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Chipotle Mexican Grill, Inc. Q3 2007 Earnings Call Transcript

Question-and-Answer Session

Operator

Thank you sir. Today's question-and-answer will be conducted electronically.

[Operator Instructions].

And we will go first to Paul Westra of Cowen And Company.

Paul Westra - Cowen And Company

Hi, thanks. Good afternoon

Jack Hartung - Chief Finance and Development Officer

Hi Paul.

Steve Ells - Founder, Chairman, and Chief Executive Officer

Hi Paul.

Paul Westra - Cowen And Company

Question for each of you individually, Mike if you can just talk a little bit more about I guess some of the human resources efforts, you mentioned management turn over can you give us those numbers and comment little bit more about the restaurant 12 program, what percentage of GM's would you like to eventually get to and a question obvious you would seem to add some I guess responsibility to maybe help other restaurants in the adjacent areas. With the restaurateur we source of field management down the roads, so how much internal churn would you like to ultimately settle down at?

Monty Moran - President and Chief Operating Officer

Yes, great question Paul. Number one, on turnover we have continued to see our turnover fall and its now in the sort of the mid 20% percent range, which is the lowest its been. As an interesting side note on turnover as a doors has been our internally promoted folks, see a lower level of turnover and then externally promoted people but actually that gap is narrowed which is such that are people we hire from the outside you have a turnover in the low 30% range and we see that as a great result because of since we are having to hire less people from outside we are able to really focus more carefully on who we hire. So that's the need. Turnover among our crew has remained in that sort of 100%, about 106% grown. In terms of restaurateurs becoming more taking on more field management, yes it is our goal to try to leverage our restaurateurs more as a way of allowing our area managers to handle more restaurants. but we also have a twin goal of making sure that the restaurateurs remain in the restaurants where they can do the most good, actually impacting customers experiences everyday. So, what we intend to do is start associating some of our restaurateurs with new restaurants which are having less lot with certain aspects of operations and make sure that we leverage the skills of those restaurateurs into some neighboring restaurants. By doing that we will allow our area managers to handle more restaurants and so now we are going through with our regional directors and identifying throughout the country which location these restaurants first going to effect and which area managers can take on more responsibility as a result of that. So, we really taking a look at our field management make sure that each of these restaurant tour area manager or operation director,

all are created and defined in such a way that maximum and possible benefit to the most people possible.

Paul Westra - Cowen And Company

And what percentage would you like to get on 10% now of restaurateurs, would you like to get the system up to 40 or 50 or--?

Monty Moran - President and Chief Operating Officer

We kind of? ideally we would like to have the more the better in terms of restaurateurs. If all of our managers are restaurateurs, that would be a perfect situation for us. So, our goal is as high as 100%. But we don't really chase a number in particular. What we are looking for is to make sure that when Steve and I interviewed our restaurateurs that we can continue to see greater and greater level of confidence among the first we are interviewing and that we continue to keep the bar pretty high to entry into this sort of elite class of managers. That being said, we are about to go interview almost 40 of them in the next couple of months. We are seeing in larger and larger percentage of those to whom that we are presented with being excepted into the program. So, we believe that over that 40, certainly, better than half if history is any guide will become restaurateurs and so we will increase our percentage quite a bit, just in the next couple of months. But even more exciting is the fact that there is 80 more kind of waiting in the wings in the next six to 12 months. That will be ready for interviews. And so, we are very excited to meet with them as well. And as that happens as we see more and more of these restaurateurs ready to be interviewed, it's? that's just a function of the fact that all of our managers know what it takes to become a restaurateurs are being given more clear direction as to how to get there, more specific training as to the areas of their weakness and we think that that will continue to increase in the amount of managers applying of the role.

Paul Westra - Cowen and Company

Okay. That's helpful. Steve, just kind of little bit more you mentioned this new equipment test with handheld POS, what's the goal, I guess, what's the extensional investment and rewards of the test?

