

04-May-2023

Portillo's, Inc. (PTLO)

Q1 2023 Earnings Call

CORPORATE PARTICIPANTS

Barbara Noverini

Director-Investor Relations, Portillo's, Inc.

Michael Osanloo

President, Chief Executive Officer & Director, Portillo's, Inc.

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

OTHER PARTICIPANTS

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Sharon Zackfia

Analyst, William Blair & Co. LLC

David E. Tarantino

Analyst, Robert W. Baird & Co., Inc.

Sara H. Senatore

Analyst, BofA Securities, Inc.

Dennis Geiger

Analyst, UBS Securities LLC

Andy Barish

Analyst, Jefferies LLC

Gregory Francfort

Analyst, Guggenheim Partners

Chris O' Cull

Analyst, Stifel, Nicolaus & Co., Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Hello and thank you for standing by. Welcome to Portillo's Fiscal First Quarter 2023 Conference Call and Webcast. I would now like to turn the call over to Barbara Noverini, Director of Investor Relations at Portillo's to begin.

Barbara Noverini

Director-Investor Relations, Portillo's, Inc.

Thank you, operator. Good morning, everyone and welcome to our fiscal first quarter 2023 earnings call. You can read through the results we announced this morning in our earnings press release and supplemental presentation at investors.portillos.com.

With me on the call today is Michael Osanloo, President and Chief Executive Officer and Michelle Hook, Chief Financial Officer. Let's begin with the reminder that any commentary made during this call about our future financial results and business conditions constitute forward-looking statements, which are based on management's current business and market expectations and are not guarantees of future performance.

We do not undertake to update these forward-looking statements unless required by law. Our annual report on Form 10-K and our Form 10-Q both include discussions of risk factors that may cause our actual results to vary materially from these forward-looking statements.

Today's earnings call we'll make reference to non-GAAP financial measures. Any non-GAAP financial measure should not be considered as an alternative to GAAP measures. We direct you to the materials we released this

morning for the reconciliations of these non-GAAP measures to the most comparable GAAP measures. Finally, after we deliver our prepared remarks, we will open the lines for your questions.

Now let me turn the call over to Michael Osanloo, President and Chief Executive Officer.

Michael Osanloo

President, Chief Executive Officer & Director, Portillo's, Inc.

Thank you, Barb and good morning, everyone. We appreciate you joining for our first quarter 2023 earnings call. I'm very happy with our first quarter performance. We grew total sales by 16% and grew our restaurant-level adjusted EBITDA by 24.4%. We also achieved restaurant-level margins of 22.3%, which reflects, both sequential and year-over-year improvement. And I'm especially proud that we were able to do this even as we added seven new restaurants, which tend to be margin-dilutive, since Q1 2022.

Michelle will review our quarterly financial results in more detail later, but, first, let me describe why I think we are well-positioned to sustain this positive momentum. First, the decision to invest in our guests throughout 2022 has given us some comp and traffic tailwind for 2023. In the first quarter, same-restaurant sales grew 9.1%, our transaction count was positive, and our entrée count remained flat. But more importantly, we've sustained multiyear highs in key operational metrics, like speed of service, accuracy, and overall guest satisfaction. These leading indicators give us confidence that our performance is sustainable.

Empowering our team members to prioritize the guest experience helps drive guest satisfaction. This, in turn, leads to higher traffic and throughput and improved margins. And when we're operationally on point and our guests are satisfied, we believe that creates pricing power. We anticipate to stay the course with our price lagger strategy in 2023, taking price only when necessary to combat higher commodity prices, ongoing wage inflation, and other investments in our team members.

Keep in mind, in an environment with persistently low consumer sentiment, we're up in total sales, up in comp, up in traffic, and we've improved our restaurant-level margins. Even as the economy continues to be uncertain, Portillo's has been thriving.

Moving on to development. Gilbert, Arizona is open and the Class of 2022 is complete. Although early, we're thrilled to see that the Class of 2022 is already exceeding its underwriting expectations. Portillo's is a brand that travels and if the lines at The Colony in Texas, which are moving quickly, aren't proof enough [indiscernible] (00:04:22) visit to Schererville, Indiana or Tucson or Gilbert, Arizona, where our teams are working hard to feed hungry Portillo's fans. It gives us great confidence in the longer term ability of our national expansion strategy to generate attractive returns for our investors.

We remain committed to opening nine new restaurants in 2023 and we've already announced the locations for six of them. We have exciting plans to build up the Dallas-Fort Worth area this year, including restaurants in Allen and Arlington. And we've recently announced our Queen Creek, Arizona location, which brings the Arizona market to seven restaurants.

You've also likely seen the announcement that we will open three Chicagoland restaurants later this year. This includes traditional restaurants in Algonquin and Cicero, as well as our second Portillo's pickup location in Rosemont, Illinois a suburb of Chicago that borders O'Hare Airport. It's a fantastic location that will benefit from both airport and entertainment traffic.

This will be the second location to offer drive-thru and pickup, no dining room. And as happy as we are with the performance of our first Portillo's pickup in Joliet, we've learned a ton over the past year about how to make that format and the operations of it even more efficient. We continue to believe that traditional restaurants are the primary means for our growth, but as an infill strategy, Portillo's pickup locations have the potential to drive standard size restaurant revenue and margin dollars through a lower cost of good.

