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Portillo's, Inc. (PTLO)

Stephens Investment Conference

CORPORATE PARTICIPANTS

Michelle Hook
Chief Financial Officer, Portillo's, Inc.

OTHER PARTICIPANTS

Joshua C. Long
Analyst, Stephens, Inc.

MANAGEMENT DISCUSSION SECTION

Joshua C. Long
Analyst, Stephens, Inc.

Great. Thank you so much for everyone for joining. My name is Joshua Long. I'm the restaurant analyst here at Stephens. Super excited about our next presentation. We've got recently initiated company in Portillo's. We've got Michelle Hook, CFO, and the team here in the audience, but really excited about this conversation. There's an opportunity here that few other in the restaurant industry are really going to be able to capitalize on. Amazing six-year-old brand in the Midwest. So those of you from the Midwest are very familiar with this. But pretty soon, nationwide, the brand will be much more understood and appreciated as well.

So, exciting growth story. We're going to talk through that today. Very interesting unit deployment and then also a sales model as well. So please feel free to get your questions ready here in the room. We're also taking them online. So if you have any questions, feel free to shoot them to me at joshua.long@stephens.com.

And with that, my extreme pleasure to invite Michelle Hook, CFO of Portillo's, to the conference. Thanks so much for being here, Michelle.

Michelle Hook
Chief Financial Officer, Portillo's, Inc.

Thanks, Josh. Appreciate you having us here.

Joshua C. Long
Analyst, Stephens, Inc.

Yeah.

Michelle Hook
Chief Financial Officer, Portillo's, Inc.

Excited to tell the story.

Joshua C. Long

Analyst, Stephens, Inc.

Absolutely. Maybe just for a level set coming out of the recent third quarter results, if you could talk about what you're seeing in the environment, how things have been shaping up. I know we'll have a lot more time to discuss the current operating environment where we come from or where we're going. But maybe just a couple comments in terms of where you're most focused on and kind of how the team is feeling heading into year-end].

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

Yeah. No, I think, look, our most recent performance we're extremely proud of when you look at the top line growth that we generated, double-digit revenue growth. And when you look at our restaurant level margins in the quarter at just over 25%, I think that really does show the health of the business, right, not just only generating that top line growth, but seeing really the flow through come within the bottom line.

And so we've been able to manage through some inflationary times in the recent past when you look at the high inflation in 2022, but we're seeing costs behave with the way we thought they would this year. Mid-single digit inflation in both our food and labor cost has allowed us to leverage some line items with that top line and grow our margins this year. That's something we're very proud of, we were very mindful of coming into this year. We gave away some margins in 2022 when we had high inflationary periods. But coming into this year, we were very purposeful about growing that margin profile for Portillo's.

But also, I'm really proud this year about the new unit growth, and I think that really is the story for Portillo's. When you look at we can sit here and talk comp all day. I know that people want to talk that and dissect the comp and that's great. But the Portillo's story really is a unit growth story and a new development story. And so, this year alone, we will have opened up, by the end of this year, 12 new restaurants for Portillo's, right? And we'll go from 72 restaurants to 84 restaurants at the end of this year. That's a lot of growth this year, right?

And I'm really proud of the teams because we prepared ourselves for that growth and to be in position to have scalable processes and have the teams in place to not just open those restaurants, but to run those restaurants. And so, we always say people are at the heart of Portillo's and really proud of the teams that are opening those restaurants and giving the guests great experiences. When our restaurants open, that's super important to us to keep the guests coming back.

We also entered a new market this year, so we entered the state of Texas, the Dallas market. We opened our first restaurant in January, but we'll be at five restaurants in the Dallas market by Q1 of 2024. So Portillo's is looking to not just scale this brand and plant flags, but to really build scale in the markets that we enter. And so I think Dallas is a perfect example of that, Josh, where we're going to get to scale really quickly in that market and then continue to grow in the state of Texas and go into Houston in 2024.

QUESTION AND ANSWER SECTION

Joshua C. Long
Analyst, Stephens, Inc.

