FREESTONE RESOURCES, INC.
Form 10-K
October 15, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-K

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

For the Fiscal Year Ended **June 30, 2018**

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXHANGE ACT OF 1934

For the Transition Period from ________ to ________

FREESTONE RESOURCES, INC.

(Exact name of registrant as specified in its charter)

NEVADA	**000-28753**	**90-0514308**
(State or other jurisdiction of incorporation)	(Commission File Number)	(IRS Employer Identification No.)

101 W. Ave D. Ennis, TX 75119	**75201**
(Address of Principal Executive Offices)	(Zip Code)

Registrant’s telephone number, including area code: **214-880-4870**

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: Common Stock, Par value $0.001

Indicate by a check mark if the registrant is a well-known seasoned issuer, as defined by Rule 405 of the Securities Act.

Yes No

Indicate by a check mark whether the registrant is not required to file reports pursuant to Section 13 or Section 15 (d) of the Securities Exchange Act. Yes No

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

Indicate by check mark whether the registrant has submitted electronically and posted on its website, if any, every Interactive File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§325.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files), Yes No

Indicate by check if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (s229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K

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

Large Accelerated Filer Accelerated Filer

Non-Accelerated Filer Smaller Reporting Company

Emerging Growth Company

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

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

Aggregate market value of the voting stock held by non-affiliates of the registrant as of December 31, 2017: $2,959,487

Indicate the number of Shares of outstanding of each of the Registrant's classes of common stock, as of the latest practicable date: As of September 30, 2018, the Registrant had 98,238,177 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

None

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FORWARD-LOOKING STATEMENTS

This report includes forward-looking statements as the term is defined in the Private Securities Litigation Reform Act of 1995 or by the U.S. Securities and Exchange Commission in its rules, regulations and releases, regarding, among other things, all statements other than statements of historical facts contained in this report, including statements regarding our future financial position, business strategy and plans and objectives of management for future operations. The words “believe,” “may,” “estimate,” “continue,” “anticipate,” “intend,” “should,” “plan,” “could,” “target,” “po likely,” “will,” “expect” and similar expressions, as they relate to us, are intended to identify forward-looking statements. We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our financial condition, results of operations, business strategy and financial needs. In addition, our past results of operations do not necessarily indicate our future results.

Other sections of this report may include additional factors which could adversely affect our business and financial performance. New risk factors emerge from time to time and it is not possible for us to anticipate all the relevant risks to our business, and we cannot assess the impact of all such risks on our business or the extent to

which any risk, or combination of risks, may cause actual results to differ materially from those contained in any forward-looking statements. Those factors include, among others, those matters disclosed in this Annual Report on Form 10-K.

Except as otherwise required by applicable laws and regulations, we undertake no obligation to publicly update or revise any forward-looking statements or the risk factors described in this report, whether as a result of new information, future events, changed circumstances or any other reason after the date of this report. Neither the Private Securities Litigation Reform Act of 1995 nor Section 27A of the Securities Act of 1933 provides any protection to us for statements made in this report. You should not rely upon forward-looking statements as predictions of future events or performance. We cannot assure you that the events and circumstances reflected in the forward-looking statements will be achieved or occur. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements.

PART I

ITEM 1. DESCRIPTION OF BUSINESS

Company Background

Freestone Resources, Inc. (the “Company” or “Freestone”), a Nevada corporation, is an oil and gas technology development company that is actively developing and marketing technologies and solvents designed to benefit various sectors in the oil and gas industry. The Company has re-launched its Petrozene™ solvent after developing a new and improved formula. Petrozene™ is primarily used to dissolve paraffin buildup, and it is primarily used for pipelines, oil storage tanks, oil sludge build up, de-emulsification, well treatment, as a corrosion inhibitor and as a catalyst in opening up formations thereby aiding in oil production.

On June 24, 2015 Freestone purchased 100% of the common stock of C.C. Crawford Retreading Company, Inc. (“CTR”), a Texas corporation. CTR is an Off-The-Road (“OTR”) tire company located in Ennis, Texas, and a wholly owned subsidiary of Freestone. CTR’s primary business is to repair, recycle, dispose of and sell OTR tires, which are used on large, industrial equipment. Freestone made the decision to purchase CTR in order to utilize the CTR facility for the production of Petrozene™ ..

On June 24, 2015, the Company formed Freestone Dynamis Energy Products, LLC (“FDEP”) with Dynamis Energy, LLC (“Dynamis”). FDEP was formed in order to operate and manage the specialized pyrolysis process that is used to create Petrozene™ and other byproducts of value. Freestone chose to work with Dynamis based on their extensive engineering and waste-to-energy expertise. Freestone owns a 70% member interest in FDEP.

The acquisition of CTR and the formation of FDEP have allowed Freestone to vertically integrate the Petrozene™ product line. CTR will remain an auxiliary company that will maintain existing operations that complement the efforts of FDEP and Freestone.

Available Information

The Freestone website is www.freestoneresources.com. The Company's references to the URLs for these websites are intended to be inactive textual references only. The Company's Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to reports filed pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended, are filed with the U.S. Securities and Exchange Commission (the "SEC").

The public may read and copy any materials filed by the Company with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Room 1580, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy, and information statements and other information regarding issuers that file electronically with the SEC at http://www.sec.gov.

Products and Services

OTR Tire Services

CTR has been involved in the OTR tire business since 1987. Since its formation, CTR has evolved into a unique company that can handle most of the needs of its customers that require OTR tire services. These services include:

- Specialized OTR tire repair services quickly and efficiently, and at competitive prices; and
- Disposal services for OTR tires that can no longer be used or repaired; and
- A substantial inventory of used OTR tires for sale; and
- Recycling OTR tires for alternative uses that prevent them from going to landfills.

Petrozene™

Freestone purchased CTR in order to use a specialized pyrolysis technology. Pyrolysis, by definition, is the decomposition of organic matter in the absence of oxygen. The Company and FDEP will use this process to convert the OTR tires that have been disposed of into byproducts of value. One of the byproducts from this process is used in the production of Petrozene™. The use of pyrolysis allows Freestone and CTR to reduce the amount of tires that would have otherwise been disposed of in landfills.

Customers

CTR provides services to many international OTR tire dealers. These OTR tire dealers make up a majority of its customer base.

Competition

OTR Tire Services

Several tire processing companies are permitted in the Dallas/Ft. Worth area, but most of them cannot handle OTR tires due to the size of the OTR tires. CTR has its own trucks, forklifts and other equipment that are necessary for the management and processing of OTR tires. CTR also has specialized, on-site shredding equipment to convert the OTR tires into one inch tire pieces that can be sold as a tire derived fuel ("TDF"), or processed in the specialized pyrolysis technology.

CTR is one of the few tire processing facilities that provide other services to its customers. These additional services include the sale of used OTR tires and the repair of OTR tires. CTR's operations focus on the states of Texas, Oklahoma, Louisiana, New Mexico and Arkansas. Focusing on these specific states allow CTR to provide some of the fastest repair turnarounds in the industry.

Petrozene™

Many oil and gas service companies and petro-chemical companies provide a product that competes with Petrozene™. The Company's advantage is that Petrozene™ is derived from a readily available waste product, and the pyrolysis process used to create Petrozene™ is extremely cost efficient. Most of the Company's competitors use synthetically derived chemicals that are extremely expensive to develop and manufacture.

Research and Development

Freestone and its partners are continuously evaluating technologies and processes that can convert waste streams into valuable byproducts. Freestone's main focus has been the development of byproducts that can be used by the oil and gas industry to increase production and efficiency. The Company's research has resulted in the relaunch of Petrozene™, and expanding the ways in which Petrozene™ can be utilized. Freestone's partners and customers have provided valuable feedback that has continued to help create a superior product.

Growth Strategy

Freestone is actively pursuing a strategy of growth through the vertical integration of Petrozene™. The implementation of this strategy allows the Company to reduce variables that could affect growth, performance and the quality of its products. In addition, Freestone and FDEP are providing CTR with another recycling option. This means that more tires will be processed each year, and thus will allow CTR to increase its disposal operations.