By the way, our ability to self-fund our development is an advantage in this environment. We're not dependent on the capital markets to finance our expansion. And our restaurants generate cash flow immediately. Even if credit conditions continue to tighten and interest rates remain elevated, our cash flow gives us tremendous financial flexibility to achieve our growth.

While we're happy with our recent performance, it's important to remain focused on laying a solid foundation to deliver value for our three core constituents, our team members, our guests, and our investors. We offer our team members exciting opportunities to grow with us as we expand across the nation. They, in turn, take great care of our guests by delivering delicious food and an unbeatable value. This, in turn, enable us to deliver a superior economic profile that generates healthy returns for our investors over both the near and long-term horizon.

With that, let me hand it off to Michelle to share a few more details of the quarter.

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

Great. Thank you, Michael. And good morning, everyone. Before we discuss our first quarter results, I want to recap our recent secondary offering. This quarter, we completed the offering of 8 million shares of the company's Class A common stock at an offering price of \$21.05 per share. Subsequent to the quarter end, the underwriter exercised its option to purchase an additional 620,000 shares of the company's Class A common stock. All the shares sold in the offering represented Class A and B shares owned by pre-IPO members. We use the proceeds to purchase shares primarily from Berkshire, the private equity firm that acquired Portillo's in 2014 and subsequently sponsored our IPO in 2021.

As of April 5, 2023 Class A shares represent 75.9% and Class B shares represent the remaining 24.1%. After these transactions, Berkshire Funds beneficially own approximately 30.8% of the company.

Now, turning to the results for Q1 where we saw strong top line growth. Revenues were \$156.1 million reflecting an increase of \$21.6 million or 16% compared to the first quarter of 2022. This increase in revenues was primarily attributed to an increase in our same-restaurant sales and the opening of new restaurants in 2022 and 2023. Same-restaurant sales increased 9.1% during the first quarter, which was attributable to an increase in average check of 7% and a 2.1% increase in transactions. The higher average check was driven by an approximate 9.2% increase in certain menu prices, partially offset by a change in mix.

Cost of goods sold, as a percentage of revenues, was flat at 34.4% in the first quarter of 2023 compared to the first quarter of 2022. This was primarily due to an 8.9% increase in commodity prices, offset by the increase in our revenue and lower third-party delivery commissions.

We continue to expect that overall commodity inflation will ease and are currently estimating mid-single digit commodity inflation for the full year. Labor, as a percentage of revenues, decreased to 25.9% in the first quarter of 2023 from 27.7% in the first quarter of 2022. This decrease was primarily driven by the increase in our revenue and operational efficiencies, partially offset by incremental investments in our team members, including hourly rate increases.

As of the end of the first quarter, our average hourly rate represents a 7% increase versus prior year and also represents a 28% increase versus 2020. We feel really good about how we are taking care of our teams. We anticipate making continued wage investments in 2023 and remain committed to providing a compelling compensation and benefits package for our team members.

Other operating expenses increased \$3.5 million or 23.3% in the first quarter of 2023. This was primarily due to timing of repair and maintenance expenses, higher credit card fees as we transitioned to cashless drive-throughs, higher insurance and operating supplies expenses, and the opening of new restaurants.

Occupancy expenses increased \$0.7 million or 9%, primarily driven by the opening of new restaurants in 2022 and 2023. As a percentage of revenues, occupancy expenses decreased 0.4% due primarily to an increase in our revenues. Restaurant-level adjusted EBITDA increased 24.4% to \$34.8 million in the first quarter of 2023 from \$28 million in the first quarter of 2022. Restaurant level adjusted EBITDA margins were 22.3% in the first quarter of 2023 versus 20.8% in the first quarter of 2022.

Restaurant-level adjusted EBITDA margin sequentially improved compared to the fourth quarter of 2022 and compared to the first quarter of 2022. Remember, this improvement versus Q1 of 2022 is on top of opening all of our new restaurants this past year, which all have a lower margin profile to start. We accomplished this through our continued efforts to elevate guest experiences, implement operational efficiencies, and deploy strategic pricing initiatives.

On pricing, in January, we increased menu prices by approximately 2%. At the beginning of May, we increased menu prices by approximately 3%. These increases continue to combat inflationary cost pressures and progress towards our goal to improve restaurant-level adjusted EBITDA margins for fiscal 2023. We still believe we have pricing power we can use as necessary. We will continue to monitor the current environment and remain flexible and strategic in our pricing approach moving forward. Our focus remains providing a great value for our guests.

Our G&A expenses increased \$3.1 million to 12% in the first quarter of 2023 from 11.7% in the first quarter of 2022. This increase was primarily driven by an increase in salaries and wages and an increase in professional and software licensing fees. Preopening expenses increased \$1.8 million to 1.5% in the first quarter of 2023 from 0.4% in the first quarter of 2022. The increase was due to the timing and geographic location of activities related to our planned new restaurant openings. All this led to adjusted EBITDA of \$19.6 million in the first quarter of 2023 versus \$17.6 million in the first quarter of 2022, an increase of 11.4%.

