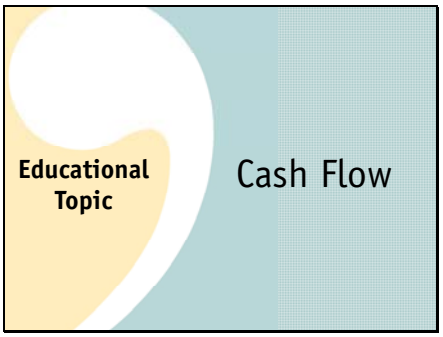
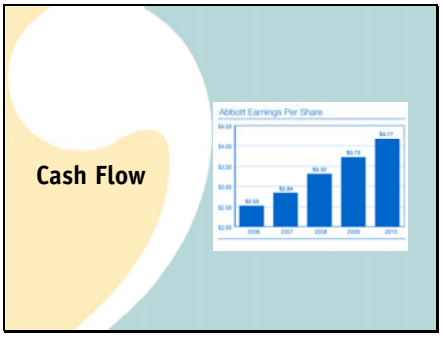
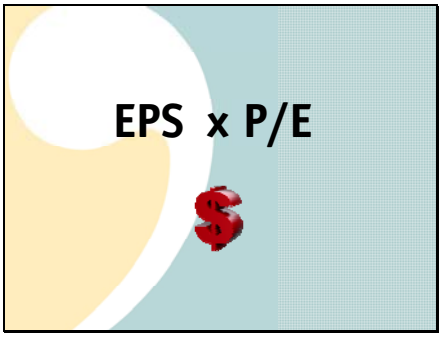


For tonights educational topic we'll be discussing cash flow. What it is and how you might use it to help you follow your stocks.



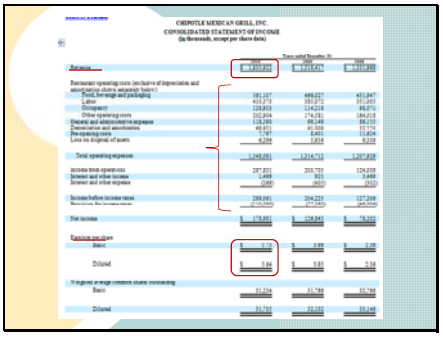
So what do we mean when we talk about cash flow? To begin to understand, lets talk about Earnings.



We use earnings per share to make our investing decisions. We make a judgment about how we think earnings will grow in the future

and then we multiply the future earnings per share times our judgment about the future Price to Earnings ratio to get a

Prediction of future stock price. By comparing this with the current price, we decide whether we'll make money purchasing a stock at todays price.



Earnings per share is the

final value you find on an one of the four basic financial reports called an Income statement. It is the amount that is left after

all the expenses for the period are subtracted from the

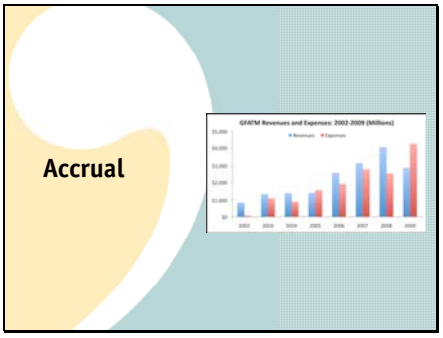
sales or revenue, shown at the top.


UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

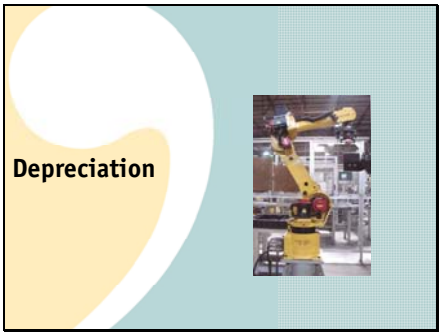
CHIPOTLE MEXICAN GRILL, INC.

Earnings are reported each quarter by publicly traded companies in their financial reports and quarterly conference calls.



An income statement is prepared using what is called accrual accounting.

In accrual accounting, expenses are matched with revenues. That means they are subtracted during the time period the revenue they generate occurs, not necessarily when the expenses are actually paid. This sometimes requires the use of accounting estimates and judgments. Since you are making projections about the future using the earnings number it is important to have a feel for the "quality" of the number being reported.



