014. Jack, I was wondering if you could comment on how the comps trended throughout the quarter. And while they were very strong on an absolute basis, they did slow a little bit from Q3 on a one and two-year basis. So I was just wondering what your thoughts are on that sort of modest slowdown that you saw there. And then secondly, if you could comment on what you're seeing so far in the first quarter, that would be helpful. Thanks.

<A - John R. Hartung>: Okay. David, during the quarter sales were lower. Our comps were lower in November than they were in the other two months. And as we can look back at the quarter and as we looked at our sales trends during November, weather was cold through much of November, and I think a lot of restaurant companies saw the same thing. And so we think there might have been a temporary weather impact during November. Now we typically don't ever say that our comp was negatively affected by weather because usually when the weather improves or returns to more normal weather, our customers come back and it makes up for it. So

I don't know that there was a net impact of weather during the quarter, but we did see that our comps did dip in November and then rebounded back in December. And then into January so far, we're seeing similar sales and transaction trends, not necessarily the same comp, in fact not the same comp because as we move to the first quarter, we're now comparing against I think a 13.3% or a 13.4%. So obviously, that comparison is a tougher comparison. But in terms of just absolute transaction and dollar levels in January, we're seeing similar trends to what we saw in the fourth quarter.

<Q - David E. Tarantino>: Great, that's helpful. Thank you.

<A - Steve Ells>: Okay.

Operator: We'll go next to John Ivankoe from JPMorgan.

<Q - John William Ivankoe>: Great, thank you, also a question on pricing and how you think about COGS. I mean 35% in the history of Chipotle is a high number. So I just wanted to get a sense of why you don't consider taking a price increase across the menu as opposed to just isolating that as a beef to I guess acknowledge that A), you could do it six or nine months ago and didn't affect customer traffic at all; and even secondly, just to expect what might be a new economic reality that pricing in general is going up across the economy, whether because of commodities, because of labor, what have you. And if we can just touch on the point that Steve made in his prepared remarks, I think there was a comment about the number of Chipotle imitators that were coming into the marketplace, if you are seeing any kind of competitive impact whatsoever on a local basis? We certainly can't see it on a national basis in your comps that are giving you at least somewhat of a hesitation of the amount of pricing that the concept can handle.

<A - John R. Hartung>: Okay, John, I'll take the menu price concept first. First of all, in terms of raising menu prices, we just don't put a very high importance on our food cost percent as a percent of sales. What we've always focused more on is what is our overall margin, and when we apply that margin to our sales what is our unit economic return, which at these sales and these margins and with the investment that we've got, we're talking about a 70% or so return on investment, which is roughly double what other successful chains are delivering. And so we don't feel this urge with these margins and these returns to increase prices just because our food costs happen to be higher. If I you told you our food costs were going to be 40% but we generate an 80% return, so our margin would be higher and our returns would be higher, would that be something that investors would accept? And I think the answer would be yes. And so our focus is less on individual line items and more on our margins and our returns. The second reason why we're not in a hurry and have never been in a hurry to raise prices is part of our vision is to remain accessible. So it's important that we go out and source these high-end premium ingredients, sustainably raised ingredients, but we want to be affordable, we want people to feel like they can come to Chipotle as often as they want, once a week, multiple times a week. And so we would rather err on the side of being more patient and not rushing to raise prices every time some of our ingredient costs move up, so that as many people as possible can enjoy Chipotle. And I think over time that strategy has worked well for us. And then in terms of the other one that was on competitor impact. We generally don't see any sustained impact. When we have a

competitor open up right next to us, we might see a week, one week maybe 10 days or something where we see sales would drop a little bit. There might be this curiosity where some of our customers may peek in and may grab a meal at another fast casual competitor, but those sales come right back. So we've not ever seen any restaurant open up near us where they've taken sales away from us on any kind of sustained basis.

<Q - John William Ivankoe>: Thank you.

<A - Montgomery F. Moran>: Thanks, John.

Operator: We'll take our next question from Jeffrey Bernstein from Barclays.

<Q - Jeffrey Andrew Bernstein>: Great, thank you very much, two questions. One, just, Monty, on the development side, just connecting the dots here on what you said on the people side, it seems like finding the right people is less of an inhibitor. I know you talked about a large backlog and whatnot. So, from a development standpoint, is it really maybe it would seem like real estate or like you said maybe increased competition to get those sites that's kind of the biggest constraint. Is that fair to say or should we assume similar to this year or similar to 2014 that you are able to upside on the unit growth or at what point maybe we - would we see an acceleration if the people side is well equipped and then I had a follow-up?