Below the EBITDA line, interest expense was \$7.4 million in the first quarter of 2023, an increase of \$1.3 million from the first quarter of 2022. This increase was primarily driven by the year-over-year rising interest rate environment, partially offset by the improved lending terms associated with our 2023 term loan and revolver facility.

On February 2, we announced that we entered into a new five-year, \$300 million term loan and \$100 million new revolver facility. During the first quarter of 2023, we also recognized a \$3.5 million loss on extinguishment of debt. As of the end of the first quarter, the effective interest rate on the term loan was 8.09%.

Income tax benefit was \$0.6 million in the first quarter of 2023, a decrease of \$0.7 million from the first quarter of 2022. Our effective tax rate for the quarter was 30.5% versus 16.6% in the first quarter of 2022. Our effective tax rate increased quarter-over-quarter due to an increase in our valuation allowance and an increase in Class A equity ownership, which increases our share of taxable income or loss. We ended the quarter with \$14.6 million in

cash. Our growth is self-funded by our operating cash flows and our available cash. We remain committed to delivering healthy top line and bottom line growth in 2023 and beyond.

Thank you for your time. And with that, I'll turn it back to Michael.

Michael Osanloo

President, Chief Executive Officer & Director, Portillo's, Inc.

Thanks, Michelle. In closing, I'd like to mention that we just celebrated our 60th anniversary. Most companies would be reaching the maturity part of the growth curve after six decades; but in many ways, we're just getting started. We have a beloved brand that was built on delivering a delicious menu in an energetic atmosphere at a value-driven price point. And we will continue to create decades' worth of memories for new fans as we expand across the nation. Even after 60 years, we have so much opportunities to develop and grow our team members, enhance the Portillo's experience for our guests, and to create enduring value for our investors. Thank you.

With that, let's turn to Q&A. Operator, please open the line for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. We'll be now conducting a question-and-answer session. [Operator Instructions] Our first question comes from Brian Harbour with Morgan Stanley. Please go ahead.

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Yeah. Thank you. Good morning, guys.

Q

Michael Osanloo

President, Chief Executive Officer & Director, Portillo's, Inc.

Good morning, Brian.

A

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Maybe just on the pricing side. I think just checking back on my notes, I think you're sort of replacing what was rolling off from last year. So, I'm curious, is that, to some extent, the philosophy going through the rest of the year and I guess just more generally on sales, anything you'd like to comment on just as you've seen April progress?

Q

Michael Osanloo

President, Chief Executive Officer & Director, Portillo's, Inc.

Let me talk about pricing and I know Michelle will smack me upside the head if I talk about April. But on pricing, we actually have priced just a hair behind where we were last year, very purposefully. So, we are lapping 3.5% pricing in May we only priced 3%. And being totally transparent, we're not sure if there's a need for more pricing. We haven't made any kind of decision on how we're going to price. You know, we'll lap some pricing in October. But pricing on a go-forward basis is very much up in the air, a lot of it depends on what we see with commodities and labor inflation, but we feel really good about where we are.

A

We also feel really good that despite the pricing that we have taken, our guests will tell us that our value scores are at some of the highest scores we've ever seen. So, we feel really good about the value that we're providing for the pricing.

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Q

Okay. Thank you. And maybe just on the labor side, too is – it seems like labor was pretty well-controlled in the quarter, but in terms of making investments in the workforce, is that – is there any particular quarter where you think those would hit? Is that more just about kind of like keeping pace with wage increases in the industry or would you expect any labor investments on your part to be outsized and therefore kind of more impactful to margins?

Michael Osanloo

President, Chief Executive Officer & Director, Portillo's, Inc.

A

I'm going to want Michelle handle that.

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

A

Yeah. I can take that one, Brian. So, we're going to make additional investments like we do every year with just our rate increase as we typically do that within the Q2 period. But I will also say that as we continue to assess all of the markets that we operate in and depending on how labor rates may move in that market, we may need to adjust appropriately, but we will make standard rate increases generally like we do every year within that Q2 timeframe.

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Q

Thank you.

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

A

Yeah.

Operator: Our next question comes from Sharon Zackfia with William Blair. Please go ahead.

Sharon Zackfia

Analyst, William Blair & Co. LLC

Q

Hi. Good morning.

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

A

Good morning.

Sharon Zackfia

Analyst, William Blair & Co. LLC

Q

Michelle, I was hoping you could talk about the cadence of commodity inflation and kind of what you expect for the second quarter versus the back half? And then I just want to confirm following on the second – the last question, does that mean you're running kind of 8.5% of price in the current quarter?

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

A

Yeah, Sharon, I'll take commodities first. So, when we look at sequentially how commodities have moved, when you look at Q4 of last year, we were at about 14.5% inflation. This quarter, we've seen that sequential improvement at 8.9% inflation. I expect we'll continue to see improvement in Q2 as well from where we were at this quarter. I don't know what that'll be, but I do expect to see some improvement there. And then the back half of the year is still TBD at this point, but I expect to continue to see sort of that mid-single digits that we've been modeling over the course of the year.