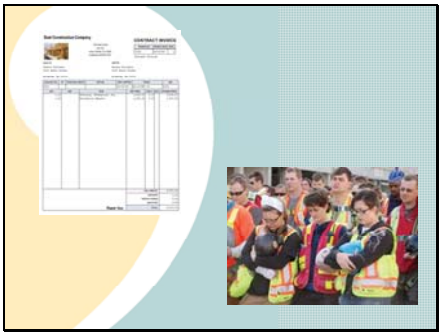
For example, if I purchase a piece of equipment to operate my business, I will pay for it today, but I may use it to produce income for months or years to come.
Rather than deducting the entire expense for the machine on the day I pay it, I deduct a little bit of it's cost, during each time period I use it to produce revenue. This type of expense is called depreciation. Determining how much to expense requires the use of accounting estimates. I need to estimate what the life of the equipment will be and what it's salvage value will be when I eventually get rid of it. I also need to estimate how long it will be useful.

Another example of accounting for an expense using the accrual method is accounting for the expense of a product I am selling. I do not deduct the cost of all inventory I purchase when I purchase it. I only deduct the value of the inventory sold during the time period the financial report covers.

Using accrual accounting also means that I record income when a customer receives a service or product, not necessarily when I receive payment. Some of the sales reported on an income statement may have been made on

credit rather than

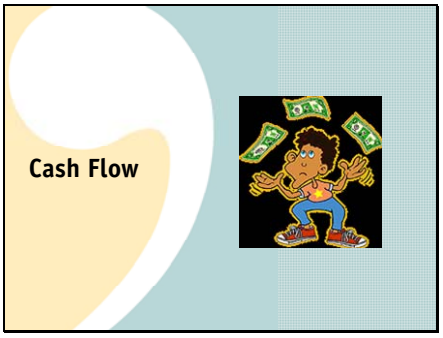
cash.



So net income is useful for telling me whether my expenses are less than my revenues and my business is profitable, but it does not tell me if I have enough cash to pay my expenses when they arise.

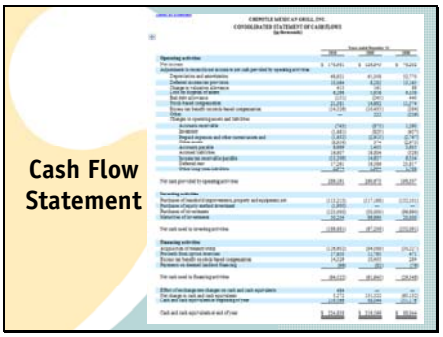
If you've ever given someone an invoice, you might have been in a situation where you had earned money performing work but you weren't going to be paid right away. On an accrual based income statement the revenue would be reported as soon as you had completed the work. So would the expenses for any employees who helped you complete the job.

But in real life, all you might have is an invoice and no cash in your checking account.
This might make it difficult for you to cover your daily expenses such as payroll. You might even have to borrow money to keep your operations going.

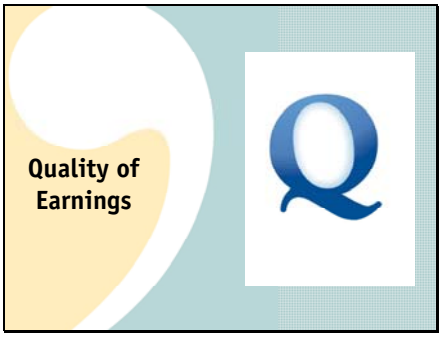


Managing cash flow is one of the most important tasks management needs to accomplish. Just as important as making sure that revenues exceed expenses.

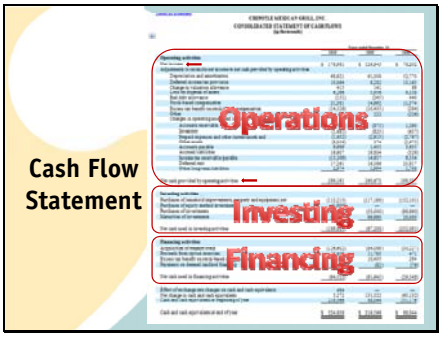
A company's earnings only tell us part of the story about the state of a company's finances. This is why, in addition to how much accrual based income they earn, companies must show us how much cash their business is generating and how it is being used. This is important information that can give us further insight into the state of their finances and help us make better predictions about what their earnings might be in the future.