Steve Ells - Founder, Chairman, and Chief Executive Officer

That's very, very early, Paul. I think one of the things that we really want to do for customers is to give them through faster especially during the busy lunch period. As you know, there are so many people who want to eat at Chipotle and certainly in the busy dense areas that we usually have very, very long lines. Most of the people in those lines know exactly what they are going to order and they also have a credit card. And so, we take care of that problem before they ever start the ordering process. And so, once they get to the line, they order just as they normally would picking and choosing among all our ingredients, and then, once they finish doing that and their breed? or order is ready, then they are just free to go have a seat and they eliminate that 18 to 22 seconds POS experience, which is really not adding anything beneficial to the overall dinning experience. So, we think it's really going to provide a lot better customer experience, especially during that busy crunch hour? hours during lunch.

Paul Westra - Cowen and Company

So, about 20 seconds, what is the total line time currently?

Steve Ells - Founder, Chairman, and Chief Executive Officer

I haven't added it up, but just to sort of help you put it in perspective, the tortilla station is probably eight to 10, putting cheese and sour cream and wrapping it up, about another eight seconds or so. The expedite is pretty quick, single digits and then you tack on the POS and that's all the way up into the high double digits, 18 to 22 seconds. So, a significant amount of time that you can save if you have allowed the guests to prepay.

Monty Moran - President and Chief Operating Officer

What's unique about Chipotle though is that you just need to know chicken burrito and then you can still go through and have all the choices. So, it is not a cumbersome ordering process in the line, it's just simply the chicken burrito or steak burrito or something like that.

Paul Westra - Cowen and Company

Great. And just two quick questions for Jack, the tax rate you got at 37.7%. You still expect that to come down over time?

Jack Hartung - Chief Finance and Development Officer

Yes, Paul, we said next year to expect to stay at 37.7%. But we think we have some opportunities in state taxes. And as though opportunities materialize, we will tell you about them. They are gaining relatively small, we were at this time last year, we were about 40% so we brought it down quite a bit and now under 48% and we are going to continue to work to bring it down. But there is going to be a limit to how much we can get it down, it is going to be 10 basis points, kind of as we see those opportunities actually materialize, we will let you know through the releases.

Paul Westra - Cowen and Company

Great. Thank you.

Jack Hartung - Chief Finance and Development Officer

Thanks, Paul.

Operator

And we will take our next question from Nicole Miller of Piper Jaffray.

Nicole Miller - Piper Jaffray

Thanks. Good afternoon.

Jack Hartung - Chief Development and Finance Officer

Hi, Nicole.

Monty Moran - President and Chief Operating Officer

Hi, Nicole.

Nicole Miller - Piper Jaffray

Hi. Can you talk to us about? it looks like you have removed the hormone from your cheese in the quarter and did you have an opportunity for pricing because of that?

Steve Ells - Founder, Chairman, and Chief Executive Officer

Could you repeat that question?

Nicole Miller - Piper Jaffray

Sure. If? was there an opportunity for pricing in the quarter, I think you? it looks like you went hormone free on the cheese. Is that correct?

Steve Ells - Founder, Chairman, and Chief Executive Officer

Yes, the cheese didn't? asking that suppliers removed are only source of milk from cows that were not treated with rBGH, did not cost us more money.

Nicole Miller - Piper Jaffray

Okay. One other last price increase and what are you looking for--?

Steve Ells - Founder, Chairman, and Chief Executive Officer

No, we did not take a price increase associated with that.

Monty Moran - President and Chief Operating Officer

Yes, we didn't? it was? there wasn't really an opportunity and the messaging around that would be tough, Nicole. So, most of our price increases have really been around natural meats and we do marketing and education with our customers around natural chicken and natural beef. We are running, Nicole, about 2.6% for the third quarter. We are actually right now? the pay for our right now through the fourth quarter is up to 3%. And as you know, that menu price increase is now in across

the Board type menu price. It's really just market-by-market as we've had the Food With Integrity opportunities.

Nicole Miller - Piper Jaffray

That's very helpful. Thank you. And then, have any commodities been contracted for next year?

Jack Hartung - Chief Finance and Development Officer

No. We would normally contract cheese or agree on a price with our supplier for cheese, and we did that and we benefited from that for all of 2007. We have not yet done that for cheese. We'll probably do something before the end of the year. But we're kind of watching what the? what the market would look like. So, right now, we have nothing really contracted for the next year, Nicole.