Q

That's really exciting. And I think you touched on several elements that I think are important, at least to maybe begin the conversation with. One, I mean, unit growth, this is very much a unit growth story, but we've seen a lot of unit growth stories over time. And from our perspective, this one's different and very unique in that it touches on both convenience, quality, value perception and replicability, so the ability to execute that at scale. And that's before we even get to the point that you're doing things, your concepts is built in a way that others just simply aren't in terms of the AUVs, the margins, what you're developing and how you're being able to scale that over time.

So can we talk a little bit about that? I know it's a six-year-old brand. There's an amazing heritage there that's grown up in the Midwest and certainly creates this very strong baseline from which you can grow over time, but I think for those that have been in the stores, they certainly get it. And those that are going to be going to the stores as you continue to build out. I mean, these are big volume stores, they're complex, but you operate them very efficiently in a way that I think others in the industry probably would love to learn how to do, but it's a very solid moat that you've created. So maybe if you could talk a little bit about just the core concept where we come from and then maybe we could go forward in terms of how we're going to scale that.

Michelle Hook
Chief Financial Officer, Portillo's, Inc.

A

Yeah, I think what – your point is very valid. When you think of Portillo's, it is definitely a unique concept in the restaurant industry. And so we're this hybrid blend of QSR, fast casual, a little bit of elements of casual dining. And so when you look at where our AUVs are today, right, we average almost $9 million across the company in AUVs for a restaurant, right, that has an average ticket of $22, right? So this isn't a fine dining restaurant that's doing these AUVs. This is really, as I said, a blend of those restaurant concepts.

So we're multichannel. I like to say we're multichannel before it was a thing, before it existed. And so when you think about a Portillo's today, 40% of our business is dine-in, 40% is drive-through , and then the other 20% is going to be delivery, catering and that I call it other off-prem type business. And so, we're doing this volume through many different channels, right? It's not dependent on one channel. And so, I think that makes Portillo's special as well in comparison to others, and it also makes us unique and when you look at where the volumes are and the channels that it's going in.

And when you look at the different markets that we're in, right, this isn't out-weighted one market or the other, but Chicagoland is where we grew up. We do just under $11 million AUVs in Chicago with 30% margins. But outside of Chicago, right, we're at about just over $6 million AUVs and over 20% margins.

If I just threw out Chicago, right, and said, hey, how about I have a restaurant concept that does $6 million in AUVs and 20% margins, that sounds pretty good, right? But the Chicago restaurants, right, being 60-year-old brand there is just producing fantastic cash flows that we're using to grow in those high-growth markets.

And so, our restaurants cash flow immediately. I think that's also another unique element to Portillo's when you look at some high-growth restaurant concepts and we're able to fund our own growth. So, I love that about our brand. This isn't a brand that's going to have to take on a bunch of additional debt or raise capital to grow. We're going to fund our own growth and we're going to continue to reinvest the capital into those new units that we're going to build.

Joshua C. Long
Analyst, Stephens, Inc.

Q

No, that's well said. I mean, if we even took just, again, throwing Chicago out of there, we just said $6 million AUVs, really strong margins in limited service doing things other can't do. I mean, that's impressive in and of itself. The no debt, the self-funding piece is – it removes a layer of complexity that others don't necessarily have. And underlying that is we touched on it and we talked a little bit this about this in the last session, too. I mean, it's a little bit challenging at times because there's never a line item in the P&L that says the power of culture and brandability and human capital focus. But I mean, that's really what gets the flywheel going.

And so maybe talk about that a little bit. I mean, you mentioned people being at the heart of the brand. That is a – it's an interesting concept. We don't talk about nearly as much because we always look at things through the lens of the model. But that's what helps these numbers and these unit growth come to life. So talk a little bit about the culture, the human capital piece and kind of how that sets you up for going forward.

Michelle Hook
Chief Financial Officer, Portillo's, Inc.