Companies need to make sure their actual cash inflows are keeping up with their outflows. An analysis of a companys cash position is reported on the cash flow statement. It is one of the four financial statements required in quarterly reports. Many of the numbers reported on an income statement are based on estimates and accounting judgments. Because the cash flow statement shows the movement of actual cash, it is not as easy to manipulate.



Many feel that cash is a more “real” number than accrual based income and the cash flow statement gives valuable insight into what many refer to as the “quality” of the reported earnings. Quality might be thought of as the ability to use the reported earnings to base future earnings projections on.



The cash flow statement is divided into three parts.

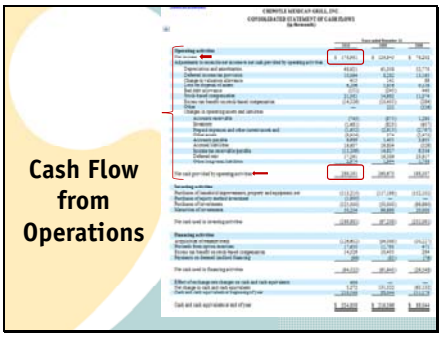
The first section shows Cash flow from operations. This is where the

accrual based net income number is adjusted to show the

actual cash produced from operations. This is done by adding back non cash expenses such as depreciation and subtracting additional uses of cash such as inventory increases in excess of amounts sold during the period.

The second section shows Cash flow from investing-These are cash inflows and outflows from acquiring and selling investments and other capital items such as property, plant and equipment. It also shows cash received from lending money and collecting loans.

The final section shows cash flow from financing- This is the cash flow related to financing activities such as issuing and repaying debt, issuing and repurchasing stock and returning equity to shareholders by paying dividends.



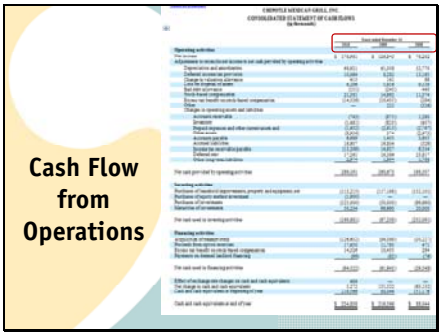
In the Cash flow from operations section you find out how much of the

net income reported on the income statement ,

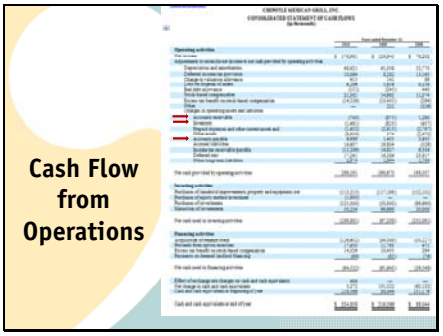
was actually cash that the company could use to cover it's day to day cash needs. Ideally, you want the

amount of cash flow from operations to be equal to or greater than the

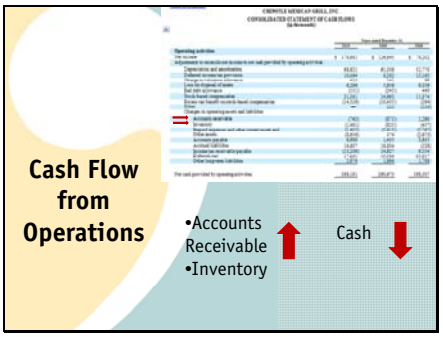
amount of net income. This is a cash flow statement for Chipotle from their 2010 annual report. You can see that they have a very healthy amount of cash being generated by their regular operations. For every dollar in accrual based net income they are reporting, they are actually generating $1.61 in cash. This is because some of the expenses they needed to report on the income statement such as depreciation did not involve a cash outflow during the period being reported.



You will always be given cash flow information for the same time period for previous years for comparision. A good quick check is to compare the line items for the different years. If you see significant differences, it is usually valuable to understand why. They will usually be explained in the notes in the financial reports and sometimes even in the earnings conference calls.



Three interesting lines to keep an eye on in this section are the change in Accounts Receivable, Inventory and Accounts payable.