Nicole Miller - Piper Jaffray

And then when we look into the development for next year, on a quarterly basis, should it be in your image of this year or is there anything that would shift that?

Jack Hartung - Chief Finance and Development Officer

I really hope so, Nicole. I mean we're really proud that our inventory building was so strong this year that we almost perfectly level loaded with 30 restaurants, 30 restaurants and now 28. I would not necessarily promise you that we'll be that perfect in terms of level loading, but inventory is nice and strong, and so, it should, for sure not be back loaded the way that we attended store clearly in a way both restaurants, so, it will be relatively even throughout the year.

Nicole Miller - Piper Jaffray

And then on a labor line, was there? there was a labor system implemented last year. Where are you at in terms of seeing that in the margins?

Jack Hartung - Chief Finance and Development Officer

Yes. We implemented that Nicole and it was our national labor matrix and we implemented that really at the end of the third quarter and into the fourth quarter. And so, what you'll see is that if you go back to last year in the fourth quarter, we started to see labor leverage. We got about 30 basis points of labor leverage in fourth quarter of last year. We got zero labor leverage or virtually zero in the second and third quarters before we implemented this national labor matrix. And so, we're starting to go comp up against that, in the fourth quarter and then for sure into 2008, Nicole, so you will see much less labor leverage going forward than we've seen in the last few quarters.

Nicole Miller - Piper Jaffray

Okay. And then just one kind of big picture question. The margin? obviously the margin results obviously very impressive. And on a corporate level, could you talk to us about the best performing margin unit? So, are they in classes by in terms of when they open or by region? What do those peak margins look like, and then what would either allow or prevent the corporate to have those margins over time?

Jack Hartung - Chief Finance and Development Officer

Well, Nicole, the very highest margin restaurant rather than by fast food store would be based on the sale and there is an occupancy. And so, for example, we have restaurants that are doing \$3 million and they are in Middle America and paying very modest occupancy costs both restaurants can easily do margins in the 30% range or higher. Your next question is what's preventing really us achieving those types of margins across the country. Well, if we could do \$3 million of volume and pay the kind of occupancy costs so we can pay Middle America, we could do that. The reality is we are not going to do \$ 3 million every restaurant and we are in New York and we are in now in Philadelphia [ph] and the occupancy costs are much, much higher. So, we don't know? I think the real answer is we have not seen a limit yet to what our volume can be either by market to that individual markets that are averaging 2.5 million across the whole market. I mentioned we got individual restaurants that are well

over 3 million. And so, we haven't seen a limit to really what we can do in terms of sales volumes and we know that our new economic model and our managers focused on strengthening that model we can continue to deliver these very, very nice margins. Now the challenge ahead of us, Nicole, is that we are going comp against international labor matrix and so that's going to see to be tough to see more of that labor leverage and commodity cost there's still pressure there. We don't see really any meaningful relief in the near future and so it's going to be tough for us to continue to deliver these margins, but our new economic model continues to be strong.

Nicole Miller - Piper Jaffray

Thanks so much for your time this afternoon and congrats on a nice quarter.

Steve Ells - Founder, Chairman, and Chief Executive Officer

Thanks Nicole.

Montgomery F. Moran - President and Chief Operating Officer

Thank you.

Operator

And we will go next to David Tarantino with Robert W. Baird.

David Tarantino - Robert W. Baird

Hi, good afternoon. And congratulations on a great quarter.

Jack Hartung - Chief Finance and Development Officer

Hi David thanks.

David Tarantino - Robert W. Baird

Jack, just a follow-up to the margin question. As you look out into 2008 with the pressure you are seeing on commodities maybe less benefit from the labor matrix, what type of same-store sales number would you need to hold restaurant level margins flat next year.

Jack Hartung - Chief Finance and Development Officer

A good question, David. We don't see any worsening of commodities let's take that off the table so commodities kind of stay where they're at. Just normal inflation creeping all the line items. Typically need about a mid single digit comp in order for us to hold our margin,

David Tarantino - Robert W. Baird

Okay. So, with that implied you are expecting then with your guidance from margin compression next year.