A

Yeah. I don't think you could do the volumes that we do without giving the guest a great experience, right? Yes, our food, look, I, of course, am biased, but I think there's many people that have tried Portillo's that will, say, our food is very craveable, right? Our food's very craveable. But if you think about why you come back to restaurants, it's because you had a good experience, right? And part of that experience is not Michelle taking your order and giving you a smile, greeting you and doing all those. It's our frontline team members that create that good experience.

And so, culture is super important to Portillo's. Our values of family, greatness, energy and fun are what we live by, what's what we breathe. And we are – we hire based on our values. And so I think that comes through in the guest experience.

And so when you look at our restaurant on average, we have to roster over 100 people per restaurant. There's a lot of labor that goes into our restaurants. But at the same time, when I look at our hourly turnover rates, they're 20 to 30 percentage points better than the rest of the industry. And I think that speaks to why people want to continue to work at Portillo's is because we – it's kind of that virtuous cycle, Josh, where if we take great care of our team members, they in turn take great, great care of the guests, which then in turn benefit our shareholders and investors, right? So I look at it that way, but absolutely, team members are at the heart of everything that we do.

It's really when we talk about growth, it has been one of the gating factors of our growth. We are committed to not opening a new Portillo's unless there is a seasoned GM running that restaurant. There's been mistakes in the past, no doubt. And we raised our hand and admit to those mistakes and say, look, in the past we've opened up a Portillo's that didn't have an experienced Portillo's general manager, and it was not fun. There were some disasters in there and those are learnings. And so we want to make sure that we had the people pipeline working to be able to grow at the rate and pace that we were comfortable growing at.

And so that's what we're committed to, is opening that with an experienced GM. So you know what, when we do a [ph] $40,000, $50,000 (00:10:39) a day at Portillo's, the GM says, I got this. I know what's going on and I'm not going to panic. My team is not going to panic and we're going to get through this. Those are busy restaurants to run. And so we have to make sure that we have the people pipeline to run those. And that's where we've really worked over the last couple years to build that out so I can sit here and look you in the eye and tell you that for the four remaining restaurants we're going to open this year as well as the restaurants in 2024, we know all the GMs are going to open those restaurants for us because we have that pipeline in place.

Joshua C. Long
Analyst, Stephens, Inc.
Q

That's super important. And I mean, could you talk a little bit about the tenure at the GM level? I mean, I know that you've got some amazing case studies and examples there, the ability to cross-pollinate from the Chicagoland market to other geographies. I mean, that really puts you a step ahead of other brands. As you mentioned, it's really not about financial gating. You have the money, you're self-funding that growth. It's really about human capital. And we've seen – the industry's seen over time, that's where groceries typically tend to stumble, is not having the right people, but it feels like you've got a great, great funnel and a great pipeline already.

Michelle Hook
Chief Financial Officer, Portillo's, Inc.
A

Yeah, we do. And look, there's definitely not a shortage of Chicagoans, Chicago team members that are raising their hand to go move to...

Joshua C. Long
Analyst, Stephens, Inc.
Q

The Sun Belt.

Michelle Hook
Chief Financial Officer, Portillo's, Inc.
A

...the Sun Belt of Arizona, Texas and Florida. And so when we looked to open our first restaurant in Dallas, we had to move team members down into that market. We over-indexed on labor and moved more people down there that we're going to open restaurant two, three and four as we went into that market and so that was very purposeful. But it's why I come back to the point of building scale in those markets is so important because then, Josh, you start to get a team of a group of individuals and team members within that market that are going to start developing within that market for restaurants six, seven and eight that open within that market. And so that's where some of the scale benefit comes into play as well. But our GMs are very much motivated for growth.

What I love about Portillo's, too, is you can have a fantastic career at Portillo's even starting out as an hourly team member. We do a lot of training internally in Portillo's, where we show people a path starting out as an hourly team member, working your way to a crew chief, which is a manager, it's an hourly manager within our restaurants, and then working into a manager and then we have an AGM, an assistant general manager and a general manager in all of our restaurants. And so they see that growth and what they can manage, right, a multi-million-dollar restaurant, right, when you get to our general manager level. And we take really good care of our team members. Our general managers, they get equity within the company, they get annual equity grants. We have very competitive base and bonus structures for them. And so from a cap and benefit standpoint, it's a very good career that you can have at Portillo's.