<A - Montgomery F. Moran>: I guess I wouldn't say that real estate or people, I wouldn't really pick one of them as being the greater obstacle right now to continued growth. I mean, our people, we feel very good about our people culture. Like I mentioned in my prepared remarks, the ratio of the number of restaurants per field leader is much lower than it's been in the last several years and we think that gives us a great opportunity to develop more restaurateurs and even where we're not developing restaurateurs, we're developing a lot of our GMs to get much, much closer to that level. So, we feel like there are worst-run restaurants if you want to call them that or much, much better and they were getting a lot more that are - they are getting close to that restaurateur level. So we feel really good about that. But, likewise, in talking to our real estate teams, they feel really good about what's out there in the real estate world, granted some of the prices are going up because a lot of other concepts are also expanding and growing more quickly due to a better economy. But also, by the same token, Chipotle is a really, really well-known name and landlords are excited to get us in their centers because they believe that we provide a real boost to the excitement of their center. And so, we find that we're able to get more than our fair share of deals. But in both - on both the people side and on the real estate side, we have very high standards, and we want to make sure that we have loads of restaurateurs and excellent general managers and really good field leaders to open up new restaurants and so we're always watching that carefully, not wanting to overstress the cultural side of what we do. But like-wise on the real estate side, we want to open aggressively, but also in a measured way where we're being careful to make sure that we're selecting great, great real estate. And while we are able to go into more secondary sorts of locations than we were say 10 years, 11 years, 12 years, 13 years ago with much more success, we want to - we still want to do that in a balanced way. So, yes, we agree, we can over time grow faster, but we don't find it super important to rush anything in that regard. What's most important to us is to continue to do a great job with our real estate and a great job with our managers, and run terrific restaurants such that the demand for what we're

doing continues to outstrip the supply such that when we open new restaurants, we have this really great success with our new restaurant openings, which I think, you heard in Jack's remarks that now we're looking at sort of $1.8 million to $1.9 million for those new restaurant openings and a great return pretty much out of the box, which very quickly catches up over the next few years with these very high average unit volumes that we now have, which are somewhere in the $2.47 million range per restaurant. So, by continuing to create demand, which we continue to have a huge opportunity out in front of us and that allows us to feel really good about our future and our growth.

<Q - Jeffrey Andrew Bernstein>: And then just to follow up on that, as you mentioned kind of the increasing volumes, you often talk about, I guess, around throughput, you talk about maybe a second line that you use sometimes, the catering and online, just wondering whether there is any potential or maybe in any markets you might offer two lines just for more traditional foot traffic that would - seem like that would increase throughput meaningfully during peak periods. I don't know, whether that's ever an option like a double lane drive-thru for a drive-thru concept, but the ability to just have a second line at least during certain hours of the day to really help the throughput, is that ever an option?

<A - Steve Ells>: Jeff, I think the answer is it's an option and it's an idea that has occurred to us and we even experimented with. But really what's most important for us is to continue to implement the four pillars of throughput because right now, our average restaurant in the country does something about one-third of the transactions during lunch as our fastest restaurant in the country does. And so the number one opportunity for us along the main service line is that we can go much, much faster and we continue to - like I said in my remarks, we have gotten quicker even though it's a fourth quarter, we're at a pace that, while it's not as quick as our busiest season is close to and faster than our busiest season used to be throughput. But we continue to make these throughput gains. But we think that there is so much low-hanging fruit still in terms of speeding up our restaurants in order to accommodate additional folks that adding a second line would be more disruptive to our operation and to the design of our restaurants than it would be helpful to the unit economic model at this point. That being said, we do have to keep in mind in almost all of our restaurants, a second make line that we've historically referred to as the fax line where we can serve catering orders or out-of-store orders, iPhone orders and such, that keeps those orders, many of which are larger orders, off our main service line. Early in my comment, just now, I mentioned that we had tried the two-line method. We have a restaurant in France at le-de-France, which is a business center right near Paris where we do have to - it's worth one really long line, but people coming in go in two directions. So, it is two service lines with two separate areas, two separate cash registers and so forth. It works and it works just fine. Like I said, it's just not a strategy we need to implement right now and in that location we had a situation where we had a lot of additional square feet where we could put that into place without losing other aspects of the operation. So at this point we're going to continue to focus on the main service line, implementing the four pillars of throughput and driving great throughput so that we can have a nice tidy efficient unit economic model.