And so in terms of pricing, to answer your second question, that would put us – when you look at Q1, we were running at 9.2% effective pricing. Q2 will be generally within that range. As Michael mentioned, we did replace the pricing that we had in place. So, it was slightly lower, but the timing of when we put the pricing in place this year versus when it rolled off last year will put us right around where we were in Q1 or possibly even slightly higher. We got to see how that shakes out in terms of where that comes into play. But that's what we're expecting as we sit here today.

Sharon Zackfia

Analyst, William Blair & Co. LLC

Q

Thanks for that. And then I just wanted to touch on the transaction gains, which I know you said entrée counts were flat, transactions were up. Is that really reflective of kind of distortion from a year ago, Omicron-related stuff early in the quarter? Or is something different happening in the business on an ongoing basis where we would see transactions up and entrées flat?

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

A

Yeah. I think Sharon, you – oh, go ahead, Michael.

Michael Osanloo

President, Chief Executive Officer & Director, Portillo's, Inc.

A

Well, I think it is what you described Sharon. But I also think it's a little bit of our channel mix is beginning to stabilize. We have massive swing in channel mix from dine-in to drive-thru. And now dine-in is taking back up. And as our channel mix stabilizes, I think that our transaction count will also stabilize and be more informative.

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

A

Yeah. And I would just add on to what Michael is saying, Sharon, is that there was an outweighed impact at the beginning of the year because of the Omicron lab. And so we're no different than what you've been seeing with the rest of the industry, that we did see that favorability within that front part of the quarter.

Sharon Zackfia

Analyst, William Blair & Co. LLC

Q

Okay. Thank you.

Operator: Our next question comes from David Tarantino with Baird. Please go ahead.

David E. Tarantino

Analyst, Robert W. Baird & Co., Inc.

Q

Hi. Good morning. I wanted to come back to the sales trends. And I know, at least the results for the quarter imply that trends may have moderated on a year-over-year basis in March. And I think that was maybe expected given the early part of the quarter benefited from Omicron and probably weather. But I guess, Michael, I just wanted to get a sense of how you're viewing the business at this point. I'm not necessarily asking for an update on Q2, but just in general your confidence level and the traffic trends and what you're seeing out there amid all the uncertainty with the consumer. Thanks.

Michael Osanloo

President, Chief Executive Officer & Director, Portillo's, Inc.

A

Yeah. David, what gives me the most confidence, honestly, are the leading indicators. So, when I look at speed of service, our value scores, our guests post that, it would suggest – those are the reasons people go back to a restaurant. They visit a restaurant. They have a good experience. They go back. If they visit a restaurant and they don't have a good experience, they tend to delay their repeat cycle. And so the fact that our guests are telling us that they're having good experiences is what gives me a lot of confidence that our performance is sustainable and that we can see a lot of positive momentum maintaining throughout the rest of the year. So, that's what gives me a lot of confidence about what we're doing.

David E. Tarantino

Analyst, Robert W. Baird & Co., Inc.

Q

Great. And then secondly, on the pricing side, I just wanted to understand what you're looking at when you are evaluating your value proposition to the consumer and perhaps what indicators would suggest you still have room or if you've taken it too far?

Michael Osanloo

President, Chief Executive Officer & Director, Portillo's, Inc.

A

Yeah. I mean, so we very carefully track a number of different things. We look at what our value scores are. We literally every guest survey, we ask them what's – how do you feel about the value you're getting at Portillo's? Those are at three year high. We compare our most popular bundle to the most popular bundle of what we believe to be our most likely competitors.

And so we pick an indicative restaurant. We look at what our bundle is versus their bundle, and we feel great about that, like every one of our people that we compete with, their most popular bundle is between a \$1 and in some cases, \$5, \$6 more expensive than the Portillo's bundle. So, that combination is what gives us a lot of confidence that we are priced appropriately, that we represent a value proposition, and that if necessary we can always [indiscernible] (25:19) if necessary.

I don't – we all know, it's not healthy to try to grow your comp via a price. What's really healthy is to grow your comp via transactions. Price is a lever I think to offset idiosyncratic things that happened in your P&L, so when commodities go up 14%, 15%, you're going to have to price. We've increased our labor – our labor costs have gone up 28% over the last couple of years. You're going to have to increase a little bit of price. But when you're not seeing that level of sort of historic inflation, then I think you can moderate on price a little bit.

And above all, we love being a sharp value. We think that that is part of the magic of the Portillo's formula is that we provide great value for our guests.

David E. Tarantino

Analyst, Robert W. Baird & Co., Inc.

Makes sense. Thank you.

Q

Michael Osanloo

President, Chief Executive Officer & Director, Portillo's, Inc.

Thank you.

A

Operator: Our next question comes from Sara Senatore with Bank of America. Please go ahead.

Sara H. Senatore

Analyst, BofA Securities, Inc.

Thank you. Just a quick follow-up and then a question. On the sort of channel mix settling out, I assume that that's why your mix on the check was negative, just maybe shifting to smaller parties. So, more transactions, smaller parties potentially. So, I wanted to just clarify that or if you're seeing any kind of lower attach, anything else that would have affected the mix.

Q

And then I do have a question on restaurant development. If you could just maybe talk a bit further, a bit more about the Chicago land development. I know you said there were some lessons from the first off-premise only, but anything else, just given how dense that market already is, anything that you can kind of tell us about cannibalization, impact on comps, anything to give us a sense of the reason for building up that market even more. Thank you.