Government Approval and Environmental Matters

CTR is registered with the Texas Commission on Environmental Quality ("TCEQ") as a transporter and scrap tire facility.

Freestone's and CTR's operations and properties are subject to extensive and changing federal, state and local laws and regulations relating to environmental protection, including the generation, storage, handling, emission, transportation and discharge of materials into the environment, and relating to safety and health. The recent trend in environmental legislation and regulation generally is toward stricter standards, and this trend will likely continue.

The permits required for our operations may be subject to revocation, modification and renewal by issuing authorities. Governmental authorities have the power to enforce their regulations, and violations are subject to fines or injunctions, or both.

On September 6, 2016 CTR received a Notice of Enforcement for Compliance Evaluation Investigation from the TCEQ informing them of potential violations related to its processing permit. On September 6, 2016 FDEP also received a Notice of Enforcement for Compliance Evaluation Investigation informing them of potential violations relating to waste disposal and its permit for pyrolysis process.

CTR's potential violations related to tires stored in excess of the numbers permitted and noncompliance with fire regulations. CTR has submitted a plan to reduce the number of tires and bring the facility into full compliance with all fire regulations.

FDEP's potential violations regarded failure to properly classify, track and dispose of hazards waste as well as operating a pyrolysis machine without a separate permit from CTR. FDEP cured the potential hazards waste issue and submitted documentation of such to the TCEQ. FDEP has applied for a separate permit for its pyrolysis operation and is awaiting approval from the TCEQ. As of June 30, 2018, the Company is awaiting approval of the permit

In conjunction with the plan submitted to the TCEQ to bring the tire storage facility into compliance CTR accrued an environmental and tire disposal liability of $400,000. (See financial statement Note 7). The Company also accrued $48,750 in proposed TCEQ fines and penalties.

On August 22, 2018 the TCEQ approved an Agree Order with CTR to settle the case. Under terms of the agreement the fine was reduced to $3,600 providing CTR reduce it number of scrap tires on hand to 5,000 within 100 days.

Intellectual Property

Freestone is the owner of the Petrozene™ trademark. Freestone does not own any patents at this time.

ITEM 1A. RISK FACTORS

As a smaller reporting company we are not required to provide the information required by this item.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. DESCRIPTION OF PROPERTY

CTR is located at 101 W. Ave. D, Ennis TX 75119 and owns approximately 10.141 acres with three buildings consisting of 32,800 square feet. During the current year Freestone relocated its corporate offices to the Ennis facilities as a cost saving measure.

ITEM 3. LEGAL PROCEEDINGS

Freestone and CTR are not subject to any material pending legal proceedings, nor are the companies aware of any material threatened claims against them.

ITEM 4. MINE SAFETY DISCLOSURES

PART II

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

The Common Stock is currently quoted on the OTCQB under the symbol “FSNR.”

The following tables set forth the quarterly high and low bid prices for the Common Stock for 2018 and 2017. The prices set forth below represent interdealer quotations, without retail markup, markdown or commission and may not be reflective of actual transactions.

Fiscal 2018	**High**	**Low**
First Quarter	$0.07	$0.04
Second Quarter	$0.08	$0.05
Third Quarter	$0.06	$0.02
Fourth Quarter	$0.06	$0.04

Fiscal 2017	**High**	**Low**
First Quarter	$0.13	$0.05
Second Quarter	$0.08	$0.05
Third Quarter	$0.09	$0.04
Fourth Quarter	$0.08	$0.04

Shareholders

As of June 30, 2018, there were approximately 260 record holders of the Common Stock. This number excludes any estimate by Freestone of the number of beneficial owners of shares held in street name, the accuracy of which cannot be guaranteed.

Dividends

Freestone has not paid cash dividends on any class of common equity since formation and Freestone does not anticipate paying any dividends on its outstanding common stock in the foreseeable future.

Warrants

As of June 30, 2018, the Company had no outstanding stock warrants.

ITEM 6. SELECTED FINANCIAL DATA

As a smaller reporting company we are not required to report selected financial data disclosures as required by item 301 of Regulation S-K.

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

At present, Freestone's management is focused on the development and vertical integration of the Petrozene™ product line. Freestone continues to look for various solvents, chemicals, and technologies that might fit into Freestone's petro-chemical line, and continues to seek opportunities in the oil and gas water industry.

Critical Accounting Policies

The Company’s consolidated financial statements were prepared in conformity with U.S. generally accepted accounting principles. As such, management is required to make certain estimates, judgments and assumptions that they believe are reasonable based upon the information available. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of income and expense during the periods presented. The significant accounting policies which management believes are the most critical to aid in fully understanding and evaluating our reported financial results include the following:

Revenue Recognition

Freestone and CTR recognize revenue from the sale of products in accordance with ASC 605. Revenue will be recognized only when all of the following criteria have been met:

- Persuasive evidence of an arrangement exists; and
- Ownership and all risks of loss have been transferred to buyer, which is generally upon delivery; and
- The price is fixed and determinable; and
- Collectability is reasonably assured.

The three main sources of revenue are recognized as follows:

- Revenues associated with tire disposals are recognized upon receipt of the tire by CTR; and

- Revenues associated with tire repairs are invoiced and recognized upon completion of repair and receipt of the tire by the customer; and

- Revenue associated with used tires and scrap sales are recognized upon delivery of the product to the customer.

Stock Based Compensation

Pursuant to Accounting Standards Codification ("ASC") 505-50, the guidelines for recording stock issued for services require the fair value of the shares granted be based on the fair value of the services received or the publicly traded share price of the Company's registered shares on the date the shares were granted (irrespective of the fact that the shares granted were unregistered), whichever is more readily determinable. This position has been further clarified by the issuance of ASC 820. ASC 820 defines fair value as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date". Accordingly, the Company elected the application of these guidelines. Freestone has determined that the fair value of all common stock issued for goods or services is more readily determinable based on the publicly traded share price on the date of grant.

Results of Operations for the Year ended June 30, 2018 Compared to the Year ended June 30, 2017

Revenue

Revenues for the years ended June 30, 2018 and 2017 were $1,163,860 and $1,079,846, respectively. An increase of 7.8% due primarily to the increase in tipping fees.

Cost of Goods and Gross Profit

Cost of Goods sold for the years ended June 30, 2018 was $904,807 compared to $839,007 in the prior year. The 7.8% increase was consistent with the Company's increase in sales. The Company's gross margin remained steady at 22.3%.

Operating Expense

Total operating expenses for the years ended June 30, 2018 and 2017 were $1,267,235 and $1,557,977, respectively. A decrease of 18.7% due to the Company's implementation of cost savings measures. The primary area of decrease were selling of $64,600 and general and administration of $207,923. The selling decreases were due to cuts in compensation at CTR while the general and administration decrease was primarily a reduction of loan administration costs.

Other Income and Expenses

Other income and expense for the year ended June 30, 2018 and the year ended June 30, 2017 consisted of interest expense of $219,944 and $165,312 respectively. The increase is reflective of the Company increase in debt used to finance the Company losses.

Net (Loss) Income

Net loss for and the year ended June 30, 2018 was $1,138,132 compared to a net loss for the year ended June 30, 2017 of $1,386,947. The decrease was primarily a result of the Company's decrease in operating cost detailed above.

Liquidity and Capital Resources

The Company has little cash reserves and liquidity to the extent we receive it from operations and through the sale of common stock.

Cash decreased from $4,109 at June 30, 2017 to $2,966 at June 30, 2018.

Net cash used by operating activities was $786,056 for the year ended June 30, 2018. The difference between the Company’s net loss and cash used is the none cash expenses of depreciation and stock compensation and an increase in accrued liabilities from the deferral of officer’s payroll.

The cash provided by financing activities totaled $780,613 funded by $270,058 of cash contributed by the non-controller member to FDEP and $974,816 increase in borrowings from stockholders offset by $464,261 of payments on term loans.