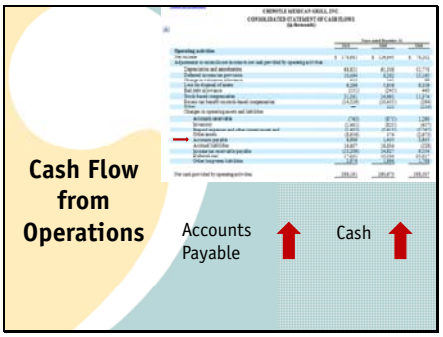


When Accounts Receivable and Inventory go up,

cash goes down.

So, if you see a negative amount for these items, it means they have increased during the reported time period. If you see big changes, or the changes seem a lot different from previous years, it's important to understand why. It is reasonable that these amounts would go up by a similar percentage to any increase in sales. But if Accounts Receivable is growing faster than sales, it may mean the company is generating sales by offering more generous credit terms. This can sometimes be an indication of trouble. It's important to research this further.

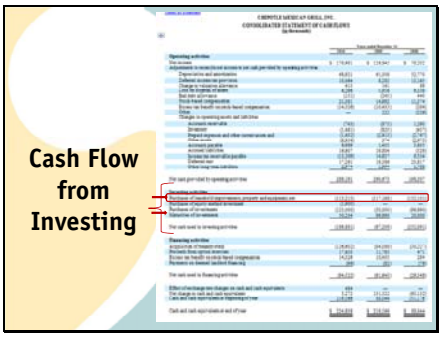
Inventory growing faster than sales is also a bad sign. A company may have misjudged future sales. Excess inventory may mean future earnings will be impacted by inventory writedowns or a decrease in sales due to pricing adjustments.



When Accounts Payable go up,

cash increases because you are taking longer to pay bills.

A large positive amount on this line may also be a red flag. A company that needs cash may delay paying it's suppliers. This is not a healthy sign. Again, it's important to understand why this is happening.

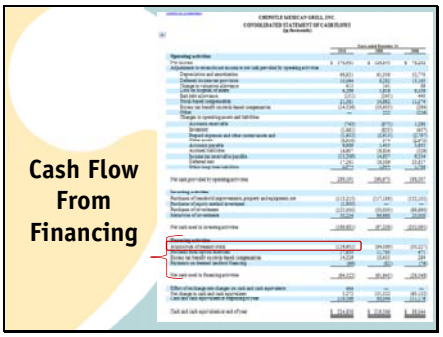


The second part of a cash flow statement shows the cash flow from investing activities, which generally include purchases or sales of long-term assets, such as property, plant and equipment, as well as investment securities.

If a company buys a piece of machinery, the cash flow statement shows this as a cash outflow from investing activities because it uses cash.

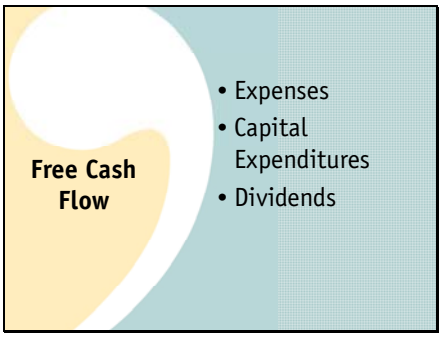
If a company has invested in bonds, they will have a cash inflow when they mature.

We can see here that Chipotle is making regular investments in capital improvements. Probably the extra cash being generated from their operations is allowing them to do so. This is a good sign. It's a bad sign if cash flow from operations is less than net income and you see that a company appears to be selling investments or capital equipment to generate enough cash to cover it's operating requirements.



The third part of a cash flow statement shows the cash flow from financing activities. In this section you can find out if a company is issuing new shares of stock and changing their long term debt by issuing or repaying bonds. You can also find how much cash they are using to pay dividends.

If a company is buying back it's own shares, it is also shown here. The repurchased shares are called Treasury stock. We can see here that Chipotle is using some of it's cash to buy back shares. This is something that may be a good sign for you as an investor since they do not pay a dividend. But it may also mean that they need shares to distribute to employees as stock options. If there is no net decrease in shares over time, you do not get much benefit from stock repurchases.
In this section, if you see a company is taking on debt or issuing shares of stock and it looks like it is doing so to cover it's operating cash flow, this might be a warning sign.

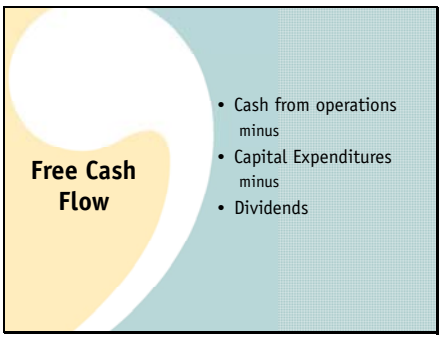


The more cash a company generates, the more flexibility it has to expand and to reward it's investors. As investors, we like to know that a company is generating enough cash to

cover it's daily expenses.