Michael Osanloo

President, Chief Executive Officer & Director, Portillo's, Inc.

You bet. Let me talk about development and I'll let Michelle handle the mix question. On development, look, Chicago is incredibly good to Portillo's. And so, when we build a restaurant in Chicago, it comes out of the gate doing exceptionally well; very, very high levels of revenue; very attractive margins. So, it is incumbent on us to thoughtfully and selectively fill in the Chicago market. So, in Algonquin, there's just a hole in our coverage. People who live in that area need to drive 20, 25 minutes to get to their Portillo's. We'd like to make it easier.

A

Cicero is a fantastic location. It's on the pad of one of the busiest Walmarts on the planet. We think it's going to be an absolute homerun for us. We're super excited. And then the Joliet pickup location, and I say pickup but remember it's drive-thru, pickup catering. What it really isn't – it isn't a dine-in experience. So, Joliet has done very well. It's doing everything that we [indiscernible] (00:28:25). But the God's honest truth is we probably overbuilt that restaurant a hair, and I think we've discovered that we can build a smaller footprint, a little bit of a tighter kitchen, and that there's some little things that we can do well. We have – it's a very busy restaurant for third-party delivery, for our own delivery, for pickup. And so we want to make sure that we have that built into the restaurant better than we did in Joliet. So, we're continuing to master how that pickup location looks. And I've said this before, Sharon, I think that a Portillo's pickup is a wonderful infill strategy, and I can imagine us building a bunch more of those in Chicago and in other markets as we achieve local scale.

Sara H. Senatore

Analyst, BofA Securities, Inc.

Thank you.

Q

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

Hey, so, Sara, I can...

A

Michael Osanloo

President, Chief Executive Officer & Director, Portillo's, Inc.

You bet.

A

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

...take the mix question.

[indiscernible] (00:29:18)

A

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

That's okay.

A

Sara H. Senatore

Analyst, BofA Securities, Inc.

Thank you.

Q

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

When you look at mix, those as you know, there's multiple things that come in to mix. Channel mix plays into it. But I think, generally, what you're seeing is a continuation of what we had been talking about over the course of the back half of last year where we are seeing a little bit less attachment. So, lower items per transaction. So, as Michael mentioned we're still seeing growth and the transaction count, but we're seeing a little bit less add-ons, whether that's a drink or a side, et cetera. That's what we're generally seeing in the mix. But you do get a little bit of channel in there as well.

A

Sara H. Senatore

Analyst, BofA Securities, Inc.

Thank you.

Q

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

Yeah.

A

Operator: Our next question comes from Dennis Geiger with UBS. Please go ahead.

Dennis Geiger

Analyst, UBS Securities LLC

Q

Hey. Thank you. Morning, Michael and Michelle. I wanted to ask about given the strength of the performance of recent opens, including I think results have generally exceeded underwriting expectations in many cases. Can you talk about how maybe – slight adjustments maybe to underwriting assumptions going forward, plus this kind of no dine-in opportunity, what that might mean for your total restaurant count over time if there's any thoughts at this juncture to share on that?

Michael Osanloo

President, Chief Executive Officer & Director, Portillo's, Inc.

A

It is an outstanding question and I apologize because I'm going to punt on it for a bit. We are going through the process of looking at our total addressable market, especially now that we are getting comfortable with this new format. And so our expectation is that we're going to have an Analyst Day, a more modest one in late September. And we're going to go through what we believe is our fully addressable market, our full potential, including standard restaurants and Portillo's pickup, as well as targeting what we think are non-traditional venues.

So, think Airports, other things like that. And we're also going to try and take a look what we think we can do with regard to international franchise. So, that's a whole process. I don't want to sneak off the cuff right now about what we think. But we'll have a very fulsome conversation about that in September.

Dennis Geiger

Analyst, UBS Securities LLC

Q

Very exciting. We'll look forward to that. Just one other one then. And I think you touched on this some. But as it relates to the new build environment and what you've done already this year and now you're on track for the full year. Any more commentary on sort of the supply chain situation, the timing on the permitting side, et cetera, that – where you see that improving as we go through the year? Any more color there? Obviously, your targets speak for themselves. But...

Michael Osanloo

President, Chief Executive Officer & Director, Portillo's, Inc.

A

Yeah. Look, I think there's a glimmer of hope, but I'm not going to describe it as much more than that. So, we're certainly seeing the supply chain. The supply chain is freeing up a hair. And so we're not quite as nervous about that part of it. The biggest issue is still the permitting processes. And I think we've talked about this before, that we have budgeted a heck of a lot more time for permitting than we ever did in the past. We've just added a ton of time. It's one of the reasons why the nine new restaurants that we're building this year are all back-end-loaded. They're all Q3, Q4. It is because of permitting issues. So, I'm not seeing – we're not seeing a ton of improvement there. But on the supply chain, it's getting a little bit more free flowing. And I think that we're seeing – I'm not going to say cost moderating, but they're not going up as fast as they were. How was that? Michelle, anything you want to add to that?