Joshua C. Long
Analyst, Stephens, Inc.
Q

It's amazing, when we think about just the upward mobility and the vehicle for wealth creation, I mean, it's disguised as hard work, of course, but there's no shortage of stories of someone who has started at the crew level. I started as a dishwasher or whatever it may be, working my way up through a lot of hard work, a lot of grit, determination. But eventually, you're running multimillion-dollar restaurants, regions, et cetera. And so I think that also underscores the importance of hiring for skill – or sorry, hiring for kind of culture and personality than training for skills, right?

Michelle Hook
Chief Financial Officer, Portillo's, Inc.
A

Right. Absolutely.

Joshua C. Long
Analyst, Stephens, Inc.
Q

When you think about kind of what we write about and I know it's true for how you focus on the business. I mean, Portillo's has a lot of elements there in terms of the convenience, the multi-channel revenues at scale, the value. You mentioned the $22 average transaction on a per person level, that's even more affordable, right, because there's more than one person in that transaction.

Michelle Hook
Chief Financial Officer, Portillo's, Inc.
A

Exactly. Yeah, say, the per person is $11, right, which is when you think about value in this day and age, right, it's on point. And to your point on value, we think about that, not just as a price point, but also when you look at the quality and abundance of food that you offer, I think it goes into that whole value equation. And I think I'd put us up against anyone in terms of value. This isn't a brand, especially in this environment that is going to – you're going to see shrinkflation, right? You're going to see less fries within your fry container. You're going to see less beef within your beef sandwich. That's not Portillo's. And so I think people realize that and understand that, and that goes into that equation as well, not just the price point, which are very sharp price points.

Joshua C. Long
Analyst, Stephens, Inc.
Q

I would agree. And then I think we'll get to this as well, but the operations focus make it a very replicable experience, right? This does really well in Chicagoland but you're also doing – you're doing amazing volumes in the new markets as well. And so let's talk a little bit about that. I mean, Chicago is a great baseline. I was fortunate enough to make that kind of Portillo's pilgrimage, if you will, in terms of seeing some of the older units all the way to the newer markets. And there's quite a range there. Granted, the system's 60 years old, so a lot of these core units that are still comping and still have great volumes were built in an era where the cost structure and just the demographic profile was very different. And so we have everything from kind of 11,000 to 12,000 square foot boxes down to the newer models that are closer to 5,000 to 6,000 square feet in newer markets. And so, can we talk a little bit about that? And maybe touch on what I've seen there in terms of these legacy stores, what you've tested and kind of what you've learned from the core markets.

Michelle Hook
Chief Financial Officer, Portillo's, Inc.
A

Yeah. No, I think we're on this journey, but I love where we're headed. And so when you look at historically like if you go into one of our restaurants in the Chicagoland market, you're generally going to see a restaurant that's 9,000 to 10,000 square feet. Some units could have two levels to them, and each restaurant will definitely look different to you. And so that's legacy and what we were building.

What we're currently building is an evolution towards what we call restaurant of the future. So what's being built today is a step towards that, which is a smaller footprint. So right now we're building 7,800 square feet. Think of a kitchen as it's very linear in our old restaurants, like a 100-plus-foot line that's shrunk down to the prototype, where the future will be 47-foot line, and so less conveyance and less movement with our team members.

But so as we evolve, we're building [ph] 7,100 square feet (00:17:17) today. These are traditional Portillo's, right, that have dine-in, drive-throughs, et cetera. And then our restaurant of the future, right now, the prototype we have is 5,500 to 6,000 square feet. We're going to start building those in late 2024, early 2025. And so when you look at that evolution, it's going where the guest is going.

Pre-COVID, 50% of our business was dine-in. We're at 40% now, as I mentioned. I don't think we're ever going to get back up to 50%. The guest continues to want to experience Portillo's and the dine-in, but also continue to experience us off-prem, right? And so when you think about that prototype going to where, again, the puck is going, but also looking at how we can get that kitchen more efficient. So we're really excited about that.