We also like to see it making smart capital investments to grow and we

really like to see we are going to be regularly rewarded with a dividend.



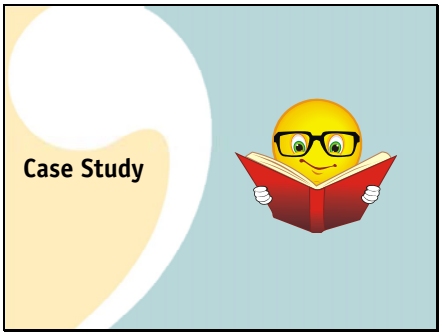
A simple calculation you can do to see how easily a company might accomplish these goals is called free cash flow.

One common definition of free cash flow is Cash from operations

Minus Capital Expenditures. The value for cash from operations is found as the bottom line in the first section of the cash flow report. The value for capital expenditures is found in the second section, the investing section.

If a company pays a dividend, that is also often seen as a commitment that must be covered by cash before it is put to other uses so this is also

sometimes subtracted to get the true free cash.
If the free cash flow is positive, you know you own a company that has a lot of flexibility to do things like pay down debt, make acquisitions or repurchase shares.



If you understand some basics, financial statements can tell you a story. You might even find that a cash flow statement will tell you a completely different story from the income statement.

Case Study

Sysco

Here's a recent story told by the Sysco cash flow statements. Many of you may be familiar with Sysco. They provide food and supplies to restaurants and institutional food service establishments. Sysco is known to be a very well managed company with a reliable and attractive dividend. Because of this, Sysco shares have historically commanded a premium in valuation. For a 10 year average earnings per share growth of 11.58, Sysco currently sells at a P/E of 15.9. Compare this to Apple with a 10 year average earnings per share growth of 30.11 which is only selling at a slightly higher current P/E of 16.5.

Net Margins

- Net Income/Sales
- 3%

The restaurant supply business is not a high margin one.

Sysco's net margins are only around 3%. But it has historically been able to generate a lot of cash, allowing it to grow it's business by acquisition and pay the attractive dividend mentioned earlier.

Cash from Operations

SYSCO
CONSOLIDATED CASH FLOWS

(In thousands)	For the Year Ended July 1, 2006	June 30, 2007	June 28, 2008	June 27, 2009
Cash flows from operating activities:				
Net earnings	$ 866,326	$ 1,001,076	$ 1,106,161	$ 1,066,948
Net cash provided by operating activities	1,124,679	1,402,922	1,570,349	1,576,749
Cash from Operations/net income	131.5%	140.1%	142.0%	149.3%

From the first section on their cash flow statement, for their fiscal years 2006-2009,

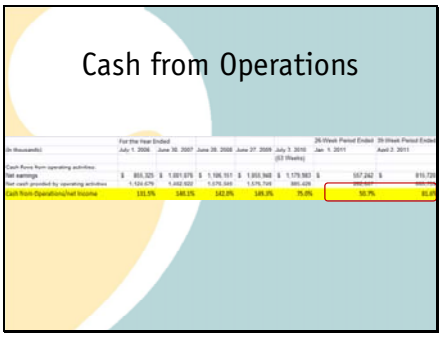
we can see by doing the simple calculation mentioned earlier to compare cash from operations to net income, that Sysco has historically been able to generate an excess of cash from their operations. This has allowed them to make acquisitions, invest in capital improvements and pay a nice dividend.

