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DAVID E. TARANTINO, DIRECTOR OF RESEARCH & SENIOR RESEARCH ANALYST, ROBERT W. BAIRD & CO. INCORPORATED, RESEARCH DIVISION: Okay. Good morning or good afternoon, depending on where you are. I'm David Tarantino, I'm the restaurants analyst at Baird and I'm thrilled to welcome the team from Chipotle to join us today. As many of you know, Chipotle is a leader in the fast casual segment of the restaurants industry with a brand that has established incredible standards of quality in terms of food quality and also has generated really strong financial returns for its shareholders.

So I'm pleased to welcome several members of the management team today, including Chairman and CEO, Brian Niccol; CFO, Jack Hartung, and the rest of the finance team here. So maybe -- well, welcome, everybody. Thank you for joining.

BRIAN R. NICCOL, CHAIRMAN & CEO, CHIPOTLE MEXICAN GRILL, INC.: Yes. Good morning. Good to be with you.

JOHN R. HARTUNG, CFO, CHIPOTLE MEXICAN GRILL, INC.: Good morning.

Questions and Answers

DAVID E. TARANTINO: Great. Brian, I thought a good place to start would be, as you think about -- you joined the company about 3 years ago, a little over 3 years ago, and you had a vision for growing Chipotle into a $10-plus billion brand with 5,000 locations and average unit volumes of $2.5 million. So a lot's changed and you've made a lot of progress over the past 3 years. So I just wanted to see if you would maybe share some thoughts on what your current vision is for the brand now that you've kind of gone through the last 3 years.

BRIAN R. NICCOL: Yes, sure. Well, definitely, a lot has happened in the last 3 years and really proud of the team and the culture that we've created over that time and then obviously, the results that we've delivered. I would say one of the things that I probably didn't anticipate was getting to that $2.5 million as fast as it looks like we've gotten there.

So as we've been talking about it, we don't see any reason why we can't get to $3 million, $3.5 million average unit volumes in the very near term and then still deliver that 6,000-plus new unit opportunity. So we've kind of, as a group, always said $2.5 million was more of a emotional milestone versus necessarily the destination point. And with the growth of our digital business now doing, call it, $2 billion, $3 billion, translating to about $1 million of AUV per restaurant or a little more, and then the dining rooms coming back, combined with great operations, smart execution on the menu and this ongoing digital system that I believe we can continue to grow, there's no reason why you can't quickly get yourself to $3 million, $3.5 million and then obviously really exciting margins to accompany that.

So there's a lot of powerful growth to be had. And I'm just talking about the U.S. opportunity. We're still in the early days now of using our stage-gate process to validate Europe. And then obviously, we'll continue to assess when the right time is to go beyond even Europe. But to answer the question about the original goal of $2.5 million and, call it, 5,000 restaurants, I'd say we kind of pivoted to now going well beyond $3 million and probably closer to 6,000 restaurants and having a lot of growth in our digital business and a lot of growth in our dining room is kind of the future we see.

DAVID E. TARANTINO: Great. And can you maybe just describe the path to $3.5 million as you think about what needs to happen to get there? Is it just a matter of recapturing a lot of the in-restaurant traffic and holding on to the digital sales? Or are you envisioning that differently if you were to get to that level?

BRIAN R. NICCOL: Yes, look. I don't know exactly what that split will be, David. But look, our restaurants -- the dining rooms without a digital business were -- definitely have the capacity to do $2.5 million worth of sales. We've demonstrated we can do over $1 million of sales digitally. And now with the new equipment that we put in that enabled us to launch quesadilla for the digital business and the fact that we got, 20 -- so how many million?

JOHN R. HARTUNG: 21 million.

BRIAN R. NICCOL: 21 million people in our rewards program, you can see how we now have equipment and technology that will allow us to grow our digital business from where it is today. And then look, our dining room experience, I think, is the way people want to experience dining rooms. It's like great customization, terrific ingredients, excellent value, terrific speed and then a great seat.

So if you want to sit in the restaurant, it's a great seat. If you want to get it to-go, you've got that option, too. So I think our strategies that we put in place are the right strategies to continue the growth path forward. What that split is? I don't know. But I think there's growth in both kind of businesses, call it, the digital make-line business and the frontline business.