And that is, Josh, the traditional Portillo's format, right, where we'll still build the kitchens the same. But I want to express that we are an experiential brand. So when you walk into a Portillo's of the future, it will still look and feel like the local communities, right? When you look at the memorabilia on the walls, when you look at the things that you'll see in the Portillo's, it will be customized to the local communities and things like that. So, each one will look a little bit different with kind of the cookie cutter kitchen.

And then I'm really excited about some of the alternate formats that I think you saw. One of our first of those in Joliet, which is a pickup-only location, it's a smaller footprint, doesn't have a dine-in and has a drive-through and then has all the other channel capabilities, delivery, pickup, catering. Our second one is scheduled to open in Rosemont, just outside of O'Hare Airport here in the next month. And those are formats that I view as infill strategies within a market that already have scale.

But we've talked about there's other formats for Portillo's out there, which is could be an airport location. Think about very dense urban areas that don't lend itself to drive-through s where you can have a walkup location, whether that's in Times Square in New York or on the Strip in Vegas, those are opportunities for Portillo's and different footprints we'll explore as we continue this progression of the brand.

Joshua C. Long
Analyst, Stephens, Inc.

Q

That's helpful. And when we think about, I mean, you're just under 80 units today system-wide, an opportunity to take that much higher over time. We recently or you recently hosted a Development Day where you outlined some of these raised targets in terms of just that full service kind of traditional Portillo's. I think it was 800 units, so a nice step up from where you were coming out of the IPO at 600. And can we talk a little bit about what you've learned between the IPO and now that allows you to increase that target? I imagine it has a lot to do with the Kitchen 23, the restaurant of the future in terms of being able to whittle that down in terms of complexity but still being able to drive volumes and margin.

Michelle Hook
Chief Financial Officer, Portillo's, Inc.

A

Yeah. Obviously, when we had done that work on the 600 at the time of the IPO, we had done that work probably in 2019-2020 timeframe. And so, as the brand continues to progress and evolve and the footprint evolves and then the markets themselves continue to evolve, that was a very data-driven approach that we took. So, we used different tools, [ph] e-site form analytics (00:20:30) to inform where populations are growing. And we give that data set parameters which basically says, here's the size of the Portillo's that we're building, here's the AUBs that we're targeting and generally limited cannibalization, right, as we move forward. And that's how we got to the 800 full-sized Portillo's with about 120 I'll call it alternate formats, which are those other pickup-type locations.

And so, yeah, we feel like that's a conservative number, Josh, when we look at the full-sized Portillo's. And right now we're going – we're frankly picking off low-hanging fruit at this point and going into the high-growth markets where we know Portillo's has latent demand.

So, some of the things people might not know is we ship our food to all 50 states. So, we have a set of data that informs where there's demand for Portillo's. And before we had our first restaurant in Dallas, that was the number one market we shipped our food. And people asked, well, why is that? It's like, okay, well, obviously, when Chicagoans get tired of the winters, they're going to go down to the Sun Belt and to Texas, Florida, Arizona, and it's no surprise that there's demand in that market.

So then my answer to questions on, well, why those markets, it's well, of course, we're going to go into those markets where there's already demand, right? Because there's such whitespace opportunity for Portillo's, you're going to again go to the spots that make the most sense. Demand, high growth, plentiful real estate, business-friendly, good labor, right, brand awareness. So that's where we're at. So we just recently opened up the new markets of Atlanta, Denver and Vegas for our development team to start scouting sites there as we go into 2025 and beyond. And so we're excited about the growth, but that's how we're thinking about growth within those markets and moving forward.

Joshua C. Long
Analyst, Stephens, Inc.

Q

Yeah, and what I hear is at the end of the day, we see a lot of long-term unit growth stories being built out and understanding kind of how that process is detailed now is always interesting. And what I hear, what I was attracted to in this case was that it's not just looking at a kind of store per population or kind of a density analysis of your core markets. This is market by market, side by side. You've got really detailed information on when and where you could go, not just looking at based off of penetration analysis.