Employees

As of June 30, 2018, CTR had 16 full-time employees including 1 leased to FDEP. Freestone’s only employees are its three officers.

Need for Additional Financing

The Company is uncertain of its ability to generate sufficient liquidity from its operations so the need for additional funding may be necessary. The Company may sell stock and/or issue additional debt to raise capital to accelerate our growth.

Going Concern Uncertainties

The accompanying consolidated financial statements are presented on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. As of the date of this annual report, there is substantial doubt regarding the Company’s ability to continue as a going concern as we have not generated sufficient cash flows to fund our business operations and loan commitments. Our future success and viability, therefore, are dependent upon our ability to generate capital financing. The failure to generate sufficient revenues or raise additional capital may have a material and adverse effect upon the Company and our shareholders.

The Company formed FDEP in order to vertically integrate its Petrozene™ product line, and utilize a specialized pyrolysis process in order to produce other byproducts of value that will generate revenue for FDEP. In turn, the ability of FDEP to process large quantities of OTR tires will allow the Company to increase the amount of OTR tires it can dispose of and process, which will generate additional revenue of the Company. Additionally, the Company intends to raise equity or debt financing that will allow the Company to expand its current operations.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk represents the risk of loss arising from adverse changes in market rates and foreign exchange rates. The amount of our outstanding debt at any time may fluctuate and we may from time to time be subject to refinancing risk. A hypothetical 100 basis point increase in interest rates would have a material effect on our annual interest expense and on our results of operations or financial condition as we rely on these notes to sustain our operations. Since we do not have transactions in foreign currencies, we do not consider it necessary to hedge against currency risk.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The consolidated financial statements of Freestone Resources, Inc. and Subsidiaries, together with the Report of Independent Registered Public Accounting Firm Pinnacle Accountancy Group of Utah for the year ended June 30, 2018 and 2017, appear on pages 20 through 38 of this report.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) as of June 30, 2018. This evaluation was accomplished under the supervision and with the participation of our chief executive officer / principal executive officer, and chief financial officer / principal financial officer who concluded that our disclosure controls and procedures are not effective to ensure that all material information required to be filed in the annual report on Form 10-K has been made known to them.

1,155,514

999,968

Labor

306,862

286,144

900,564

820,751

Occupancy

83,199

74,201

242,482

217,147

Other operating costs

162,312

166,045

476,606

473,390

General and administrative expenses

99,182

78,405

238,698

211,171

Depreciation and amortization

41,546

37,434

121,906

108,296

Pre-opening costs

2,792

4,490

9,764

13,044

Loss on disposal and impairment of assets

6,747

16,637

10,013

22,040

Total operating expenses

1,097,207

1,027,256

3,155,547

2,865,807

Income from operations

30,867

9,726

210,765

4,017

Interest and other income, net

1,275

672

3,512

3,584

Income before income taxes

32,142

10,398

214,277

7,601

Provision for income taxes

(12,532)

(2,599)

(81,817)

(638)

Net income

$

19,610

$

7,799

$

132,460

$

6,963

Earnings per share:

Basic

$

0.69

$

0.27

$

4.63

$

0.24

Diluted

$

0.69

$

0.27

$

4.62

$

0.23

Weighted average common shares outstanding:

Basic

28,415

29,063

28,604

29,387

Diluted

28,439

29,171

28,696

29,792

Condensed Consolidated Statement of Comprehensive Income

(unaudited)

(in thousands)

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Net income	$ 19,610	$ 7,799	$ 132,460	$ 6,963
Other comprehensive income (loss), net of income taxes:				
Foreign currency translation adjustments	1,778	(203)	4,589	961
Unrealized gain (loss) on available-for-sale securities	272	(882)	(99)	3,051
Tax benefit (expense)	(104)	346	27	(1,185)
Other comprehensive income (loss), net of income taxes	1,946	(739)	4,517	2,827
Comprehensive income	$ 21,556	$ 7,060	$ 136,977	$ 9,790

See accompanying notes to condensed consolidated financial statements.

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Chipotle Mexican Grill, Inc.

Condensed Consolidated Statement of Cash Flows

(unaudited)

(in thousands)

	Nine months ended September 30, 2017		2016	
Operating activities				
Net income	$	132,460	$	6,963
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization		121,906		108,296
Deferred income tax (benefit) provision		(11,323)		380
Loss on disposal and impairment of assets		10,013		22,040
Bad debt allowance		181		99
Stock-based compensation expense		54,596		48,389
Excess tax benefit on stock-based compensation		-		(1,888)
Other		(126)		(224)
Changes in operating assets and liabilities:				
Accounts receivable		16,477		16,084
Inventory		(7,023)		(3,442)
Prepaid expenses and other current assets		(4,890)		(5,362)
Other assets		(1,382)		1,509
Accounts payable		14,771		(11,938)
Accrued liabilities		35,514		36,245
Income tax payable/receivable		(7,810)		36,026
Deferred rent		22,410		27,319
Other long-term liabilities		3,060		576
Net cash provided by operating activities		378,834		281,072
Investing activities				
Purchases of leasehold improvements, property and equipment		(165,506)		(192,252)
Purchases of investments		(120,084)		-
Maturities of investments		140,000		45,000
Proceeds from sale of investments		-		540,648
Net cash provided by (used in) investing activities		(145,590)		393,396
Financing activities				
Acquisition of treasury stock		(209,585)		(771,354)
Excess tax benefit on stock-based compensation		-		1,888

Stock plan transactions and other financing activities		10		23
Net cash used in financing activities		(209,575)		(769,443)
Effect of exchange rate changes on cash and cash equivalents		1,931		1,098
Net change in cash and cash equivalents		25,600		(93,877)
Cash and cash equivalents at beginning of period		87,880		248,005
Cash and cash equivalents at end of period	$	113,480	$	154,128

See accompanying notes to condensed consolidated financial statements.

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Chipotle Mexican Grill, Inc.

Notes to Condensed Consolidated Financial Statements

(unaudited)

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

1. Basis of Presentation

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

We develop and operate restaurants that serve a focused menu of burritos, tacos, burrito bowls, and salads, made using fresh, high-quality ingredients. As of September 30, 2017, we operated 2,330 Chipotle restaurants throughout the United States as well as 36 international Chipotle restaurants and 8 non-Chipotle restaurants. We managed our operations based on 11 regions during the third quarter of 2017 and have aggregated our operations to one reportable segment.

We have prepared the accompanying unaudited condensed consolidated financial statements in accordance with U.S. generally accepted accounting principles for interim financial statements and pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments consisting of normal recurring adjustments necessary for a fair presentation of our financial position and results of operations. Interim results of operations are not necessarily indicative of the results that may be achieved for the full year. The financial statements and related notes do not include all information and footnotes required by U.S. generally accepted accounting principles for annual reports. This quarterly report should be read in conjunction with the consolidated financial statements included in our annual report on Form 10-K for the year ended December 31, 2016.

2. Recent Accounting Standards

Recently Issued Accounting Standards

In February 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2016-02, “Leases (Topic 842).” The pronouncement requires lessees to recognize a liability for lease obligations, which represent the discounted obligation to make future minimum lease payments, and a corresponding right-of-use asset on the balance sheet. The guidance requires disclosure of key information about leasing arrangements which are intended to give financial statement users the ability to assess the amount, timing, and potential uncertainty of cash flows related to leases. We expect to adopt the requirements of the new lease standard effective January 1, 2019, using a modified retrospective adoption method. We are currently evaluating the provisions of the new lease standard, including optional practical expedients, and assessing our existing lease portfolio in order to determine the impact to our accounting systems, processes and internal control over financial reporting. The adoption of ASU 2016-02 will have a significant impact on our consolidated balance sheet because we will record material assets and obligations for current operating leases. We are still assessing the expected impact on our consolidated statements of income and cash flows.

In May 2014, the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers (Topic 606),” as amended by multiple standards updates. This guidance requires an entity to recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Additionally, this guidance will require us to enhance our disclosures, including disclosing performance obligations to customers arising from gift cards and certain promotional activity. The pronouncement is effective for reporting periods beginning after December 15, 2017. The adoption is not expected to have an impact on our consolidated financial position or results of operations.