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

A

No. I would just add to that, Dennis, to Michael's point on the build cost side. He's exactly correct. We're not seeing any moderation from what we previously talked about. The good news is we're not seeing hefty increases. The availability is getting a little bit better. And so we'll see how the Class of 2023 shapes out, but we feel good about the timing, to Michael's point, that we put out there and our ability to get those built within the back half of the year.

Dennis Geiger

Analyst, UBS Securities LLC

Thanks, guys. Appreciate it.

Q

Michael Osanloo

President, Chief Executive Officer & Director, Portillo's, Inc.

Thanks, Dennis.

A

Operator: Our next question comes from Andy Barish with Jefferies. Please go ahead.

Andy Barish

Analyst, Jefferies LLC

Hey, guys. Good morning. Quick update on The Colony. Would you like to share kind of where that's settling in on an average weekly sales basis?

Q

Michael Osanloo

President, Chief Executive Officer & Director, Portillo's, Inc.

What I'll say, Andy, is that it continues to flout all of our expectations. It's crushing it. It's still on pace to be one of our top three or four restaurants in the company. It's maintaining outstanding momentum. It puts a twinkle in my eye. Colony is just – it's doing really, really well, continues to give us a lot of confidence about what we can accomplish in Texas.

A

Andy Barish

Analyst, Jefferies LLC

Yeah. Look forward to seeing it. Michelle and maybe Michael, on the margin improvement, I mean, for restaurant-level margins for this year just given the back half, 9%, and some of the inefficiencies associated with that, I mean, should we think of that as kind of modest restaurant-level margin improvement versus 2022? And then I wanted to kind of get a little bit more color on labor as well. I mean, do we kind of think of the efficiencies that you continue to get out of the business as a way to sort of fund some of the wage investment and some of the NRO inefficiencies? Just any more color on that would be helpful.

Q

Michael Osanloo

President, Chief Executive Officer & Director, Portillo's, Inc.

Yeah.

A

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

Yeah.

A

Michael Osanloo

President, Chief Executive Officer & Director, Portillo's, Inc.

Let me tackle the second...

A

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

A

Sure, go ahead.

Michael Osanloo

President, Chief Executive Officer & Director, Portillo's, Inc.

A

Let me – and let Michelle handle the first. So, Andy, you're 100% right that we are getting smarter and smarter and smarter about how to run our restaurants efficiently. So, we continue to outsource some of the prep that is actually stuff that our team members don't want to do, don't enjoy doing. And we're getting smart at letting our suppliers do more prep for us. And then recall that we rolled out what we call Kitchen 2023, which is a retrofit of some of our existing kitchens in the Chicagoland market. It spruces up the restaurant. It moves the salad bowl area back into the line. It puts in a grab-and-go merchandising inside the restaurant. It's actually quite beautiful. It's eye catching. And it's got to – we think that there's a little bit of upside in terms of sales, that's not why we're doing it. But it does let us be more efficient with labor.

So, that's a big unlock for us. It's got the potential of reducing somewhere between one and two FTEs during the day. And so that's a big deal. Those people can do other things for us. They don't need to be moving – because it's a lot of conveyance, it's how the kitchen was designed.

So, Kitchen 2023 is a big unlock. Continuing to take prep to the suppliers and letting them do more for us is another big unlock for us.

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

A

Yeah. And I can tackle the restaurant-level margin question, Andy. So, to your point, I am expecting for the full year, right, looking at modest improvement versus full-year 2022, [indiscernible] (00:37:30) the compares as we get into Q2 last year comping over 25.5% margin in Q2 and looking at Q3, Q4, et cetera. But as you look at those key input costs, you mentioned one labor, the other being food costs. And so, as we look at how those continue to behave, right, I think that's going to drive where we see margins coming in at.

And as I mentioned on my remarks, we're going to be flexible in our pricing approach. You saw stake pricing just this month in reaction to the continued increases that we're seeing in particularly commodities and additionally in labor. And so, it's unknown quarter-over-quarter how that's going to behave, but I'm just going to stick to the point that, yes, for the full year, we definitely expect margin improvement versus 2022.

Andy Barish

Analyst, Jefferies LLC

Q

And just a quick follow-up on the remodels. I think the number this year you were trying to get to is 15 to 20. Do you – you kind of have a schedule you're willing to share with us on when those are taking place or how many you're expecting in the first half of the year?

Michael Osanloo

President, Chief Executive Officer & Director, Portillo's, Inc.

A

I wanted to just not rush into it. So, we took a little bit of time to figure out exactly what the right merchandising is and how to make that section of the restaurant look beautiful. So, I suspect that we'll start deploying these and do a lot of that heavy lifting beginning in the third quarter. So, it's very much a back half-loaded dynamic. And it is – we're still targeting between 15 and 20 in Chicago.

Andy Barish

Analyst, Jefferies LLC

Thanks, guys.

Q

Michael Osanloo

President, Chief Executive Officer & Director, Portillo's, Inc.

You bet.

A

Operator: Our next question comes from Gregory Francfort with Guggenheim Securities. Please go ahead.