DAVID E. TARANTINO: Got it. Maybe segueing to growth. I guess, what -- how do you think about unit expansion, which is kind of one of the key engines of the growth story here? So you've laid out a target to get to about 200 gross opening this year. I mean, where could that go over time? Is that 200 just sort of on your way to a higher number? And I guess, how are you thinking about growth as it relates to the next few years?

BRIAN R. NICCOL: Yes. Look, I think you said it well. It's like probably 200 on our way to a higher number. The good news is the demand for **Chipotle** is really high. And the #1 barrier that consumers tell us is access. And it's both physical access. I think we've done a pretty good job on the digital access. But the physical access is still one of the number -- it is the #1 barrier to **Chipotle**.

So as we continue to open Chipotlanes and our traditional **Chipotle**, we continue to get great returns. We're on track definitely to do our 200-plus this year and we'll continue growing from there because I think we've got now the operational capability and we're building the people capability.

So how high does that go? I think it will, frankly, be more of us making sure we've got the right people capability for the speed at which we open them because the economics are there, the landlords want us and the sites are ripe. So I don't know if you want to add anything to that, Jack.

JOHN R. HARTUNG: Yes. I just think, David, when we think about the 200 this year is a step-up from what we did the year before. The inventory building is going really well. Now other restaurant companies are back in the market now so we're bumping into them. But generally, landlords want us in our building. So I feel good about the pipeline. And I definitely agree with Brian that the 200 is on our way to something higher than that.

And as we've always been very careful about, the 1 thing that we have to make sure we don't do is outgrow our people pipeline. And so some of the steps we took recently is to make sure our pipeline keeps up with our growth, and we feel good about that as well.

DAVID E. TARANTINO: Got it. Do you think **Chipotle** could be a double-digit unit growth company or is that too lofty in terms of the number that, that would require?

BRIAN R. NICCOL: I think you could be in the ballpark of that but we've never set a percentage of existing. It's more been about on the ground, what is the inventory building look like? Like for the quality sites and the areas that we're looking, how well is that going and what's our people pipeline look like? And if you get the right intersection of those 2, David, the right number will fall out.

I know a lot of companies will say, "We're going to shoot for X number or X percent," and then come hell or high water, they're shooting for that. And ours is a little bit more organic and a little bit more, let's get the right mix of those 2 things. Could it theoretically lead to something that's 10% or would be in the 300? I think there's that possibility but we're a ways away from that right now.

DAVID E. TARANTINO: Yes, makes sense. And Jack, can you give us a refresher on what your unit economic model looks like at the current, I guess, or targeted volumes and margins from -- on both (inaudible) units? And then how much different are Chipotlanes relative to the traditional ones?

JOHN R. HARTUNG: Yes, listen. The economics continue, David, on our new restaurants continue to be very, very, very strong. I mean, out of the box, the average restaurant is generating a cash-on-cash return in that kind of 40% range. And keep in mind, the restaurants open up and then they are -- in year 1, they're our highest comping restaurants. And the margins in the first year are a little bit bumpy, too. When you open up new restaurants, you're not as efficient. So it's not too long that, that 40% turns into a 60%, 65%, approaching 70%.

And then I would say the gap between a Chipotlane versus a non-Chipotlane is about 10 full percentage points, meaning if a non-Chipotlane opens up at a 40% cash-on-cash, a Chipotlane on average because of higher volume and higher margins is probably more in the 50% range. So it's fully 10% whole -- 10% above a non-Chipotlane. So that's obviously why we're leaning in and why we've announced that we expect to open at least 70% of our restaurants this year will have a Chipotlane.

DAVID E. TARANTINO: Yes, great. And while we're on the subject of growth, Brian, can you give, or Jack, can you give an update on international and how you're -- I think you got some markets that are on the stage-gate process? And I guess when does international, in your mind, become a bigger part of the story?

BRIAN R. NICCOL: Yes. Look, I'm very excited about what our learning plans are for Europe. I feel like we've now put the digital system into Europe, which gives us a new tool as part of our opening approach. And now we also have varying formats from small to the traditional size **Chipotle** that you've seen. Although -- so when I mean small, small as a dark kitchen only all the way to a full **Chipotle**, okay?

And then we're wrappering it now with our digital system, so everybody has a digital make-line and then you obviously have that frontline experience. And we just opened a restaurant, I guess, it was about 2 weeks ago in a town in Chiswick and then we're about to open a new 1 here in Clapham in about, I think, next week or maybe it might even be today, June 8 to 9.

JOHN R. HARTUNG: It's this week.