Michelle Hook
Chief Financial Officer, Portillo's, Inc.

A

Exactly. And it's not just – again, as I mentioned, these aren't pie in the sky numbers. It's very market-driven where, again, there's people, there's populations, there's where we think Portillo's would be successful, right, in those markets. And as we approach a market, this isn't a situation where we just go into, again, I'll use Dallas because it's the most recent market we entered with, oh, well, I think we should plan a restaurant here, here and here. It's a very thoughtful analysis within each market where we look at, again, where is the population at? We look at Tier 1 markets versus Tier 2 markets, and that's where we start building. And then we work with local brokers in those markets, our development team, does to scout sites at that point.

And we need – we're not – we're very humble. And so we know – you can put a Portillo's anywhere within Chicago. And this is actually truth and reality. You can park it in the back of a mall that we have one at and nobody knows it's there and it does $10 plus million.

Outside of Chicago, you can't do that. You have to have other draws to the area, and that's what we look for. So we look for where are people going, where they're heading, and then we have to be on call it Main and Main, where we have good visibility, we have good access. I mean, our restaurants are busy. They have busy drive-through s, a lot of cars going in and out, a lot of park spots. So there's certain things that we look for within a market, again, that have to exist. And then once we get to scale in those markets and continue to build out, I think we have our opportunities to infill with some of those alternate formats.

Joshua C. Long
Analyst, Stephens, Inc.

Q

That's great. That's a great point. I mean, we're happy to take any questions here in the room, and I'm getting some via e-mail as well. So for those on the webcast, it's joshua.long@stephens.com. And the question that came in here is largely targeted at this idea of moving into new markets and kind of the strategy there. So moving from Chicagoland into the Sun Belt here near term, but then also talking about this strategic plan. So we've talked about human capital, that's super important. We don't need to necessarily worry about financial capital. You're self-funding the growth. But then within a market like Dallas, it's not just about putting one store in there from a flagship perspective, you've lined out five to six units that are going to be filling out that density and driving the awareness piece, and then you're using that as a model going forward. And so there's still opportunity to infill, but you're getting to that kind of critical or minimum threshold relatively in short order. Is that right?

Michelle Hook
Chief Financial Officer, Portillo's, Inc.

A

Yeah. We believe that minimum efficient scale in a market of six to eight restaurants, right? And why is that? Well, we know there's scale matters or scale benefits. You can start to leverage your distribution networks, you can start to leverage your local marketing and that brand awareness. You can start leveraging that multi-unit manager. So we have market managers, which again is that multi-unit manager. They on average can handle, call it, six to eight restaurants. Well, if you have two restaurants in a market, you're underutilizing that resource and that team member. And so, we know that getting to scale sooner rather than later is going to benefit those restaurants and is going to enhance those margins. And so that's the goal is, again, to get to scale as quickly as possible, and Dallas is the perfect example of that.

Joshua C. Long
Analyst, Stephens, Inc.

Q

When you think about kind of just the robust economic model at a baseline, talk about how that kind of works into the models. I mean, big volumes, open to a lot of fanfare. How do you lay – how do stores get layered into the comp base? And then, as you think about some of those big volumes, can we talk about some of the initiatives you put in place to maybe undersell initially or at least manage the volume initially so that we don't burn consumers or your team members out?

Michelle Hook
Chief Financial Officer, Portillo's, Inc.

A

Yeah. Yeah. So our restaurants don't enter the comp base until after 24 months for a reason because generally that first year they're opening with I'll call it more of a big bang. You see a dip in AUVs in that year or two, and then by year three, when they enter the comp base, they start growing. We're targeting that low single digits comp growth, right, as they enter the comp base.

And so one of the things that we found is that historically when a Portillo's opens, it's people are going to flock to the Portillo's. And we got to make sure that you handle that volume and you give the guests a good experience. And historically, the bigger the bang, the better. Well, what we found is that wasn't always true, because when you actually look at the guest metrics, the guest was having a poor experience. So it's how can we relieve or take some of that pressure off the opening and try and give the guest a better experience.