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

Recently Adopted Accounting Standards

In March 2016, the FASB issued ASU 2016-09, “Compensation-Stock Compensation (Topic 718).” The pronouncement was issued to simplify several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities and classification on the condensed consolidated statement of cash flows.

We adopted ASU 2016-09 on January 1, 2017, prospectively (prior periods have not been restated). The primary impact of adoption was the recognition during the three months ended September 30, 2017, of a $77 tax deficiency, which increases our provision for income taxes and for the nine months ended September 30, 2017, an excess tax benefit of $587, which reduces our provision for income taxes and the classification of these excess tax benefits in operating activities in the condensed consolidated statement of cash flows instead of financing activities.

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The presentation requirements for cash flows related to employee taxes paid for withheld shares had no impact to any of the periods presented in the condensed consolidated statement of cash flows, since such cash flows have historically been presented in financing activities. We also elected to continue estimating forfeitures when determining the amount of stock-based compensation costs to be recognized in each period. No other provisions of ASU 2016-09 had a material impact on our financial statements or disclosures.

3. Fair Value of Financial Instruments

The carrying value of our cash and cash equivalents, accounts receivable and accounts payable approximate fair value because of their short-term nature. Investments are carried at fair value and are classified as available-for-sale. Investments consist of U.S. treasury notes with maturities up to approximately one year. Fair value of investments is measured using Level 1 inputs (quoted prices for identical assets in active markets).

The following is a summary of available-for-sale securities:

	September 30, 2017	December 31, 2016
Amortized cost	$ 435,193	$ 455,109
Unrealized gains (losses)	(316)	(218)
Fair market value	$ 434,877	$ 454,891

The following is a summary of unrealized gains (losses) on available-for-sale securities recorded in other comprehensive income (loss) in the condensed consolidated statement of comprehensive income:

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Unrealized gains (losses) on available-for-sale securities	$ 272	$ (882)	$ (99)	$ 3,051
Unrealized gains (losses) on available-for-sale securities, net of tax	$ 168	$ (536)	$ (72)	$ 1,866

Realized gains and losses on available-for-sale securities are recorded in interest and other income, net on the condensed consolidated statement of income. We had no realized gains or losses for the three and nine months ended September 30, 2017, and we had $0 and $547 of realized gains on available-for-sale securities for the three and nine months ended September 30, 2016.

We also maintain a rabbi trust to fund obligations under a deferred compensation plan. Amounts in the rabbi trust are invested in mutual funds, which are designated as trading securities and carried at fair value, and are included in other assets in the condensed consolidated balance sheet. Fair value of mutual funds is measured using Level 1 inputs. The fair value of the investments in the rabbi trust was $19,157 and $17,843 as of September 30, 2017, and December 31, 2016, respectively. We record trading gains and losses in general and administrative expenses in the condensed consolidated statement of income, along with the offsetting amount related to the increase or decrease in deferred compensation to reflect our exposure to liabilities for payment under the deferred plan.

The following table sets forth unrealized gains (losses) on trading securities held in the rabbi trust:

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Unrealized gains (losses) on trading securities held in rabbi trust	$ 335	$ 391	$ 1,157	$ 677

4. Impairment of Long-Lived Assets

During the three and nine months ended September 30, 2017, we recognized non-cash impairment charges of $2,427 and $4,441 ($1,475 and $2,699 net of tax, respectively), representing substantially all of the value of the long-lived assets of a small number of underperforming Chipotle restaurants, in loss on disposal and impairment of assets on the condensed consolidated statement of income ($0.05 and $0.09 per basic and diluted earnings per share). The fair value of the impaired restaurants was determined using Level 3 inputs (unobservable inputs) based on a discounted cash flow method.

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5. Shareholders' Equity

Through September 30, 2017, we had announced authorizations by our Board of Directors of repurchases of shares of common stock, which in the aggregate authorized expenditures of up to $2.3 billion. On October 24, 2017, we announced that our Board of Directors authorized the expenditure of an additional $100,000 to repurchase shares of common stock. Under the remaining repurchase authorizations, shares may be purchased from time to time in open market transactions, subject to market conditions.

During the nine months ended September 30, 2017, we repurchased 545 shares of common stock under authorized programs, for a total cost of $207,159. The cumulative shares repurchased under authorized programs as of September 30, 2017, were 7,408 for a total cost of $2,204,968. As of September 30, 2017, $95,425 was available to repurchase shares under the announced repurchase authorizations. Shares repurchased are being held in treasury stock until such time as they are reissued or retired at the discretion of the Board of Directors.

6. Stock-based Compensation

During the nine months ended September 30, 2017, we granted stock only stock appreciation rights ("SOSARs") on 304 shares of our common stock to eligible employees. The weighted average grant date fair value of the SOSARs was $105.97 per share with a weighted average exercise price of $426.70 per share based on the closing price of common stock on the date of grant. The SOSARs vest in two equal installments on the second and third anniversary of the grant date. During the nine months ended September 30, 2017, 32 SOSARs were exercised and 124 SOSARs were forfeited.

During the nine months ended September 30, 2017, we granted restricted stock units ("RSUs") on 89 shares of our common stock to eligible employees. The weighted average grant date fair value of the RSUs was $427.30 per share. The RSUs generally vest in two equal installments on the second and third anniversary of the grant date.

During the first quarter of 2017, we awarded 36 performance shares ("PSUs") that are subject to service, market and performance vesting conditions. Two-thirds of the PSUs had a grant date fair value of $485.53 per share and vest based on the price of our common stock reaching certain targets for a consecutive number of days during the three-year period starting on the grant date and the quantity of shares that will vest range from 0% to 350% of the targeted number of shares. The remaining one-third of PSUs had a grant date fair value of $427.61 and vest based on reaching certain comparable restaurant sales increases during the three-year period starting on January 1, 2017, and the quantity of shares that will vest range from 0% to 300% of the targeted number of shares. If the defined minimum targets are not met, then no shares will vest.

During the nine months ended September 30, 2017, 20 stock awards that were subject to service and performance or market conditions were forfeited.

The following table sets forth total stock based compensation expense:

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Stock based compensation expense	$ 18,069	$ 18,636	$ 55,545	$ 49,357
Stock based compensation expense, net of tax	$ 10,983	$ 10,971	$ 33,760	$ 29,056
Stock based compensation expense recognized as capitalized development	$ 319	$ 285	$ 949	$ 968
Excess tax benefit (deficiency) on stock based compensation recognized in provision for income taxes	$ (77)	$ -	$ 587	$ -

7. 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 (“diluted EPS”) 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 common shares related to SOSARs and non-vested stock awards (collectively “stock awards”). Diluted EPS considers the impact of potentially dilutive securities except in periods in which there is a loss because the inclusion of the potential common shares would have an antidilutive effect. Stock awards are excluded from the calculation of diluted EPS in the event they are subject to performance conditions or are antidilutive.

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

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Stock awards subject to performance conditions	245	226	244	276
Stock awards that were antidilutive	1,738	1,356	1,567	1,312
Total stock awards excluded from diluted earnings per share	1,983	1,582	1,811	1,588

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

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Net income	$ 19,610	$ 7,799	$ 132,460	$ 6,963
Shares:				
Weighted average number of common shares outstanding	28,415	29,063	28,604	29,387
Dilutive stock awards	24	108	92	405
Diluted weighted average number of common shares outstanding	28,439	29,171	28,696	29,792
Basic earnings per share	$ 0.69	$ 0.27	$ 4.63	$ 0.24
Diluted earnings per share	$ 0.69	$ 0.27	$ 4.62	$ 0.23

8. Commitments and Contingencies

Data Security Incident

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

During the three months ended September 30, 2017, we recorded an expense of $30,000 ($18,234 after tax), or $0.64 per basic and diluted earnings per share, as an estimate of potential liabilities associated with anticipated claims and assessments by payment card networks in connection with the data security incident. We may ultimately be subject to liabilities greater than or less than the amount accrued. The expense is recorded in general and administrative expenses in our condensed consolidated statement of income and a corresponding liability in accrued liabilities on our condensed consolidated balance sheet.