BRIAN R. NICCOL: Yes, it's this week. And what I love about this is we'll have all these different formats now in various trade areas so that we get clarity on, hey, what's the 1 that gives us the best return with the highest probability of success? And look, COVID has slowed us down. Our plan was to do this, about a year ago, to have these things built and already have a year of learning in it. But we're probably 18, 24 months out before we get great learning on the sites that we're opening. But it's -- I think it's the right disciplined approach, and we're a week or 2 into some of these openings and they're off to a good start.

DAVID E. TARANTINO: Great, great. And is the plan, I guess, if you like what you see, will you accelerate fairly quickly over there? Or will it be more of a -- how long will it -- I guess, how long will it take before this becomes a meaningful driver?

BRIAN R. NICCOL: Yes. I mean, look, I think if we get the unit economics to perform the way we think they could, the good news is we really don't have any barriers to get us rolling in a meaningful way. Now it will take some time because obviously you can't build restaurants overnight, whether they're dark kitchens or full build restaurants. But it's going to be a couple of year process. And I love what I'm seeing as far as learning plan. I love the customer experience that we're providing, whether it's a digital experience or an in-person experience. And Jim and the team, I think, are doing a really good job.

DAVID E. TARANTINO: Great, great. Maybe shifting gears to the same-store sales strength that you saw in the first quarter, up over 20% versus 2019, pretty impressive numbers. I guess, what do you think are the drivers of that? That's among the strongest we've seen in the industry. I guess, what do you think has made **Chipotle**, I guess, a brand of choice as we've kind of gone through the pandemic or exited the pandemic?

BRIAN R. NICCOL: Yes, yes. I mean, what, I think, we've been very maniacal about is great ingredients, great culinary to give a great customer experience. And the brand continues to be very strong. People, I think, understand even more so than ever that we have that commitment to ingredients and culinary. And then it's also a company that's got a purpose around doing the right thing for its people, obviously the communities and then obviously, food and the supply chain associated with it.

So that's been -- I think the brand has been really powerful and has only gotten stronger. And then specifically, as you think about the tactics underneath it, look, our digital system continues to be a flywheel that continues to grow. We just added the quesadilla platform to it. That was back in March. For our menu, just to keep it, I think, relevant, we did cauliflower rice. Obviously, that's going to be coming off and then we're -- probably have some news that we'll do in the back half of this year.

And that's kind of the cadence we're getting into, one item about every 6 months. And it's all about keeping the menu relevant and very much in front of culture. And then look, I think our operations did a phenomenal job throughout the pandemic so people stayed with us. And then as the dining rooms open, frankly, we need to get back to being great at throughput again. I think as our team members get used to having a line again and moving people down the line and our customers get used to moving down the line again, we're going to continue to grow from here.

And that's what I love about where we are right now is I get to go visit restaurants, it's great to see the lines back. I wish they would be moving a little faster, but that will happen. And I'm already starting to see that happen. In places where the dining rooms have been open longer, that's already happening.

So look, those strategies of great operations, using a disciplined approach to innovation so that we keep our innovation within our operating model and then making sure that it's customer-centric, it's working and then continuing to build the brand is another key piece of the puzzle. So we're going to keep doing it because it's working.

DAVID E. TARANTINO: Yes, makes sense. One question I had about your -- maybe a little bit shorter term in nature around your second quarter guidance, you had -- the guidance you gave for same-store sales implied a deceleration, if I look at a 2-year comp metric versus what you had been running in the -- even in the fourth quarter and in the first quarter. So I guess, can you maybe elaborate on the reasons why that might be the case or whether that guidance was conservative? Or how do -- how are you thinking about it when you issued the guidance?

BRIAN R. NICCOL: Yes. Look, I think there is a lot of still unknowns when we were talking about this. What I would tell you is comps go up and down every day and our goal is to keep them growing. And I was having a conversation with Chris just the other day, and we were joking because it's like we're constantly turning over double-digit, pushing 20% type comps like, well, geez, why isn't it 30%? And it's one of those crazy moments in time where you just have to remind yourself, when you look at it on a 2-year basis, it's like, look, we are performing. We have strength. We have, I would say, a lot of brand tailwind driven by the initiatives that we have as well as the goodwill behind the brand.