Jack Hartung - Chief Finance and Development Officer

Well, if food cost stay the same and if we can do something I think if we were at the high-end of that range, we could probably hold our margin if we hit the low end of our guidance range in the lower single digits, yes, I would expect to see margins degradation and the way to accept that would be for menu price increase which you have seen over the last couple of years we're been running kind of it is in the 2% to 3% range. If we could do a couple of percent comp in transactions and a couple 3% comp in margins that in menu price that would be another way to at least keep the restaurant level margins. There's a lot of different ways to get there, David, but if we don't do a mid single digit comp and we don't have price increases normal inflation would begin to eat away at the margin.

David Tarantino - Robert W. Baird

Okay. That's helpful. And then just a broader question about next year's earnings growth I know you didn't give a specific target for next year, but you said you are committed to 25% plus EPS growth over the long-term. Is that what you might expect for next year and if so whether the components that get you there next year if you are just holding restaurant level margins, flat?

Jack Hartung - Chief Finance and Development Officer

Yes, they would never have broken out given as you know given specific details guidance so we felt comfortable over the long term with that 25% rate, so into next year, I mean we are not going to give a specific whether it is 25% or something different than that but it is going to be more new store openings, I mean based on our current guidance, we are finishing this year with double digit. Our comp guidance, we have been low to mid single digits so that means we have to rely more on the new store openings. Now the good news is, our new store openings continue to perform at exceptional level so even though we are now over \$1.7 million with our restaurants open more than 12 months, our new restaurants continue to open up at 85% of that level and so they are? they open up within striking distance, with just a year, couple of years of comp to that \$1.7 million, that \$1.7 million range. We also look at our restaurant? new restaurant openings as a cash? a cash flow positive within the first 12 months. And within? by the end of the first full 12 months they are not all the way up into what our average margins are today but they? they are way up there and so they are much stronger today than they have ever been before and so relying on new store openings based on a higher number of 130, 140 and based on the better quality, the quality that gets better and better every year, we feel that will be the main driver of our? of our EPS growth for next year.

David Tarantino - Robert W. Baird

Great. That's helpful and then a broader question. What are your thoughts on expanding the brand and to international markets beyond Canada at this stage?

Steve Ells - Founder, Chairman, and Chief Executive Officer

Well, I'll say the same kind of thing that I said last time that I certainly think going into the big markets in Europe, U.K., France, Germany are no brainers for us. I think the concept is going to do really, really well. The whole idea of super, high quality ingredients, prepared in front of the customer served in an interactive format is something that's going to do well. If there is one thing that we have learnt over the past 40 years is that? is that we come out of the blocks really, really strong when we have a great team in place and we pick great real estate and so that's our plan for our International expansion. But we are not in any hurry to get there? I mean we still have thousands of restaurants that we can build in the United States so that's where you should expect to see a lot of the short and mid term growth for us. International is a long term opportunity and we are confident that we are going to do it right, we have got the experience and we have got? we have picked out great areas to go into that we are confident are going to be real, real strong countries and cities for us. So again it looks really good but think of it as long-term expansion.

David Tarantino - Robert W. Baird

Okay. Great. Thanks a lot.

Jack Hartung - Chief Finance and Development Officer

Thanks, David.

Operator

And we'll take our next question from Stephen Rees of JP Morgan

Steven Rees - JP Morgan

Hi, thanks. I just wanted to ask about the need and voluntary which do sound like they're strengthening and growing even closer to the system average. Is this a trend that we should expect to continue into next year or is there anything, I know you mentioned you are going to demote existing markets next year. Should we expect that gap to widen at all?

Jack Hartung - Chief Finance and Development Officer

Well, it's a good question Steven. First of all let me clarify. Our new store openings have grown every single year. But they haven't closed the gap. What happened is our average for the restaurants

opened 12 months or more has risen pretty dramatically over the last three, four years, really over the last five years. but what's happened is our new restaurants over the last three years at least, has cut pace at this 85% and so, it's grown every year at the same pace that a restaurant opens 12 months or more at the same gross rate so in terms of what's in set for next year nothing Steven that we are doing differently in terms of building our pipe line. That would cause us to believe that next year's numbers would be higher or lower than this 85% range. We're still looking for a high quality real estate. Most of the openings are going to be in markets that we're already in. I mean we did just open up Philadelphia and you never know how restaurant two, three or four is going to be in a new market. But we're not doing anything fundamentally different that would expect that trend would change either way.