Cash from Operations

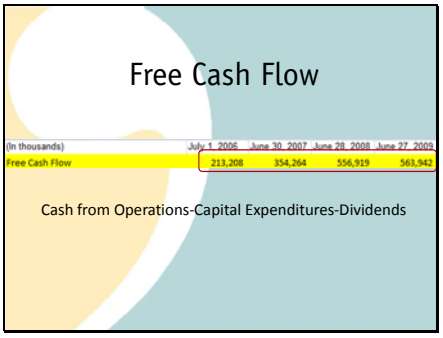
(In thousands)	For the Year Ended July 1, 2006	June 30, 2007	June 28, 2008	June 27, 2009	July 3, 2010 (53 Weeks)
Cash flows from operating activities:					
Net earnings	$ 866,326	$ 1,001,076	$ 1,106,161	$ 1,066,948	$ 1,179,983
Net cash provided by operating activities	1,124,679	1,402,922	1,570,349	1,576,749	885,428
Cash from Operations/net income	131.5%	140.1%	142.0%	149.3%	75.0%

But it turns out some of the reason they had had the extra cash was because they had taken a tax position that taxes on income from one of their divisions set up as a cooperative could be deferred. Unfortunately, in 2010, they received an unfavorable ruling from the IRS disallowing this treatment. Not only did they have to stop deferring taxes, they owed substantial back taxes, fines and penalties. In 2010, they had to pay the first portion of their settlement with the IRS. This is continuing in 2011 and 2012.

As you can see, in 2010, this cut their cash being generated from their operations to almost half the percentage it had been historically.

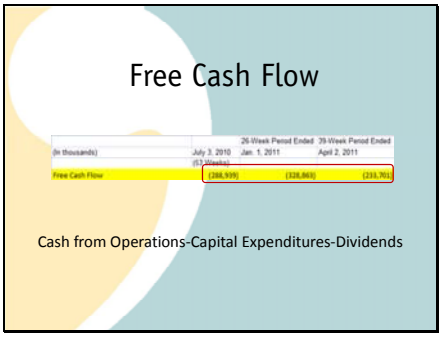


A similar trend has continued in the first 3 quarters of the current fiscal year.



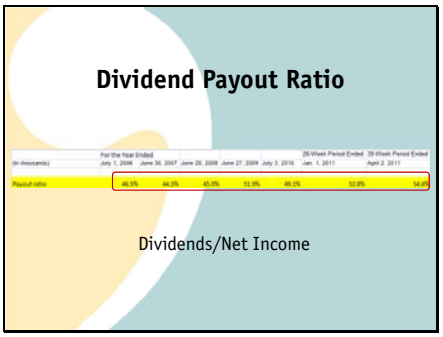
If we look at their free cash flow we can see that historically,

their cash from operations allowed them to fund their capital expenditures and pay their dividend with cash left over.



But for 2011, their

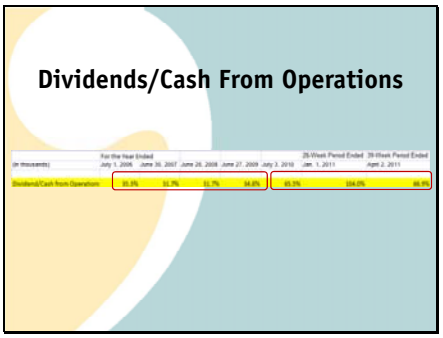
free cash flow has been negative. Meaning that funding their dividend has meant they have had to use cash reserves and even take on some extra debt.



The dividend issue is not seen as dramatically in the more common fundamental used to keep an eye on whether dividends are safe, called the Payout ratio.

Payout ratio is defined as Dividends paid divided by net income

As you can see here, it has crept up, but not to alarming levels.



But if we look at dividends paid compared to cash from operations,

The story looks a bit more disturbing. You can see that prior to the 2011 fiscal year, this percentage has been around 35%.

It has been much higher than that this year.

$1,197,682,745	Earnings Projection
958,146,196	Est. Cash Flow, Operations (CFO)
625,000,000	Capital Expenditures (Capex)
333,146,196	CFO-Capex
579,763,000	2010 Dividend
(246,616,804)	Free Cash - Dividend
209,755,000	Cash end of third qtr
(3,6861,804)	Extra cash needed

Let's try and assimilate some of this information to try get a sense of what might be coming. Analysts have recently revised Sysco fiscal year earnings projections upward to 1.5% higher than last year. This would mean earnings would be:

$1,197,682,745

If cash flow from operations holds at the 80% level, it will end up as: $958,146,196

In their recent third quarter earnings conference call they indicated they have decreased their capital expenditures projection to 625000000-650000000.

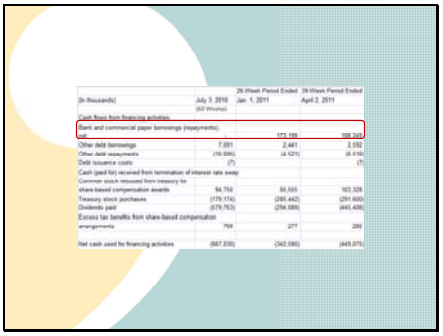
Subtracting the low end of this range would leave $333,146,196.