<Q - Jeffrey Andrew Bernstein>: Understood, thank you.

<A - Steve Ells>: Thank you Jeff.

Operator: We will go next to Nicole Miller from Piper Jaffray.

<Q - Nicole M. Miller Regan>: Thanks. Good afternoon. On price, from a company or concept perspective, why don't you just dictate something more structural? A menu price practice that kind of systematically takes 1%, 2%, 3% a year. And there is certainly patented statistical ways to do that that protects the value proposition. Also thinking about the stock perspective, it seems to create a lot of volatility in the share price just from not always fully understanding or appreciating when you are or when you are not going to take price. So could you comment on it from both perspectives, please?

<A - John R. Hartung>: First of all, Nicole, none of our discussion is about price and what we should charge and ingredients to source and what the going rate is with that, how we should price additional food and integrate initiatives, what kind of price we should charge. None of that ever involves a discussion of the stock price, and so our belief has always been that we have this vision to change food culture, the fast food culture in this country. And if we are successful at that, we just believe that we can add lots and lots of value and we have done that, we've done that, I think even may be more than a lot of people, including ourselves thought were possible eight years ago when we first went public. And so we think that our vision is working or it's becoming a reality, people more than ever care about where their food comes from, recognize that Chipotle is offering something that many other restaurant companies don't or are unable to offer and sell. We've always been guided more by our vision than the stock price knowing that the stock price will take care of itself if we are successful. Then back to why not just do an every year thing, it's not linear. Food inflation is not linear, and so we don't think our price increases should be linear, and in addition to that even if you did have regular inflationary pressure, we are constantly investing in our food and so we might have significant investments that we want make one year, and in the early days when we were first introducing after the rates meets to our market that would dictate the timing of when we would go ahead and raise prices, and so we don't think that the way our cost, either because of food integrity or because of inflation is ever going to be kind of a linear 1% to 2% or 3% per year and so we don't think the pricing should be linear as well. So that would be the way I would describe it.

<Q - Nicole M. Miller Regan>: Thank you.

<A - John R. Hartung>: Thanks, Nicole.

Operator: We'll go next to Joe Buckley with Bank of America Merrill Lynch.

<Q - Joseph Terrence Buckley>: Hi. Thank you. Jack, did you mention a $2 million first quarter charge in connection to the pork issue? And if so, could you explain?

<A - John R. Hartung>: We had supplies of pork that were in various - some was supplied within our restaurant, some was in our distribution centers. And so the cost of removing all of that pork and disposing of it, we were able to donate a lot of it. We were able to sell some of it, but it meant we had to take a loss, Joe, and so that loss will total about $2 million. We don't think it will be more than $2 million, but we think it will cost about $2 million, and that will hit our food line during this first quarter.

<Q - Joseph Terrence Buckley>: Okay. Is there any breach of contract issue that you can pursue?

<A - John R. Hartung>: Possibly, we haven't done that yet. Our first concern was what are we going to do? How are we going to make sure we don't serve this pork? And we're now working with our supplier to figure out what the next step is, so there is a possibility. But as of right now, Joe, we're going to take the hit. And if there is any kind of - sorry, Joe. The other thing is rather than go and make this a legal issue, what we'd like to do is we'd like to find a way to get this supplier to rise up to our protocol on a more consistent basis. And so rather than this being a legal issue, we'd rather look at this as a how can we make sure that we can have assured supply going forward, and that would be more important.

<Q - Joseph Terrence Buckley>: Okay, and then maybe just one on the development side. Monty, I think you said you opened some lower - the cost of new sites will be a little bit lower in 2015 as you shift away from freestanding, away from the Northeast in 2014, but the new store volumes are still expected to be higher. Again, is that the message, and could you just explain a little?