Steven Rees - JP Morgan

Okay. and then just for Steve. You mentioned fast food in your comments but, as you look at your consumer research on some of your more developed and mature markets like a Denver or Dallas. How is your customer using the concept today versus when it was more in it's earlier stages. Are you still growing traffic in these units and who do you think is the right competition for you at this point is it fast food or is it increasingly casual dining?

Steve Ells - Founder, Chairman, and Chief Executive Officer

It is an ongoing debate that we have here internally and we've even been working with some consultants, some branding consultants and we have that argument with them also. Are we fast food? are we fast casual, are we more toward casual dining but fast. I guess I can't answer that question and everybody should be excited that I can't answer that question. The answer really is that we draw from so many different places. Chipotle was built on my experiences from fine dining. I didn't know anything else. I didn't know the fast food rules. So Chipotle was built on fine dining classical cooking methods but done in the format that allows us to serve it fast so if you want to call it fast food go ahead, but realize that the kinds of ingredients that we use are like fine dining ingredients and so I guess I would summarize by saying our demographics is very, very broad and we draw from all different places, from fast food, from health conscious people, from casual dining, and certainly, not dive in the middle of where people a lot of people put us in this fast casual. But I think that's good news. I think it's just drawing primarily from one area that's kind of limiter. So, we are excited that this is a hard thing to define.

Steven Rees - JP Morgan

Okay. Great. Thank you very much.

Operator

And we'll take our next question from Mark Wiltamuth with Morgan Stanley.

Mark Wiltamuth - Morgan Stanley

Hi, congratulations on a great quarter.

Steve Ells - Founder, Chairman, and Chief Executive Officer

Hi, Mark. Thank you.

Mark Wiltamuth - Morgan Stanley

I would like to ask a little bit about your cash levels, what are your plans for your cash and maybe a thought on CapEx and free cash flow generation moving forward?

Jack Hartung - Chief Finance and Development Officer

Yes, Mark, we don't really plan to do anything different with our cash balance frankly there are limits without getting into it there are limits of what we can do in terms of buyback or dividends of any thing like that because of the separation we had with McDonalds. But we plan to we have invested it in highly liquid highly safe high quality instruments. We are doing things like? we are taking a small step

into Canada. We feel like we are very privileged to have this very strong balance sheet such that if we decide that Canada opens very well and we have got a very strong team there and we want to dialed it up, we've got the capital to o that. I think that here in the U.S., we? the inventory building is going well our development of our people is going very well. So, we can step up our openings from this range of 130 to 140. And so, we feel privileged to be able to do that without have to go to a bank or without having to raise more money. So, we don't plan to really change our balance sheet in any kind of fundamental way. Going forward, Mark, I would expect that we'll continue to invest the vast majority of our cash flow that generates from the business in the new restaurant and in maintaining our existing restaurants. We might takeaway from that cash balance a little bit, we might add to it a little bit, but I wouldn't see any really dramatic change in that cash balance either way as we move forward.

Mark Wiltamuth - Morgan Stanley

Okay. And when is the restriction on the McDonalds over, so you could start doing share purchase or other activities.

Jack Hartung - Chief Finance and Development Officer

Well, there really isn't an over. There are some dates where it's a really hard and fast cant do anything and that's a couple of years October of 2008. But even beyond that, it then, Mark, boils down to facts and circumstances that we would not want to do ant thing we would be very thoughtful and careful not to do any thing that might affect the tax free nature of split up that McDonalds entered into back a year ago.

Mark Wiltamuth - Morgan Stanley

Okay. Thank you very much.

Jack Hartung - Chief Finance and Development Officer

Thank you, Mark.

Operator

And we'll take our next question from Glen Petraglia of Citigroup.

Jeff Hans - Citigroup

Hi, this is Jeff actually talking on behalf of Glen. How are you?

Jack Hartung - Chief Finance and Development Officer

Hi Jeff.