Gregory Francfort

Analyst, Guggenheim Partners

Hey, guys. Thanks for the questions. The first one I had was just on maybe the new store openings recently outside of Texas, the one in Kissimmee and the couple in Arizona. How have they been performing? And I guess I ask within the context of I think the Sunbelt market has performed pretty substantially kind of above the system on AUVs. And I'm wondering if the new store volumes this year, sales this year might come in meaningfully above \$6 million you guys have seen historically. Just any thoughts on that.

Q

Michael Osanloo

President, Chief Executive Officer & Director, Portillo's, Inc.

Yeah. Look, I have certainly bragged about The Colony, and partly because I think there were some questions whether or not we could survive or do well in Texas. So, I felt it was important to talk about the performance of The Colony. The rest of the Class of 2022, Greg, is doing outstanding. So, whether it is Tucson, Gilbert, Schererville, Indiana is killing it. And so we're extremely happy with the Class of 2022.

A

As a class, we're very comfortable that it's going to be all of our underwriting expectations. And we've got a [indiscernible] (00:40:35). And that's how we think about it, right. We're not going to have every single restaurant crush it every single year. Our goal is as a class to beat our underwriting expectations. And we're very comfortable the Class of 2022 is doing that.

Honestly, I think we've kind of figured out a formula on where to build, how to build, why to build. That gives me a lot of confidence that we – that there's a replicable model now. And that we can find restaurants that are going to outperform. So, I'm really excited. I'm just as excited by the Class of 2023. I think the restaurants that we've already announced are going to be outstanding. I would be – if – I'm not a betting man, but if I was, I'd certainly bet on the over on how I think that the Class of 2023 is going to do.

Gregory Francfort

Analyst, Guggenheim Partners

Awesome. Thanks. And then maybe one for Michelle. Just I think one of the kind of topics we hear a bit is the beef inflation in the next few years. And can you maybe remind us where that stands if you're able to hedge it, and as you look towards the end of the year, I guess the mid-single digit inflation would suggest you drop into the kind of flat to low single-digit range. What is embedded in there around beef and maybe the rest of the commodity basket that are the offsets? Thank you.

Q

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

A

Yeah, Greg, no problem. So, as you know, beef is about 35% of our total basket, with the beef flats in particularly being a heavier portion of that. So, when we look at what we've done with that, on the flats, we have about 50% hedged on that for the remainder of the year, with close to 70% of that hedged in Q2 alone. So, we feel good about that line item in particular and being able to lock that in at prices that are below our internal budget as we looked at that line item. But you're right, we do – we've expected all along that beef was still going to be elevated this year in 2023 versus 2022.

I think what you're seeing offsetting some of that, when you look at the other items in our basket, chicken and pork in particular are the other two proteins, make up just over somewhere between 15%, 16% of our basket. We're seeing deflation on those proteins right this year, so that's buffering some of that increase. But then as I've mentioned before, we are seeing heavier increases in our French fries and onion rings as well. And so that's hurting us as we look at 2023 versus 2022.

But when we look at the overall basket of goods and where we're at today, as I mentioned, the flats are hedged. We still are hedged about 35% for the full year. And so with the flats being the strong portion of that. So, I feel good about where we're set. We're still exposed a little bit on some of the beef items like our burgers, but I think, to your point, we do expect to see some deflation both within Q2 and particularly in Q3 and Q4.

Gregory Francfort

Analyst, Guggenheim Partners

Awesome. Thank you, guys.

Q

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

No problem.

A

Operator: Our next question comes from Chris O'Cull with Stifel. Please go ahead.

Chris O'Cull

Analyst, Stifel, Nicolaus & Co., Inc.

Thanks. Good morning, guys. Michael, I understand a few of the openings from the Class of 2022 fell into this year, but the company's planning to open a significantly higher number of units in a shorter timeframe than it was initially planning. So, I was hoping you could speak to the availability of resources, such as training teams and things like that that you might need to – that are going to clearly support these openings.

Q

Michael Osanloo

President, Chief Executive Officer & Director, Portillo's, Inc.

Yeah. It's a great question, Chris. I will phrase this slightly differently. It's not that we're opening a bunch more. It's that, honestly, we missed some deadlines in the Class of 2022 that slipped into 2023. So, the plans for 2023 have always been the plans for 2023. And the thing that matters the most to me, to Michelle, to the leadership team, is that every one of the restaurants that we're opening has an experienced Portillo's General Manager at the helm. If you said, what is the key to de-risking this investment and making sure these restaurants open well? I would tell you I believe it is experienced management.

A

And so every one of the – the nine restaurants we're targeting for the Class of 2023, we know who the GMs are. In fact, the restaurants that we're targeting for the Class of 2024, we know who the GMs are. And so that to me is a massively important unlock. We have a wonderful new restaurant opening team. And where our new restaurant

opening teams operate is it's – we've announced we'd be like the fire department, right. You've got full time people on the NRO team. But then you've got volunteer NRO people in markets where they can help out as necessary. So, when we open in Arizona at this point, it's honestly it's just super easy for us because we've got GMs in place. We've got very experienced team members in place. So, Queen Creek, I suspect, will open really seamlessly quite well.