<A - Montgomery F. Moran>: We didn't make a specific comment of what we think the new store opening levels are going to be, but we are very confident in the pipeline of real estate that we have in front of us, and our real estate people feel very good about it. So we have no reason to believe that we won't continue to open restaurants in that $1.8 million - $1.9 million range. The reason that we believe development costs are going to come down is a few-fold. One thing is that just in 2014 we had an unusually high number of freestanders. Sometimes we take what we can get. That's not necessarily the result of a strategic objective to open more of them. We just happened to find more of them in 2014 that met our screens and looked like exciting pieces of real estate that we should build Chipotle restaurants in. In 2015, it's looking like a lot more of our mix is going to the end-cap locations, which tend to do wonderfully well, but also tend to cost less to build, more of our bread and butter you might say. So also we think we can get development cost down because we're working very hard from a design standpoint to implement some of our new better design methodologies, but to do it in a more efficient way and to gain some economies of scale on what we're doing. So we're approaching the development cost puzzle from a number of different directions. But strategically, we're not trying to eliminate freestanders. We just understand that the end-cap locations that we do very, very well with them. And during 2015, it looks like more of the pipeline is comprised of them than it was in 2014.

<Q - Joseph Terrence Buckley>: Thank you.

<A - Montgomery F. Moran>: You bet. Thank you, Joe.

Operator: We'll take our next question from Karen Holthouse from Goldman Sachs.

<Q - Karen Holthouse>: Hi. So the commentary on sequential trends in the quarter and end of January, are we to take that basically as sales per week seasonally adjusted were flat? And if so, if there is still incremental opportunities on the throughput side, why isn't that continuing to grow? And I'm also curious as it relates to sequential trends as well, if you saw it, you were seeing any benefit from the stronger low-income consumer that's become a buzzword across the

restaurant industry given what I think is very legitimate accessibility and value even to a lower-income consumer compared to what you would typically think of as a fast casual company.

<A - Montgomery F. Moran>: First of all on the sequential trends, I think the answer is yes, but let me clarify so that we're talking the same language. Yes, into January, for the first - the next four and a half weeks or so into the quarter, similar sales and more transactions seasonally adjusted than we saw in the fourth quarter. That would be at a higher level than last year. So when you say flat, yes, flat sequentially, but not flat compared to last year. In terms of higher throughput, higher throughput really comes into play more so as we move into the spring months. This is seasonally our lower average daily sales period. And so throughput is important throughout the year, but it becomes even more important as the weather gets nicer as more and more people are out and about. Our lines tend to get a little bit longer. And if our throughput is excellent at that time, the lines actually won't get longer. And so people will walk into Chipotle, be served quickly. And so that's when we would expect to see a benefit. In essence, Karen, for us to change that trend line, we're going to have to invite more customers and have faster throughput, as I mentioned, as we hit more of our seasonally higher sales months, and hopefully we will see a trend change. Very often we do see a trend change or two or three during a year. We just happened to see one as we moved just a few weeks from the fourth quarter and into January so far. And then in terms of the impact on the customer, Chipotle has never really seen a lot of sensitivity in terms of when customers - when the recession first hit, we weren't the first. In fact, we were one of the last ones to see any impact on our sales. And when the recession was ending and we were coming out of recession, we were one of the first ones to see a sales increase, and we returned to double-digit comps pretty quickly as the recession was ending. And so generally our customers come to Chipotle; sure, they say it's great value. When we do research, our customers give us very, very high scores on the great value. But we have very loyal customers such that they don't stop coming to Chipotle when they have a few less dollars in their pocket and they don't all of a sudden say boy, I'm going to start going to Chipotle more often because I got a few more bucks. I think the good news here is that people find ways to visit Chipotle, and it's not necessarily affected by whether they've got a few extra bucks in their pocket. Our customer loyalty overcomes these what I would call relatively minor changes in our customers' spending ability.

<Q - Karen Holthouse>: I just have a quick follow-up. You really haven't seen sequential trends stabilize. What's the thought process around not more explicitly addressing that with you under-spend on marketing versus the peer group, yet more explicitly addressing it in some of the nuts and bolts ways to get more people in the door?

<A - John R. Hartung>: Gee, the comp was 16.1%. So are you saying spend more money to get a higher than 16.1% comp? I'm not sure I understand the question.

<Q - Karen Holthouse>: Sequentially, things have stabilized week over week or month over month. There aren't more people coming in the door. You're basically just staring down a perpetually decelerating comp. Why not be more proactive about putting things in place that prevent that?