Litigation Arising from Security Incident

On May 4, 2017, Bellwether Community Credit Union filed a purported class action complaint in the United States District Court for the District of Colorado alleging that we negligently failed to provide adequate security to protect the payment card information of customers of the plaintiffs and those of other similarly situated credit unions, banks and other financial institutions alleged to be part of the putative class, causing those institutions to suffer financial losses. The complaint also claims we were negligent per se based on alleged violations of Section 5 of the Federal Trade Commission Act and similar state laws. The plaintiff seeks monetary damages, injunctive relief and attorneys' fees. On May 26, 2017, Alcoa Community Credit Union filed a purported class action complaint in the U. S. District Court for the District of Colorado making substantially the same allegations as the Bellwether complaint and seeking substantially the same relief. The Bellwether and Alcoa cases have been consolidated and will proceed as a single action.

On June 9, 2017, Todd Gordon filed a purported class action complaint in the U. S. District Court for the District of Colorado alleging that we negligently failed to provide adequate security to protect the payment card information of the plaintiff and other similarly situated customers alleged to be part of the putative class, causing such customers to suffer financial losses. The complaint also claims we were negligent per se based on alleged violations of Section 5 of the Federal Trade Commission Act and similar state laws, and also alleges breach of contract, unjust enrichment, and violations of the Arizona Consumer Fraud Act. Additionally, on August 21, 2017, Greg Lawson and Judy Conard filed a purported class action complaint in the U. S. District Court for the District of Colorado making allegations substantially similar to those in the Gordon complaint, and stating substantially similar claims as well as claims under the Colorado Consumer Protection Act. The plaintiffs in the Gordon case and the Lawson and Conard case have notified the court of their agreement to consolidate their cases and file an amended consolidated complaint for the consolidated matter.

We intend to vigorously defend each of the aforementioned cases, but it is not possible at this time to reasonably estimate the outcome of or any potential liability from these cases. Although certain fees and costs associated with the data security incident and the aforementioned litigation to date have been paid or reimbursed by our cyber liability insurer, the ultimate amount of liabilities arising from the litigation may be in excess of the limits of our applicable insurance coverage.

Receipt of Grand Jury Subpoenas

On January 28, 2016, we were served with a Federal Grand Jury Subpoena from the U.S. District Court for the Central District of California in connection with an official criminal investigation being conducted by the U.S. Attorney’s Office for the Central District of California, in conjunction with the U.S. Food and Drug Administration’s Office of Criminal Investigations. The subpoena requires the production of documents and information related to company-wide food safety matters dating back to January 1, 2013. We received a follow-up subpoena on July 19, 2017 requesting information related to illness incidents associated with a single Chipotle restaurant in Sterling, Virginia. We intend to continue to fully cooperate in the investigation. It is not possible at this time to determine whether we will incur, or to reasonably estimate the amount of, any fines or penalties in connection with the investigation pursuant to which the subpoena was issued.

Shareholder Derivative Actions

On April 6, 2016, Uri Skorski filed a shareholder derivative action in Colorado state court in Denver, Colorado, alleging that our Board of Directors and officers breached their fiduciary duties in connection with our alleged failure to disclose material information about our food safety policies and procedures, and also alleging that our Board of Directors and officers breached their fiduciary duties in connection with allegedly excessive compensation awarded from 2011 to 2015 under our stock incentive plan. On April 14, 2016, Mark Arnold and Zachary Arata filed a shareholder derivative action in Colorado state court in Denver, Colorado, making largely the same allegations as the Skorski complaint. On May 26, 2016, the court issued an order consolidating the Skorski and Arnold/Arata actions into a single case. On August 8, 2016, Sean Gubricky filed a shareholder derivative action in the U.S. District Court for the District of Colorado, alleging that our Board of Directors and certain officers failed to institute proper food safety controls and policies, issued materially false and misleading statements in violation of federal securities laws, and otherwise breached their fiduciary duties to us. On September 1, 2016, Ross Weintraub filed a shareholder derivative action in Colorado state court in Denver, Colorado, making largely the same allegations as the Gubricky complaint. On March 27, 2017, the Weintraub case was consolidated with the Skorski and Arnold/Arata action into a single case. On December 27, 2016, Cyrus Lashkari filed a shareholder derivative action in the U.S. District Court for the District of Colorado, making largely the same allegations as the foregoing shareholder derivative complaints. Each of these actions purports to state a claim for damages on our behalf, and is based on statements in our SEC filings and related public disclosures, as well as media reports and company records. We have reached an agreement to settle the foregoing actions, and the proposed settlement has been preliminarily approved by the U.S. District Court for the District of Colorado.

On July 28, 2017, Mark Blau filed a shareholder derivative action in the U.S. District Court for the District of Colorado, making allegations similar to those of the several shareholder derivative actions described above, and adding further allegations related to the Board's investigation of the foregoing matters, as well as customer illnesses and operational issues associated with two Chipotle restaurants in July 2017. The action purports to state claims for damages on our behalf, and is based on statements in our SEC filings and related public disclosures, as well as media reports and company records. We intend to defend this case vigorously, but it is not possible at this time to reasonably estimate the outcome of or any potential liability from the case.

Shareholder Class Actions

On January 8, 2016, Susie Ong filed a complaint in the U.S. District Court for the Southern District of New York on behalf of a purported class of purchasers of shares of our common stock between February 4, 2015 and January 5, 2016. The complaint purports to state claims against us, each of the co-Chief Executive Officers serving during the claimed class period and the Chief Financial Officer under Sections 10(b) and 20(a) of the Exchange Act and related rules, based on our alleged failure during the claimed class period to disclose material information about our quality controls and safeguards in relation to consumer and employee health. The complaint asserts that those failures and related public statements were false and misleading and that, as a result, the market price of our stock was artificially inflated during the claimed class period. The complaint seeks damages on behalf of the purported class in an unspecified amount, interest, and an award of reasonable attorneys' fees, expert fees and other costs. On March 8, 2017, the court granted our motion to dismiss the complaint, with leave to amend. The plaintiff filed an amended complaint on April 7, 2017. Additionally, on July 20, 2017, Elizabeth Kelly filed a complaint in the U.S. District Court for the District of Colorado on behalf of a purported class of purchasers of shares of our common stock between February 5, 2016 and July 19, 2017,

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with claims and factual allegations similar to the Ong complaint, based primarily on media reports regarding illnesses associated with a Chipotle restaurant in Sterling, Virginia. We intend to defend these cases vigorously, but it is not possible at this time to reasonably estimate the outcome of or any potential liability from the cases.

Miscellaneous

We are involved in various other claims and legal actions that arise in the ordinary course of business. We do not believe that the ultimate resolution of these actions will have a material adverse effect on our financial position, results of operations, liquidity or capital resources. However, a significant increase in the number of these claims, or one or more successful claims under which we incur greater liabilities than we currently anticipate, could materially and adversely affect our business, financial condition, results of operations and cash flows.

ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Cautionary Note Regarding Forward-Looking Statements

Certain statements in this report, including projections of our expected comparable restaurant sales increases for 2017, projected new restaurant openings for 2017 and 2018, discussion of the potential impacts of our roll-out of queso and of menu price increases, projections of expected changes in food, beverage and packaging costs and marketing and promotional spend, estimates of our effective tax rates, and discussion of liabilities associated with the recent data security incident, 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”, “ 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, 2016, as updated in Part II, Item 1A. of this report.

Overview

Steve Ells, our founder, Chairman and CEO, started Chipotle with the idea that food served fast did not have to be a typical fast food experience. Today, Chipotle continues to offer a focused menu of burritos, tacos, burrito bowls, and salads made from fresh, high-quality raw ingredients, prepared using classic cooking methods and served in an interactive style allowing our customers to get what they want. Chipotle seeks out extraordinary ingredients that are not only fresh, but that are raised responsibly, with respect for the animals, land, and people who produce them. Chipotle prepares its food using real, whole ingredients and without the use of added colors, flavors or other additives typically found in fast food.