And as we talk -- where we started this conversation, it's like you could say maybe we're conservative, maybe it should be higher, maybe it should be lower. What I keep the eye of the prize on is we're going to $3 million, $3.5 million and thousands more restaurants. So you can tell me what you think about the second quarter. I think we're doing a great job with the strategies and where we're ultimately going.

JOHN R. HARTUNG: And David, just to add 1 other thing. I mean, listen, we look at your report that comes out every week as well where you do the survey of what the trends are. And there was something happening in April. And to Brian's point, we weren't sure how the next chapter would unfold, but we started to see that industry-wide and with our sales as well. So something, whether it was maybe the stimulus, the previous stimulus maybe wearing off or just something going on with the reopening. So it feels like our results just somewhat mirrored -- when we were looking at this in April for the guidance, mirrored what was happening in the industry. Just a little bit of a leveling off going on.

DAVID E. TARANTINO: Yes, makes sense. On digital, I wanted to sort of get kind of the interplay with what's happening with in-restaurant transactions returning and what's happening in the digital channel. I guess, are you seeing the digital sales stick as some of these (inaudible) in-restaurant transactions come back? I guess, what are you seeing so far?

BRIAN R. NICCOL: Yes. Look, well, 1 thing that's been really terrific is, I think we've been saying it, it's hanging in at around 80-plus percent. And what I love about that is, look, the percentages will change but the dollars we're seeing are hanging in there. And as I mentioned earlier, I think we're going to be able to grow from here, the absolute dollars and the transactions. Where that lands ultimately in percentage, we'll figure that out down the path.

But like I said, we continue to get people joining our rewards program. We continue to get better at using that data. And then we've now got new capability with the oven that we've added to our digital make-line. So the occasion is clearly different and we're going to continue to drive it.

DAVID E. TARANTINO: Yes. On the quesadilla, I think you were pretty excited about that the last time you talked. I guess, how has that kind of trial period evolved in the repeat customers? And I guess, what's your current views on how that platform is doing from the days -- as you move further away from launch?

BRIAN R. NICCOL: Yes. Look, it's doing great. It's meeting all of our expectations. And the thing I really am excited about is our operators love making it this way, which that's really important because when they love making a product, they end up making it really well. And then that translates into the customer loving the product. So I'd say it's off to a great start. I think it's a platform we're going to leverage going forward.

And we're making great quesadillas. I think they're better than they were when people order them on the front line and we use that tortilla -- well, I know they are better for a lot of reasons. We're faster, the product is hotter, the cheese is really melted. And I think what's the line? It's like it's a whole new way to **Chipotle**.

And people are -- they're liking it. They love the idea of being able to dip it into our guac and sour cream. So it's got a lot of leg span. And I think I talked about it. I'm a sucker for that barbacoa quesadilla, it's tough to beat. So my wife asked me why am I ordering a burrito and the quesadilla? And I'm like, "Are you trying to say something?" But it's really good.

DAVID E. TARANTINO: I agree. Is that -- Brian, do you have a vision for that becoming an in-restaurant item as opposed to just a digital make-line item? Or is it -- are you pretty happy with it just being digital-only?

BRIAN R. NICCOL: We're pretty happy with it being digital-only right now. We would have to make some tweaks to the operating model in order to put it in the dining room. And our guys make it on an exception basis because luckily, it's still a lot faster than making it on that tortilla press when somebody comes in the restaurant and asks for it. But we'd probably need to add another TurboChef oven or something in those lines to enable the frontline experience. So for now we're going to keep it on the digital make-line.

DAVID E. TARANTINO: Got it. Yes, okay. And then pricing, you recently -- at least our data would suggest you recently rolled out a price increase to cover some of the labor investments you're making. I guess, how do you feel about the pricing power that you have? I guess, you're running more pricing than what you've done historically. So I guess, what do you view as kind of the upper limit or how do you feel about the current level?

BRIAN R. NICCOL: Yes. Look, here's a really fortunate thing. Our brand has a lot of pricing power in it. And even after we've taken this pricing, the Chicken Burrito, excluding like a New York or some of the higher-priced markets, it's still well below $8. So I'd just like to remind everybody, I know when we talk in percentages like, geez, you're taking 3% or you just did whatever we did on delivery. We're usually talking about quarters and dimes that we're layering in. And the feedback we've gotten is we still have a really strong value proposition with more pricing power if we had to pull that lever.