Their dividend payout for the 2010 fiscal year was $579,763,000.

Meaning they would be short $246,616,804 and would have to draw from their cash reserves to cover it.

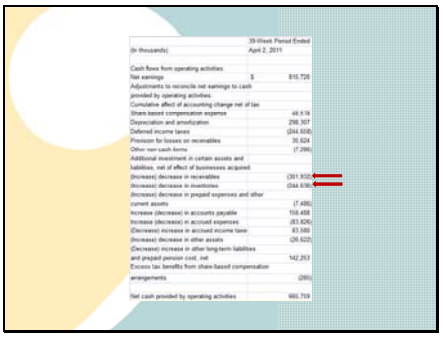
At the end of the third quarter their cash reserves stood at $209,755,000.

Meaning they would still be short almost $4 million dollars needed to cover the dividend, let alone have any cash available for making acquisitions and repurchasing shares.



In the financing section of the cash flow statement

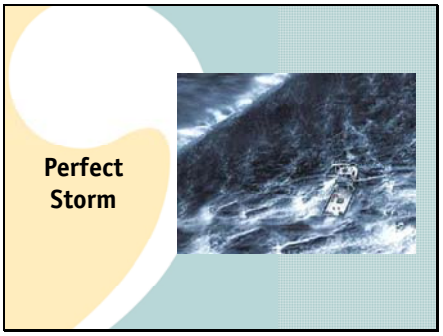
we can already see that there has been an increase in long term debt borrowings this year.



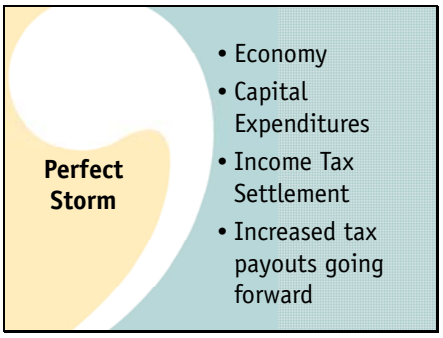
In addition to this information, the cash flow statement shows us that

receivables and

inventory have increased pretty substantially in the first ¾ of the fiscal year. In the most recent quarter, sales increased by 9.1%, but receivables increased by 11% and Inventory increased by 17%. This is something to keep an eye on. An increase in sales due to more extension of credit or an inventory build up are not positive signs.



If nothing else, if you own or are considering a purchase of this stock, I hope this analysis has given you some things to watch out for in subsequent earnings reports. Sysco is a good company but it is up against some tough headwinds.
If you own the stock, the cash flow statement has shown you things are not quite as good as the recent earnings report which showed a 9% increase in sales and a 4.8% increase in earnings. Some of the sales growth may have come from a more generous extension of credit. The earnings growth came about because of a lower tax rate than the previous year. Sysco is facing a perfect storm.



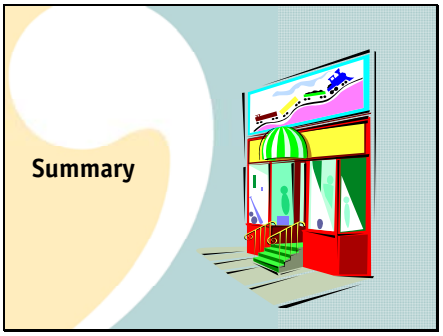
It's a bad time in the economy. The restaurant business is not doing so well and their sales have been pressured.

In addition, they've taken on an ambitious capital improvement plan.

They have large extra income tax settlement payments due this year and next

And they will have an increase in taxes payable each year going forward due to the elimination of the tax deferral. It looks like for a while, Sysco is going to have cash flow pressure. This could bring on extra expenses in the form of interest payments on debt.
If sales and margins don't recover soon for Sysco, they will be facing more near term headwinds trying to maintain their net income increases as they have in the past. If things really get tight, the reliability of their dividend may be in question.

Sysco is a very well managed company. Hopefully things will be improving for them soon. They do expect to come out of this eventually. But they have emphasized in online presentations as recently as June 2, that things are the worst they've ever seen and that everyone should expect choppiness for a while. If you own this as an investment, it might mean you won't see much movement in the stock price until the economy picks up and people start going out to eat again like they used to.