Throughout our history as a public company, we have pursued a mission to change the way people think about and eat fast food. We have expanded our mission to: Ensure that better food, prepared from whole, unprocessed ingredients is accessible to everyone. Additionally, our focus during 2017 is to return to sales and profitability growth and restore our restaurant economic model. To do so, we have a renewed focus on ensuring that every guest in every one of our restaurants is provided with an excellent customer experience.

2017 Highlights

Sales Trends. Comparable restaurant sales increases were 1.0% and 8.3% for the three and nine months ended September 30, 2017, respectively. Our sales comparisons for the first nine months of 2017 were lapping an easier comparison due to lower sales levels in the first six months of 2016. Additionally, sales comparisons for the three and nine months ended September 30, 2017, benefitted from lower revenue in the comparable periods of 2016 due to revenue deferrals for outstanding rewards under our limited-time Chiptopia Summer Rewards program (though the first quarter 2017 also benefitted from the recognition of a portion of the deferred revenue). During the third quarter of 2017, increases in comparable restaurant sales were offset by adverse company-wide sales impacts resulting from news regarding a norovirus incident in Sterling, Virginia, and to a lesser extent due to restaurant closures and lower customer traffic resulting from Hurricanes Harvey and Irma. We expect full year 2017 comparable restaurant sales increases to be around 6.5% including impacts from a menu price increase planned for the fourth quarter of 2017 and the roll-out of queso. Comparable restaurant sales represent the change in period-over-period sales for restaurants beginning in their 13th full calendar month of operation. Average restaurant sales were $1.948 million as of September 30, 2017, increasing from $1.914 million as of September 30, 2016, but a decrease from $1.957 million as of June 30, 2017. We define average restaurant sales as the average trailing 12-month sales for restaurants in operation for at least 12 full calendar months.

Restaurant Operating Costs. Our restaurant operating costs (food, beverage and packaging; labor; occupancy; and other operating costs) as a percentage of revenue decreased to 82.4% in the first nine months of 2017, as compared to 87.5% in the first nine months of 2016. The decrease was primarily due to lower marketing and promotional spend, sales leverage, labor efficiencies, and lower food costs. Food costs were lower in the first nine months of 2017 despite significantly higher pricing of avocados during the third quarter of 2017.

Restaurant Development. As of September 30, 2017, we had 2,374 restaurants in operation, including 2,330 Chipotle restaurants throughout the United States, 36 international Chipotle restaurants and 8 non-Chipotle restaurants. We opened 145 restaurants and we closed or relocated 21 restaurants during the nine months ended September 30, 2017, including the closure of all 15 ShopHouse Southeast Asian Kitchen restaurants. We expect new restaurant openings for the full year 2017 to be slightly below the low end of our previously-disclosed range of 195 to 210. For 2018, we expect new restaurant openings in a range of approximately 130 to 150, as we focus our resources for the next 12 to 18 months on improving our operations and delivering an outstanding experience to every one of our guests.

Data Security Incident. As previously reported, in April 2017, our information security team detected unauthorized activity on the network that supports payment processing for our restaurants, and immediately began an investigation with the help of leading computer security firms. The investigation detected malware designed to access payment card data from cards used at point-of-sale devices at most Chipotle restaurants.

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The malware searched for track data, which may include cardholder name, card number, expiration date, and internal verification codes; however, no other customer information was affected. We have removed the malware from our systems and continue to evaluate ways to enhance our security measures.

During the three months ended September 30, 2017, we recorded a liability of $30.0 million ($18.2 million after tax) or $0.64 per basic and diluted earnings per share, as an estimate of potential losses associated with anticipated claims and assessments by payment card networks. We may ultimately be subject to liabilities greater or less than the amount accrued. In addition, legal claims have been made against us related to this matter, and are further discussed in Note 8. “Commitments and Contingencies” within Item 1. “Financial Statements.”

Restaurant Activity

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

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Beginning of period	2,339	2,124	2,250	2,010
Openings	38	55	145	171
Relocations/closures	(3)	(1)	(6)	(3)
ShopHouse closures	-	-	(15)	-
Total restaurants at end of period	2,374	2,178	2,374	2,178

Results of Operations

Our results of operations as a percentage of revenue and period-over-period changes are discussed in the following section. As our business grows and we open more restaurants and hire more employees, our aggregate restaurant operating costs and depreciation and amortization generally increase.

Revenue

	Three months ended September 30,		% increase	Nine months ended September 30,		% increase
	2017	2016		2017	2016	
	(dollars in millions)			(dollars in millions)		
Revenue	$ 1,128.1	$ 1,037.0	8.8%	$ 3,366.3	$ 2,869.8	17.3%
Average restaurant sales	$ 1.948	$ 1.914	1.8%	$ 1.948	$ 1.914	1.8%
Comparable restaurant sales increases (decreases)	1.0%	(21.9%)		8.3%	(24.9%)	
Number of restaurants as of the end of the period	2,374	2,178	9.0%	2,374	2,178	9.0%
Number of restaurants opened in the period	38	55		145	171	

The most significant factor contributing to the increase in revenue for the three months ended September 30, 2017, was $84.9 million in revenue from restaurants not yet in the comparable base, of which $46.1 million was attributable to restaurants opened in 2017. Comparable restaurant sales increased $6.2 million. For the nine months ended September 30, 2017, revenue from restaurants not yet in the comparable restaurant base contributed $268.0 million to the revenue increase, of which $91.3 million was attributable to restaurants opened in 2017, and comparable restaurant sales increased $228.4 million. For the nine months ended September 30, 2017, the increase in comparable restaurant sales was attributable to an increase in the number of paid transactions and an increase in paid average check due to fewer promotions during the first nine months of 2017.

Food, Beverage and Packaging Costs

	Three months ended September 30,		%	Nine months ended September 30,		
	2017	2016	increase	2017	2016	% increase
	(dollars in millions)			(dollars in millions)		
Food, beverage and packaging	$ 394.6	$ 363.9	8.4%	$ 1,155.5	$ 1,000.0	15.6%
As a percentage of revenue	35.0%	35.1%		34.3%	34.8%	

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Food, beverage and packaging costs remained consistent as a percentage of revenue for the three months ended September 30, 2017. The benefit of the menu price increases taken in select restaurants during the second quarter of 2017 and decreased paper cost and usage were offset by higher avocado and beef prices, as well as steak making up a higher portion of our product mix compared to the third quarter of 2016. The decrease in food, beverage and packing costs as a percentage of revenue for the nine months ended September 30, 2017, was due primarily bringing the preparation of lettuce and bell peppers back into our restaurants after using pre-cut produce during portions of 2016, reduced testing and waste costs, and the benefit of the menu price increase that went into effect during the second quarter of 2017. The decrease was partially offset by higher avocado prices. Lower projected avocado prices are expected to drive decreased food costs as a percentage of revenue during the fourth quarter of 2017, and we expect food costs for the full year to be consistent with the first nine months of 2017.

Labor Costs

	Three months ended September 30,		%	Nine months ended September 30,		
	2017	2016	increase	2017	2016	% increase
	(dollars in millions)			(dollars in millions)		
Labor costs	$ 306.9	$ 286.1	7.2%	$ 900.6	$ 820.8	9.7%
As a percentage of revenue	27.2%	27.6%		26.8%	28.6%	

Labor costs as a percentage of revenue decreased for the three months ended September 30, 2017, primarily due to labor efficiencies resulting from more efficient crew deployment and fewer managers in each of our restaurants, partially offset by wage inflation. Labor costs as a percentage of revenue decreased for the nine months ended September 30, 2017 due to labor efficiencies from more efficient crew deployment and fewer managers in each of our restaurants, as well as sales leverage, partially offset by wage inflation. Labor efficiencies in the three and nine months ended September 30, 2017 benefitted from abnormally high labor expenses in the comparable 2016 periods as a result of being fully staffed during the heavy sales promotional activity we were conducting during those periods.