Jeff Hans - Citigroup

Question for you, mention before about commodity costs and your expectation of they not going to get worse from here. If you given any thought as to maybe doing some purchase or spot purchases on cheese, for instance, for next year? Have you ever done that in the past, or is it typically all contracted?

Jack Hartung - Chief Finance and Development Officer

First of all, Jeff, I don't think I said that they should not get worse. I think I said I don't see them getting better. If anything we see continued pressure and all the key commodities that have caused pressure for this year so far what we have actually? we have brought into cheese like for example this year we are not seeing any of the degradation of our margin due to cheese at all like other restaurant companies are because we did lock into with our supplier a fixed price for the entire year. We have the ability to do that again for next year. Normally, we would have done it by now. We just have kind of been waiting because the market has been so volatile. We expect that we will probably lock into a price for some maybe all of the cheese for next year so we have taken advantage of that in the past.

Jeff Hans - Citigroup

Okay. And then are there any pockets of consumer weakness that you maybe seeing from a regional prospective i.e. certain states not performing as well as maybe the Company average.

Jack Hartung - Chief Finance and Development Officer

It's a great question and we seen that other restaurant companies have reported pretty severe weakness in a number of markets I can tell you we have not see what I would call severe weakness the way other restaurant companies are defining it. In markets like California and Florida and those hyper markets where there is a housing bubble has happened one market that we have seen some softening that other markets have as well is in Arizona in Phoenix. We've got about 25 restaurants there and we did see our sales are still well in the kind of mid single digits range in terms of comps, but earlier this year they were in low double digits and so we have seen impact there, but that's really the only one our sales in California continue to impress our sales in California so very, very strong. And so, we have not seen what I think you have been reading about with other restaurant companies.

Jeff Hans - Citigroup

And has there been any price increases in Arizona at all--?

Jack Hartung - Chief Finance and Development Officer

No, there's not although. We are hoping in the near future we can introduce nature meats to Arizona and so we think there is an opportunity to really talk to our customers and talk to them about the high quality ingredients? about nature meat. So we hope that might happen by the end of this year.

Jeff Hans - Citigroup

Okay. Then one last one for you. I thought you had mentioned about a potential same-store sales fall off in this coming December. Is that correct?

Jack Hartung - Chief Finance and Development Officer

Well, no what I wanted to tell you is? is we did see a fall out in the second half of September.

Jeff Hans - Citigroup

Okay.

Jack Hartung - Chief Finance and Development Officer

Ends up trouble so far, so double digits but we didn't want anyone to expect that our comps will sequentially increase in the third quarter because that's what a comp has done each quarter, they kind of climb from the first quarter to the second, from the second to the third. So far we have seen, it's just a slight fall out so double digits still very strong but not as high in terms of the third quarter.

Jeff Hans - Citigroup

Okay. Thanks a lot.

Jack Hartung - Chief Finance and Development Officer

Thanks Jeff.

Operator

And we do have time for one final question. We will go to Rachel Rothman of Merrill Lynch.

Rachel Rothman – Merrill Lynch

Hey guys.

Steve Ells - Founder, Chairman, and Chief Executive Officer

Hi Rachel.

Rachel Rothman – Merrill Lynch

Same store sales first got it. I guess if you go back 58 to this time last year and the guidance that you gave out for '07 was low to mid single digit. Can you maybe talk about what surprised you the most in terms of the comp stores this year, what drove the upside surprise and how we should think about the conservative? the conservatism of next year's guidance in that context.

Jack Hartung - Chief Finance and Development Officer

Okay. Tough question. I will give it a shot, Rachel. We were going up again when we were at the same time last year, we were looking ahead to the first quarter where we were going up against the 19.7% comp and that was very scary. We are going up again, the awareness building from the IPO which we know was significant. We are going up again, kind of an initial surge that we saw in our comps due to Cooper because we kind of had the increased awareness about food poisoning and we are much more aggressive in communicating what works for food poison and really holding out our fastest stores and telling all the restaurant managers how the stores are performing at the level that they are performing and so it was scary at the time last year to be going up again so outlook was very, very strong trying to? at this time this year, it's still very, very difficult to predict. We now are a restaurant company that has relative 500 restaurants that are averaging over \$1.7 million and so and looking ahead into next year, following on our tenth consecutive year of double digit comp we did don't know what to expect for next year. We are not going to change what our strategies are, we are going to continue to focus on running great restaurants, so that we have great managers, developing great food and focus on ?Food and Integrity?, focus on serving the very best food that we can and we hope that we both end better comps than what the guidance says but we don't know what the comps are going to be and so we feel like it's the appropriate guidance to give at this time.