The goal of this presentation was not to turn you into an accountant but to give you some more insight into thinking like a business owner when you own a stock. There is information from the cash flow statement that can provide you potential insight into future earnings results. Since earnings drive stock prices, the more you understand the potential changes in a companies revenue and expenses, the better you will get at understanding why a stock price is behaving as it is. If you want to know why a stocks price is stagnating, it might be because others are seeing these things also.

With a little practice, you can start to pick them out and improve your stock picking efforts in the process!

Club Activity

- Purpose
  - Look at a Cash Flow Statement
  - Identify the Operating, Investing and Financing sections
  - Do some simple cash flow analysis

I hope I have at least peaked your interest in looking at a cash flow statement. As I've shown there is lots of good stuff to learn there about the operations of the business you own a piece of. Much of it is very easy to read and understand and all of it will help you to make better investing decisions about a company. So how might you get started? Here's an idea for a club activity.

It's purpose is to help you

Look at a Cash Flow Statement

Identify the Operating, Investing and Financing sections

Do some simple cash flow analysis

First of all, I'd suggest you get up your courage by finding the

latest annual or quarterly report with the latest cash flow statement in it for a company your club owns. I find that the nicest versions of these can be found on the company websites in their investor relations sections.

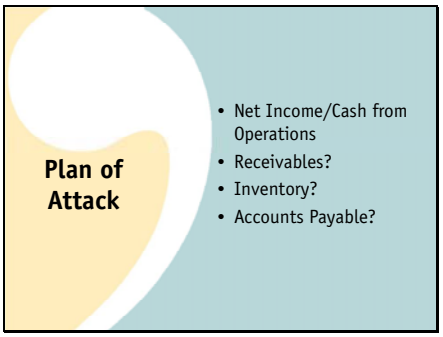
Plan of Attack

- Open up the file and find the cash flow statement
- Find the Operating, Investing and Financing sections

To get your momentum going,

open up the file and find the cash flow statement,

Find the Operating, Investing and Financing sections



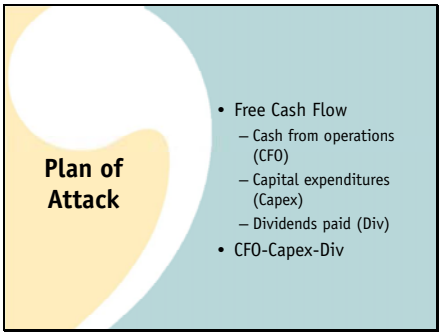
Compare the

net income at the top of the operating section to the Cash from operations at the bottom of that section. Are the companies operations producing or consuming cash? What are the major items that appear to be influencing this?

Are their receivables or

inventory increasing (negative amounts)?

How about their accounts payable? (positive amount).
If anything looks out of line, what does management say about it in the report or in their earnings conference call?



See if you can calculate the free cash flow.

Start with the cash from operations at the bottom of the first section.

See if you can find the capital expenditures in the second section, the investing section. It might be called something like Additions to plant and equipment. If there is also a line for sales of plant and equipment, you should net the two amounts.

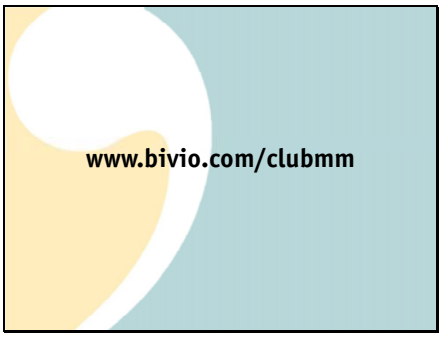
Finally, if your company pays a dividend, you'll find a line for dividends paid in the third section, the financing section.

Subtract the three amounts. Is there still cash left over? If not, do you see in the financing section where additional debt or shares of stock are being issued? What is company management saying about that? Does this create any concerns for you about how their earnings will be growing in the future?

And that's it.

Pat yourselves on the back. You've taken another step into understanding more about the business of a company you own. You're positioning yourself better to understand what might be coming for their future earnings and therefore what might be happening

to their stock price going forward!



Thank you for coming tonight. Just a reminder that you can find this presentation already posted as a PDF file on the clubMM website at this address. We'll also post the recording as soon as we're able to get it edited.

Questions?