We're opening – we announced two more restaurants in Texas. Both the GMs in Texas are already at The Colony and that's where they're getting their legs under them. We overinvested in The Colony with talent to make sure that we can open it. So, when it comes to management, because that's the gating factor. And when it comes to the NRO team, I feel like we're in a really, really good position. And we can open not just get it open, that's not good enough, but get it open in an outstanding way and give guests and team members great experiences from the get go.

Let me pause there if you got [indiscernible] (00:46:35). Yeah.

Chris O'Cull

Analyst, Stifel, Nicolaus & Co., Inc.

Q

No. That's great. How is the mix, the menu mix, then in The Colony and maybe some of these other new stores? Has it been representative of the system?

Michael Osanloo

President, Chief Executive Officer & Director, Portillo's, Inc.

A

In general, yes, although there is an oddity with The Colony, which is that we're selling a heck of a lot more beef sandwiches than I think is normal for an out-of-market restaurant. I mean, actually heck of a lot more of beef sandwiches than we sell at any of our restaurants, so – which is wonderful news, by the way, because I think in the back of some investors' mind, does this – this Italian beef sandwich actually travel. And boy, is it traveling in Texas. And it gives me a lot of comfort because it's truly an iconic menu item. If you want an Italian beef sandwich in Texas, you pretty much come to us.

And so, I love the fact that it's mixing very high. I love the fact that people are coming in for those beef sandwiches and they're coming back for those beef sandwiches because, again, it gives me a lot of confidence that our concept and the food will travel better than maybe some people expected.

Chris O'Cull

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Yeah, I agree. That's encouraging to hear that. And then just lastly, Michelle, how much do you believe new unit performance was a drag on the restaurant margin during the quarter? I think you called that out as a drag.

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

A

Yeah. We haven't quantified that, Chris, and so, I'm not going to give you an exact number. Obviously, as Michael alluded to, it's exceeding our expectations. So, I would just point to that. But as you know, it's definitely going to be a drag as we've talked about the profile of restaurants in year one. Particularly in that first quarter, right, that they open, Chris, it's going to be a bigger drag than it normally would be as you look at the whole totality of the year, because you're staffing up the restaurants, as Michael mentioned, with some additional labor to make sure you're servicing the guests, et cetera. So, we're not quantifying that, but you're spot on, it was a little bit of a drag, particularly in Q1, as we had more new openings.

Chris O'Cull

Analyst, Stifel, Nicolaus & Co., Inc.

Great. Thanks, guys.

Q

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

Yeah.

A

Michael Osanloo

President, Chief Executive Officer & Director, Portillo's, Inc.

Thanks, Chris.

A

Operator: There are no further questions at this time. This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.

Disclaimer

The information herein is based on sources we believe to be reliable but is not guaranteed by us and does not purport to be a complete or error-free statement or summary of the available data. As such, we do not warrant, endorse or guarantee the completeness, accuracy, integrity, or timeliness of the information. You must evaluate, and bear all risks associated with, the use of any information provided hereunder, including any reliance on the accuracy, completeness, safety or usefulness of such information. This information is not intended to be used as the primary basis of investment decisions. It should not be construed as advice designed to meet the particular investment needs of any investor. This report is published solely for information purposes, and is not to be construed as financial or other advice or as an offer to sell or the solicitation of an offer to buy any security in any state where such an offer or solicitation would be illegal. Any information expressed herein on this date is subject to change without notice. Any opinions or assertions contained in this information do not represent the opinions or beliefs of FactSet CallStreet, LLC. FactSet CallStreet, LLC, or one or more of its employees, including the writer of this report, may have a position in any of the securities discussed herein.

THE INFORMATION PROVIDED TO YOU HEREUNDER IS PROVIDED "AS IS," AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, FactSet CallStreet, LLC AND ITS LICENSORS, BUSINESS ASSOCIATES AND SUPPLIERS DISCLAIM ALL WARRANTIES WITH RESPECT TO THE SAME, EXPRESS, IMPLIED AND STATUTORY, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, ACCURACY, COMPLETENESS, AND NON-INFRINGEMENT. TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, NEITHER FACTSET CALLSTREET, LLC NOR ITS OFFICERS, MEMBERS, DIRECTORS, PARTNERS, AFFILIATES, BUSINESS ASSOCIATES, LICENSORS OR SUPPLIERS WILL BE LIABLE FOR ANY INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL OR PUNITIVE DAMAGES, INCLUDING WITHOUT LIMITATION DAMAGES FOR LOST PROFITS OR REVENUES, GOODWILL, WORK STOPPAGE, SECURITY BREACHES, VIRUSES, COMPUTER FAILURE OR MALFUNCTION, USE, DATA OR OTHER INTANGIBLE LOSSES OR COMMERCIAL DAMAGES, EVEN IF ANY OF SUCH PARTIES IS ADVISED OF THE POSSIBILITY OF SUCH LOSSES, ARISING UNDER OR IN CONNECTION WITH THE INFORMATION PROVIDED HEREIN OR ANY OTHER SUBJECT MATTER HEREOF.

The contents and appearance of this report are Copyrighted FactSet CallStreet, LLC 2023 CallStreet and FactSet CallStreet, LLC are trademarks and service marks of FactSet CallStreet, LLC. All other trademarks mentioned are trademarks of their respective companies. All rights reserved.