Rachel Rothman – Merrill Lynch

And then should I? sure you guys comment just a little nature contributed 150 bits of those 190 and if that is correct, does that mean that the insurance was the incremental 40. How should we think about that rolling through? Is that going to continue for the next three quarters as you now occurred a lower rate or was that a one time reversal of some prior??

Jack Hartung - Chief Finance and Development Officer

No, what? for the? you are talking about the insurance?

Rachel Rothman – Merrill Lynch

Yes.

Jack Hartung - Chief Finance and Development Officer

Yes, that's a recurring number but we are going to go comp against that in the middle of next year, okay? So you will see the benefit for another quarter

For the? you are talking about the insurance?

Rachel Rothman – Merrill Lynch

Yes,

Jack Hartung - Chief Finance and Development Officer

Yes. That's a recurring number but we are going to go comp against that in the middle of next year.

Okay, so you will see this benefit for another quarter or two and then you will going comp against them you won't see that benefit any more.

Rachel Rothman – Merrill Lynch

Okay. And then one last one, on the incentive comp or restricted shares and options, I know you talked about it being higher dollar impacts in next year G&A. Can you just talk about that given it I mean is it based on a fixed number of shares, or is it a fixed dollar amount of compensation that given that your share prices doubled, you would just be allocated fewer shares?

Jack Hartung - Chief Finance and Development Officer

Well, it's hard to perfectly answer that.

Rachel Rothman – Merrill Lynch

Well I am not phrasing it well but.

Steve Ells - Founder, Chairman, and Chief Executive Officer

And I get your question and I'll answer to it the best I can. We don't know what the grants are going to be and we really need to let our comp committee do that and they will look at a number of different factors that you can imagine and notice what your perfect comp rate would be but to give you an example what happens is you are layering on whatever the grants are in terms of stock and in terms of stock options whatever the grants are they are going to be at the higher price than they were last year based on stock price today. What's removed from our stock option expense is options that were granted back in 2004 which were at a much, much lower rate and so, for example if we issue the same number of options and the same number of shares exactly as last year, and we should have done it last year price which is less than a half what we are at today, we would see a 50% increase in our stock comp from kind of \$8 million to \$8.5 million this year to a 50% higher number like a \$12 million to \$13 million number. If we issued the same number of shares as last year, at this much, much, much higher price, our stock comp would more than double. So it's a dramatic increase. It's going to be increasing no matter what, we don't know exactly what the numbers are going to be, we need our comp committee to do that but we wanted to let you know that this is ahead of us and no matter how we slice it and no matter what matter we go through, its going to have a meaningful impact on our G&A next year.

Rachel Rothman – Merrill Lynch

Should we think about it as a number of shares or based on the out performance that you guys have been giving this year, I guess is there any way let's imagine?

Jack Hartung - Chief Finance and Development Officer

Numbers, it's non-cash and so last year we issued 275,000 options and a 120,000 restricted shares. And so, we don't know what numbers are going to be issued for next year but the accounting expense that contacting our G&A it's a non cash expense and so, I would leave it up to you in terms of how you want to deal with that non cash expense. First of the dilutive effect that will happen in the future, when a restrictions lifted and these options are exercised.

Rachel Rothman – Merrill Lynch

Okay, thank you.

Jack Hartung - Chief Finance and Development Officer

Thank you, Rachel.

Operator

And there are no further questions at this time. Ms. Sandra I'll turn the call back over to you for any additional or closing remarks.

Sandra Curlander - Investor Relation

Thank you everyone for joining us. We certainly appreciate your time today.

Jack Hartung - Chief Finance and Development Officer

Thanks everyone.

Sandra Curlander - Investor Relation

Thanks Dana.

Operator

Thank you. And that does conclude today's conference call, you may disconnect at this time.

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