So some of the things that we do now is we actually have soft openings. So, basically, we're ready to go. We open the restaurant. We don't tell anyone that we're open. So it's not like we put a big sign up and say Portillo's is open and people find us. They know that we're open and we start to serve the community. And so we'll do some of that to relieve some of the pressure.

Even before we open, Josh, do that soft opening, we have our team members in the restaurant training for volume. And as they're training and producing food and mass volumes, we donate that food to the local communities. So we will contact them and say, hey, local schools, local hospitals, police, firemen, here's Portillo's. We have all the – this is our – this is what we're doing. And we'd love to donate this food. So we kind of try and get into the local communities and make ourselves upfront with them.

And so, again, those soft openings relieve the pressure valve. So by the time you do the ribbon cutting or grand opening, it's not, oh, my gosh, this is the first time they're ever touching Portillo's or having the food. And we found that when we look at the guest metrics, then the guest has a better experience, which they're more inclined to come back, because if you have a terrible experience that first time, you're less inclined to come back. And that's the exact opposite of what we want when we open a restaurant in a new market.

And so, as you do that, we found this and Orlando was a good example. We opened Orlando in 2021. And again, we're just getting these data points and learning is that when we did that, you actually see, you see it dip in year two. But as the year three which they're in now, it start – you see it starting to come back and the dip wasn't as drastic in year two. So, I love that we're doing that and taking some of that pressure off so that we don't see as significant of a dip in year two.

Joshua C. Long
Analyst, Stephens, Inc.

Q

I mean, especially when we're thinking about new units across the industry, but particularly for you, these are 20- and 30-year capital allocation decisions you're making when you pick a new site. So although the shock and awe of a new restaurant is always impressive, lines around the building makes for soundbite worthy news clips, I mean, it burns out your store-level team members, potentially sets up the guest for a subpar experience, and to your point, that makes it really hard to -you have to work extra hard to get them back into the funnel the next time around.

Michelle Hook
Chief Financial Officer, Portillo's, Inc.

A

Yeah.

Joshua C. Long
Analyst, Stephens, Inc.

Q

When you think about kind of scaling up over time, I mean, you've identified the Sun Belt as the next kind of big markets for growth. Talk a little bit about that. I mean, Texas, Florida, Arizona. You're in Texas in a big way right now in Dallas. But what else is kind of in plan and how do you think – how should investors be thinking about this being layered in over the next several years?

Michelle Hook
Chief Financial Officer, Portillo's, Inc.

A

Yeah. I think definitely those high-growth markets, that's what we're targeting. So next year we've been very open. We're going to continue to build in Dallas. We're going to enter the Houston market next year. Generally speaking, we don't want to go into more than two markets a year. I'd say probably one is ideal for us at this stage. And so Houston will be our new market that we enter next year. We're going to continue to build the scale in Dallas, but you're going to see a good chunk of our growth within those Sun Belt markets, Josh, in 2024, 2025. We're still going to continue to build in the Midwest, right? There's opportunities in Chicagoland. Within our eight restaurants in the class of 2023, three are going to be in Chicagoland. 2024 I don't think has any in Chicagoland, but if the opportunities come up then we'll continue to build there. But the bulk is going to be in those high-growth markets.

After that, I mentioned we're opening up Atlanta, Denver and Vegas as we're going to continue to scout sites there for 2025 and beyond. But even after Houston, we'll go into San Antonio, Austin, and we're looking at sites there as well as we speak today. So, I think for Portillo's, when you look at the next three to five years, those are the markets we're going to target and, again, just continue to build scale.

Joshua C. Long
Analyst, Stephens, Inc.

Q

It makes sense, right? I mean, at the end of the day, Chicago does amazing volumes and still does amazing margins and that's going to be where the brand's cultural legacy is. But we look at maps and see where demographic trends and where people are moving and cost profiles, I mean, the Sun Belt states and other markets that you've targeted for fiscal 2025 and beyond offer a lot of tailwinds and a lot of attractive dynamics to them as well.

Michelle Hook
Chief Financial Officer, Portillo's, Inc.