Occupancy Costs

	Three months ended September 30,		%	Nine months ended September 30,		
	2017	2016	increase	2017	2016	% increase
	(dollars in millions)			(dollars in millions)		
Occupancy costs	$ 83.2	$ 74.2	12.1%	$ 242.5	$ 217.1	11.7%
As a percentage of revenue	7.4%	7.2%		7.2%	7.6%	

Occupancy costs as a percentage of revenue increased for the three months ended September 30, 2017, primarily due to lower average daily restaurant sales due to new restaurants opening at lower sales volumes than restaurants in the comparable base, and those sales volumes being applied across a partially fixed-cost base. Occupancy costs as a percentage of revenue decreased for the nine months ended September 30, 2017, primarily due to sales leverage on a partially fixed-cost base.

Other Operating Costs

	Three months ended September 30,		%	Nine months ended September 30,		
	2017	2016	decrease	2017	2016	% increase
	(dollars in millions)			(dollars in millions)		
Other operating costs	$ 162.3	$ 166.0	(2.2%)	$ 476.6	$ 473.4	0.7%
As a percentage of revenue	14.4%	16.0%		14.2%	16.5%	

Other operating costs include, among other items, marketing and promotional costs, bank and credit card fees, and restaurant utilities and maintenance costs. Other operating costs as a percentage of revenue decreased for the three and nine months ended September 30, 2017 due primarily to decreased marketing and promotional spend, and decreased kitchen supplies expense. While marketing and promotional spend decreased to 3.4% of revenue for the first nine months of 2017, as compared to 5.2% for the first nine months of 2016, it remains above historical levels as we continue our efforts to drive customer traffic. We expect to increase marketing and advertising expenses in the fourth quarter of 2017 as we continue national television advertising, and as a result, we expect full year 2017 other operating costs as a percentage of revenue to be higher in the fourth quarter and the full year 2017 than they were in the first nine months of 2017, but lower than the full year 2016.

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General and Administrative Expenses

	Three months ended September 30,		%	Nine months ended September 30,		
	2017	2016	increase	2017	2016	% increase
	(dollars in millions)			(dollars in millions)		
General and administrative expense	$ 99.2	$ 78.4	26.5%	$ 238.7	$ 211.2	13.0%
As a percentage of revenue	8.8%	7.6%		7.1%	7.4%	

General and administrative expense increased during the three and nine months ended September 30, 2017, due to recording a liability of $30.0 million, as an estimate of potential losses associated with anticipated claims and assessments by payment card networks, for the data security incident that occurred in the first six months of 2017. For the three months ended September 30, 2017, the increase was partially offset by a decrease in meeting costs because of the bi-annual All Managers Conference held in September 2016. Additionally, for the nine months ended September 30, 2017, higher non-cash stock-based compensation expense and increased bonus costs were more than offset by lower meeting and legal costs. The increase in stock-based compensation expense during 2017 was primarily a result of a cumulative reduction of expense in the first quarter of 2016 for performance share awards that were no longer expected to vest.

Depreciation and Amortization

	Three months ended September 30,		%	Nine months ended September 30,		
	2017	2016	increase	2017	2016	% increase
	(dollars in millions)			(dollars in millions)		
Depreciation and amortization	$ 41.5	$ 37.4	11.0%	$ 121.9	$ 108.3	12.6%
As a percentage of revenue	3.7%	3.6%		3.6%	3.8%	

For the three months ended September 30, 2017, depreciation and amortization remained relatively consistent as a percent of revenue. For the nine months ended September 30, 2017, depreciation and amortization decreased as a percentage of revenue due to sales leverage on a partially fixed-cost base.

Loss on Disposal and Impairment of Assets

	Three months ended September 30,		% decrease	Nine months ended September 30,		% decrease
	2017	2016		2017	2016	
	(dollars in millions)			(dollars in millions)		
Loss on disposal and impairment of assets	$ 6.7	$ 16.6	(59.4%)	$ 10.0	$ 22.0	(54.6%)
As a percentage of revenue	0.6%	1.6%		0.3%	0.8%	

Loss on disposal and impairment of assets decreased in dollar terms for the three and nine months ended September 30, 2017 primarily due to a non-cash impairment charge in the third quarter of 2016 to write-down substantially all of the value of the long-lived assets of our ShopHouse restaurants that occurred during the third quarter of 2016. In 2017, we recorded losses related to the closure of a small number of underperforming Chipotle restaurants, the replacement of certain kitchen equipment, and assets that were damaged by natural disasters occurring during the quarter.

Provision for Income Taxes

	Three months ended September 30,		% increase	Nine months ended September 30,		% increase
	2017	2016		2017	2016	
	(dollars in millions)			(dollars in millions)		
Provision for income taxes	$ 12.5	$ 2.6	382.2%	$ 81.8	$ 0.6	n/m*
Effective tax rate	39.0%	25.0%		38.2%	8.4%	

*Not meaningful

For the full year 2017, we estimate our effective tax rate will be approximately 39.1% compared to 40.8% for the full year 2016. The lower 2017 estimated annual effective tax rate is due to a decrease in the state tax rate. The effective tax rate for the nine months ended September 30, 2017, is lower than the estimated annual rate due to non-recurring adjustments related to state income taxes and excess tax

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deductions for stock compensation. The adoption on January 1, 2017, of ASU 2016-09 will subject our tax rate to quarterly volatility from the effect of stock award exercises and vesting activities.

Seasonality

Seasonal factors cause our profitability to fluctuate from quarter to quarter. Historically, our average daily restaurant sales are lower and net income has generally been lower in the first and fourth quarters due, in part, to the holiday season and because fewer people eat out during periods of inclement weather (the winter months) than during periods of mild or warm weather (the spring, summer and fall months). Other factors also have a seasonal effect on our results. For example, restaurants located near colleges and universities generally do more business during the academic year. Seasonal factors, however, might be moderated or outweighed by other factors that may influence our quarterly results, such as unexpected publicity impacting our business in a positive or negative way, as well as fluctuations in food or packaging costs or the timing of menu price increases. The number of trading days in a quarter can also affect our results, although, on an overall annual basis, changes in trading days do not have a significant impact.

Our quarterly results are also affected by other factors such as the amount and timing of non-cash stock-based compensation expense, the number of new restaurants opened in a quarter, and anticipated and unanticipated events. New restaurants typically have lower margins following opening as a result of the expenses associated with opening new restaurants and their operating inefficiencies in the months immediately following opening. 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. As of September 30, 2017, we had a cash and short-term investment balance of $548.4 million that we expect to utilize, along with cash flow from operations, to provide capital to support the growth of our business (primarily through opening restaurants), to repurchase additional shares of our common stock subject to market conditions, to maintain our existing restaurants and for general corporate purposes. As of September 30, 2017, $95.4 million remained available under previously-announced repurchase authorizations. On October 24, 2017, we announced that our Board of Directors authorized the expenditure of an additional $100 million to repurchase shares of common stock. Under the remaining repurchase authorizations, shares may be purchased from time to time in open market transactions, subject to market conditions. We believe that cash from operations, together with our cash and investment balances, will be enough to meet ongoing capital expenditures, working capital requirements and other cash needs for the foreseeable future.

We haven’t required significant working capital because customers generally pay using cash or credit and debit cards and because our operations do not require significant receivables, nor do they require significant inventories due, in part, to our use of various fresh ingredients. In addition, we generally have the right to pay for the purchase of food, beverage and supplies some time after the receipt of those items, generally within ten days, thereby reducing the need for incremental working capital to support our growth.

Off-Balance Sheet Arrangements

As of September 30, 2017, we had no off-balance sheet arrangements or obligations.