Now I think Jack and I have said this over and over again, we really prefer not to take pricing. But it made sense in this scenario to invest in our employees and get these restaurants staffed and make sure that we have the pipeline of people to support our growth. And then with that, we've taken some pricing to cover that -- some of that investment. So -- but to date, our value proposition is as strong as it was before we had to make some of these moves. Jack, you might want to add something?

JOHN R. HARTUNG: Yes. Just the only other thing, David, is there are some inflation pressures that we're all feeling, the whole industry is feeling, even outside our industry is feeling. Right now, it's on labor. Ingredient costs, we just talked about it and we'll see where that leads as well. So it feels like the industry is going to have to react. Our approach was to get in front of this and lead, to first invest in our people and then to do the right thing so we can pass that through.

So it feels like the right thing at the right time, and it feels like the industry is now going to have to either do something similar or play some kind of catch-up. Otherwise, you'll just lose the staffing game. And if you lose the staffing game in this business, it's not going to end well.

BRIAN R. NICCOL: Yes, high correlation to being staffed and delivering sales.

DAVID E. TARANTINO: Makes sense. So can you remind us how much pricing you are taking in this latest round? Is that...

JOHN R. HARTUNG: Yes. It's in that $4-ish, $3.50 to $4, $3.75 to $4 or something like that, David, depending on how the product mix shakes out. And the intent there was to basically cover the dollar cost of the increase in wages, okay, not to protect margin but to cover the dollar cost. And we'll see how the rest of the year unfolds and see what our margins do, see what resistance, if any, we see and then see what happens to the labor markets. But so far, we like how things have played out so far in terms of the response to the increase, both from our existing people, as well as applicants as well. So that part of the move was the most important part, and we're pleased with how that's going so far.

DAVID E. TARANTINO: Yes, got it. And then on the margins, I don't think we can complete the discussion here without talking about this matrix that you've laid out. So I guess, Jack, how are you -- I guess, what's your confidence level in being able to get to that matrix? I think you had previously said by the end of the year.

JOHN R. HARTUNG: Yes. Listen, David, the mechanics are now changed, okay? So this idea of this handy 2.5% versus 25% are going to be challenged by just what I'll call mechanics. And for example, the move that we just took is going to, on an annual basis, push up our volume $100,000, okay? And we won't get margin for that, all right? So what I just mentioned to you, you take about a 4% price increase to cover the dollar cost of the extra labor.

While you're now at a higher sales volume, you've got the same cash flow, that margin is actually going to be a little bit lower. So the algorithm mechanics are going to be very, very different. So I think what you'll see us do over the next few quarters, just talk about what the adjusted algorithm will look like. The profitability will be the same or greater. But in terms of just the relative -- what's the margin? Does it line up perfectly to 2.5% and 25%? That's going to have to be restated a bit. But in terms of our profitability, our ability to drive either at or in the ballpark of the industry-leading margins, we think all that still applies. But just a mechanic, it will be a little bit differently going forward.

DAVID E. TARANTINO: Great. Just so I understand this, it's just some mathematical exercise as opposed to a change in confidence in being able to deliver kind of gross profit in line with what you thought previously?

JOHN R. HARTUNG: Yes, exactly, David. I mean, just to go through the math of take -- we're knocking on the door. We were knocking on the door in the first quarter of being on the algorithm. We had confidence before this latest move that we would be on the algorithm as our sales approached to $2.4 million and then $2.5 million. Let me just go through the math and say, take a $2.4 million buy and 24% margin, then take a 4% price increase, which holds the dollar profit the same. If you just moved 100 basis points, you just moved $100,000 on the sales.

If you calculate that same cash flow, you probably moved your margin down about 80 basis points or something like that. So there's a mechanical difference, yet we're making the exact same amount of money, all right? So from a return standpoint, which is the most important thing, the things that we talked about in your earlier questions, our returns of opening up new restaurants and getting a 40% return growing to 60%, 70% over a few year period, that's all preserved, okay? But the mechanics of just the algorithm, it's just going to have to be redefined a bit as we move forward.

DAVID E. TARANTINO: Great. Well, I think we're running short on time so maybe we'll wrap it there. So appreciate all of you for being here today, and thank you for the discussion and have a good rest of the conference. Before we wrap up, I wanted to highlight the next sessions at the conference are going to be FICO, Malibu Boats, Gypsum Management and Supply, Interface, ScanSource and FARO Technologies. Thanks, everyone. Have a great day.

BRIAN R. NICCOL: Thanks, David.

JOHN R. HARTUNG: Thanks, David.

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