<A - Montgomery F. Moran>: For about, I don't know, for over 20 years we've been working very hard to improve every aspect of the customer experience. So for instance, we got roughly speaking the same menu we had 20 years ago. During all of those 20 years and particularly during the years since we've been public, we've been hearing a crescendo of people wondering why we don't add additional menu items and change other aspects of what we do and yet we've had the highest comps, I think in the history of the restaurant business during that time and likewise, we keep trying to improve the quality of our culture, so we have better people serving you. We've been improving the quality of our average raw ingredient, every ingredient we have has been under our scrutiny, in order to make sure the food tastes as good as it can taste, then we worked on throughput to make sure that that aspect of the customer experience also improves. And what we find is that by focusing on those things that we do really, really well, but yet getting even better at them, we've been able to sustain a much stronger comp than any other restaurant company has done. So while it may look like we are staring down the pike at sort of flattening sales and no increased comps, it looked that way 10 years ago, and nine years ago, and eight years ago, and seven years, six years, five years, four years, three years, two years, one year ago and I think, even a year ago, if you looked at what our guidance was for the year, I believe at the very beginning of 2014 we said that there would be a low single-digit comp, I think, a flat-to-low single-digit comp and that looked like what it was going to be at that time. How did we get to a mid-teen, mid-to-high teen comp? Doing that which we do even better. And so, it is possible of course that our comp will flatten out and there won't be sequential trend changes to the positive, but we hope that our continued focus on trying to do everything we do better will work out just super.

<Q - Karen Holthouse>: Great, thank you.

Operator: We'll take our next question from Jeff Farmer from Wells Fargo.

<Q - Jeff D. Farmer>: Jack, you touched on it, but you increased your labor staffing ratios in early 2014. I think you addressed largely the double-digit transaction growth and some other things, but as we're modeling the labor line in 2015, how should we be thinking about staffing levels relative to what we saw last year, meaning do you think there is another little bump in staffing levels or you're going to hold tight with what you saw in 2014?

<A - John R. Hartung>: Jeff, I wouldn't expect another bump. Now, we'll add people as we see more transactions. So, as our comps continue to be in the high-single or low double-digits, we'll add people at kind of at normal level. I would expect that it would not be as much as we saw in the last year or so. We've talked on other calls that we have some labor inefficiencies and so, we have more staffing at the restaurant level, meaning we have just more crew that we can schedule. We have more managers, hourly - our salary managers and hourly managers on our teams than ever before. And so the hours that we're deploying are higher than we think they normally should be, even at these very high-comps that we've been delivering. But we've also said, we're not going to be in a hurry to go shake those inefficiencies out of the restaurants, it's been an extraordinary year in terms of throughput, in terms of transaction, we've moved to a whole another sales level here and so the fact that we've had some, what I would call relatively modest labor inefficiencies, somewhere in the maybe 50 basis points, 60 basis points, 70 basis points kind of range. We're not going to be in a hurry to shake that. We're aware of it. Our teams are

aware of it. And so I wouldn't see additional inefficiencies creep in, and at some point in the future, I just wouldn't want to pinpoint one. We believe we'll get this efficiency back, but I wouldn't see a similar kind of step-up for the reasons I just mentioned. I don't think you'll see another layer of inefficiency creep in like you've seen in the last year-and-a-half.

<Q - Jeff D. Farmer>: All right, helpful. And just one quick follow up. So, excluding stock based comp which you made that clear that we still need to figure out what that number potentially could be, so again excluding stock based comp, how should we be thinking about G&A dollar growth in 2015 or even absolute sort of G&A dollars in 2015, do you have any color?

<A - John R. Hartung>: I would expect at this level Jeff that, that our G&A, excluding non-cash comp and excluding any kind of one-time things that might happen, would be at a similar, but hopefully slightly lower as a percentage of sales. There is not a ton of leverage left, but I would say there is slight leverage that hopefully we would get. And so I would expect the G&A as a percentage of sales, not counting things like stock comp, should drift slightly lower over the coming years.

<Q - Jeff D. Farmer>: Okay, thank you.

<A - Montgomery F. Moran>: Thanks, Jeff.

Operator: And this does conclude the question-and-answer session of today's call. I'd like to turn the call back over to Mark Alexee for any additional or closing remarks.

Mark Alexee: Thank you all for joining us, really appreciate it. We look forward to speaking with you next quarter for our first quarter financial results. Thanks.

Operator: That does conclude today's conference. We thank you for your participation.