Critical Accounting Estimates

Critical accounting estimates are those that we believe are both significant and that require us to make difficult, subjective or complex judgments, often because we need to estimate the effect of inherently uncertain matters. We base our estimates and judgments on historical experiences and various other factors that we believe to be appropriate under the circumstances. Actual results may differ from these estimates, and we might obtain different estimates if we used different assumptions or factors. We had no significant changes in our critical accounting estimates since our last annual report. Our critical accounting estimates are identified and described in our annual report on Form 10-K for the year ended December 31, 2016.

ITEM 3.QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Commodity Price Risks

We are exposed to commodity price risks. Many of the ingredients we use to prepare our food, our packaging materials, as well as utilities to run our restaurants are commodities or ingredients that are affected by the price of other commodities, exchange rates, foreign demand, weather, seasonality, production, availability and other factors outside our control. We work closely with our suppliers and use a mix of forward pricing protocols under which we agree with our supplier on fixed prices for deliveries at some time in the future, fixed pricing protocols under which we agree on a fixed price with our supplier for the duration of that protocol, 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. However, a majority of the dollar value of goods purchased by us is effectively at spot prices. Generally, our pricing protocols with suppliers can remain in effect for periods ranging from one to 24 months, depending on the outlook for prices of the particular ingredient. In several cases, we have minimum purchase obligations. We have tried to increase, where necessary, the number of suppliers for our ingredients, which we believe can help mitigate pricing volatility. We follow industry news, trade issues, exchange rates, foreign demand, weather, crises and other world events that may affect our ingredient prices. Increases in ingredient prices could adversely affect our results if we choose for competitive or other reasons not to increase menu prices at the same rate at which ingredient costs increase, or if menu price increases result in customer resistance.

Changing Interest Rates

We are also exposed to interest rate risk through fluctuations of interest rates on our investments. Changes in interest rates affect the interest income we earn, and therefore impact our cash flows and results of operations. As of September 30, 2017, we had $475.4 million in investments and interest-bearing cash accounts, including insurance-related restricted trust accounts classified in other assets, and $66.8 million in accounts with an earnings credit we classify as interest income, which combined earned a weighted-average interest rate of 0.87%.

Foreign Currency Exchange Risk

A portion of our operations consists of activities outside of the U.S. and we have currency risk on the transactions in other currencies and translation adjustments resulting from the conversion of our international financial results into the U.S. dollar. However, a substantial majority of our operations and investment activities are transacted in the U.S. and therefore our foreign currency risk is not material at this date.

ITEM 4.CONTROLS AND PROCEDURES

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

As of September 30, 2017, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

There were no changes during the three months ended September 30, 2017, 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

For information regarding legal proceedings, see Note 8. “Commitments and Contingencies” in our notes to the condensed consolidated financial statements included in Item 1. “Financial Statements”.

ITEM 1A.RISK FACTORS

There have been no material changes in our risk factors since our annual report on Form 10-K for the year ended December 31, 2016, except as set forth below.

We may be harmed by security risks we face in connection with our electronic processing and transmission of confidential customer and employee information.

We accept electronic payment cards for payment in our restaurants. During 2016 approximately 70% of our sales were attributable to credit and debit card transactions, and credit and debit card usage could continue to increase. A number of retailers have experienced actual or potential security breaches in which credit and debit card information may have been stolen, including a number of highly publicized incidents with well-known retailers in recent years.

In April 2017, our information security team detected unauthorized activity on the network that supports payment processing for our restaurants, and immediately began an investigation with the help of leading computer security firms. We also self-reported the issue to payment card processors and law enforcement. Our investigation detected malware designed to access payment card data from cards used at point-of-sale

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devices at most Chipotle restaurants, primarily in the period from March 24, 2017 through April 18, 2017. We have removed the malware from our systems and continue to evaluate ways to enhance our security measures. However, we expect to be subject to payment card network assessments and may incur regulatory fines or penalties, for which our insurance coverage is limited, and as a result, we recorded a $30 million estimated liability. We may ultimately be subject to liabilities greater than or less than the amount accrued. See Note 8. “Commitments and Contingencies” within Item 1. “Financial Statements,” for further discussion of potential liabilities and pending litigation filed against us in connection with this incident.

We may be subject to additional lawsuits or other proceedings in the future relating to the incident or any future incidents in which payment card data may have been compromised. Proceedings related to theft of credit or debit card information may be brought by payment card providers, banks and credit unions that issue cards, cardholders (either individually or as part of a class action lawsuit), or federal and state regulators. Any such proceedings could distract our management from running our business and cause us to incur significant unplanned losses and expenses. Consumer perception of our brand could also be negatively affected by these events, which could further adversely affect our results and prospects.

We are also required to collect and maintain personal information about our employees, and we collect information about customers as part of some of our marketing programs as well. The collection and use of such information is regulated at the federal and state levels, by the European Union and its member states, and the regulatory environment related to information security and privacy is increasingly demanding. At the same time, we are increasingly relying on cloud computing and other technologies that result in third parties holding significant amounts of customer or employee information on our behalf. We have seen an increase over the past several years in the frequency and sophistication of attempts to compromise the security of several of these systems. If the security and information systems that we or our outsourced third party providers use to store or process such information are compromised or if we, or such third parties, otherwise fail to comply with these laws and regulations, we could face litigation and the imposition of penalties that could adversely affect our financial performance. Our reputation as a brand or as an employer could also be adversely affected from these types of security breaches or regulatory violations, which could impair our sales or ability to attract and keep qualified employees.

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

Purchases of Equity Securities by the Issuer

The table below reflects shares of common stock we repurchased during the third quarter of 2017.

		Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs(1)	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs(2)
July		111,385	$ 375.36	111,385	$ 156,117,762
	Purchased 7/1 through 7/31				

August	Purchased 8/1 through 8/31	156,772	$ 322.73	156,772	$ 105,521,981
September	Purchased 9/1 through 9/30	32,405	$ 311.59	32,405	$ 95,424,817
Total		300,562	$ 341.03	300,562	$ 95,424,817

(1) Shares were repurchased pursuant to repurchase programs announced on January 11, 2017 and May 23, 2017.

(2) This column does not include an additional $100 million in authorized repurchases announced on October 24, 2017. Each repurchase program has no expiration date. Authorization of repurchase programs may be modified, suspended or discontinued at any time.

ITEM 3.DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4.MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5.OTHER INFORMATION

None.

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ITEM 6.EXHIBITS

EXHIBIT INDEX

		Description of Exhibit Incorporated Herein by Reference				
Exhibit Number	Exhibit Description	Form	File No.	Filing Date	Exhibit Number	Filed Herewith
3.1	Amended and Restated Certificate of Incorporation of Chipotle Mexican Grill, Inc.	10-Q	001-32731	October 26, 2016	3.1	
3.2	Chipotle Mexican Grill, Inc. Amended and Restated Bylaws	8-K	001-32731	October 6, 2016	3.1	
4.1	Form of Stock Certificate for Shares of Common Stock	10-K	001-32731	February 10, 2012	4.1	
31.1	Certification of Chief Executive Officer of Chipotle Mexican Grill, Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	-	-	-	-	X
31.2	Certification of Chief Financial Officer of Chipotle Mexican Grill, Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	-	-	-	-	X
32.1	Certification of Chief Executive Officer and Chief Financial Officer of Chipotle Mexican Grill, Inc. pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	-	-	-	-	X
101	The following financial statements, formatted in XBRL: (i) Condensed Consolidated Balance Sheet as of September 30, 2017 and December 31, 2016, (ii) Condensed Consolidated Statement of Income for the three and nine months ended September 30, 2017 and 2016, (iii) Condensed Consolidated Statement of Comprehensive Income for the three and nine months ended September 30, 2017 and 2016, (iv) Condensed Consolidated Statement of Cash Flows for the nine months ended September 30, 2017 and 2016; and (v) Notes to the Condensed Consolidated Financial Statements	-	-	-	-	X

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CHIPOTLE MEXICAN GRILL, INC.

By: /S/ JOHN R. HARTUNG

Name: John R. Hartung
Title: Chief Financial Officer (principal financial officer and duly authorized signatory for the registrant)

Date: October 24, 2017