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Yeah, they do. I mean, I kind of look at it as two different businesses, so to speak. So, you have your core in Chicagoland, right, which generally has shrinking population and then you have your high-growth markets. So, if you look at, take Chicagoland, yeah, averaging almost $11 million AUVs, 30% margins, how are you going to grow your comp there? Generally, if you want to grow traffic, you're going to have to take share from others. Okay, I think there's a chance to do that. It's going to be tougher.

So I think, as you look at growth in that market, you look at ticket, smart ticket growth in my mind. So, you think about the ability to continue to take some smart pricing and to continue to see can we grow that ticket by items per transaction, things of that nature in terms of that ticket growth.

Outside of Chicagoland, population growth, natural comp tailwinds, as you look at those markets, while at the same time, I think having the ability to take ticket growth in those markets. So, there's two dynamics of when you think about the comp growth within those markets that I think comes together to create, I think, a really good business model for Portillo's, which is, look, we're going to continue to – and our long-term growth algorithm is low single-digit comp growth, which I think is extremely achievable. And then we'll look at 2024, 10% unit growth. 2025, we're targeting 12% unit growth. And then 2026 and beyond, it's 12% to 15% unit growth which then leads you to mid-teens revenue growth. And so I think that's a great formula for us.

Joshua C. Long
Analyst, Stephens, Inc.

Q

I would agree and you've got a lot of visibility in that, too. I mean, if I think back to when you came public at the IPO, you said some impressive targets, low to mid 20% cash-on-cash returns. If we flash forward to kind of doing some results analysis, you ended up getting there, although maybe the pathway was a little bit different, right? The last couple of years have been pretty interesting, to say the least, for the overall industry. But what I took away from that is, I mean, volumes came in well ahead of expectations. Development costs were higher. That's something everyone experienced. And so, as we think to those targets of building from 10% to 12% to ultimately a 12% to 15% growth, you've done a lot to optimize the box in terms of maintain the kind of the cultural heritage, but then also drive efficiency, reduce complexity to the extent you can and you've got several instances of that within your new Dallas market, right? So I think if I'm correct, Arlington's open today, you've got 80 units, well on track to go to that 800 that you've targeted. Can you talk a little bit about how you stair step from kind of the traditional model, the Kitchen 23 format and then where we're going with restaurant of the future?

Michelle Hook
Chief Financial Officer, Portillo's, Inc.

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Yeah. And this is something that we've seen, high inflation not just in those food and labor costs but on build costs. And so, to your point, when we looked at – and we gave these stats for our class of 2022 restaurants. When you look at how we got to those returns, right, $8 million AUVs for that class and $7 million build cost, right?

But as we look at the future, what we're building today, the cost of those restaurants is $6.2 million to $6.5 million. The AUV target on the top line year three is $7.3 million to $7.5 million. We think that as we build the restaurant of the future, which again comes at the end of 2024, early 2025, we can shave another $1 million off the build cost. And so we'd be looking at a $5.3 million to $5.5 million build cost compared to what we're building today in the class of 2023 and 2024.

So we're excited about the new prototype. We're excited that we can continue to be efficient in our builds, and we know that the inflationary costs aren't all of a sudden going to come down. So we're trying to take matters in our own hands, so to speak, and do what we can, I think, to be more efficient with our builds, and we're super excited about what the future holds for what we're going to build and the return profile, Josh, as we look at building those new units at that $5.3 million to $5.5 million build cost.

Joshua C. Long
Analyst, Stephens, Inc.

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And if I remember correctly, I mean that you had targeted kind of low to mid 20s on the cash-on-cash return basis. You ended up getting there. And then as we step to what that vision could be for the rest of the future, I mean, that gets you to the mid to upper 20s, if not even to the low 30% potential?

Michelle Hook
Chief Financial Officer, Portillo's, Inc.

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Yeah. No, by that year three if you do the math, it'd be 28% to 31% cash-on-cash returns in that year three. And we had targeted at the IPO, as you mentioned, 25%, which we feel comfortable hitting those targets. But as we again build these new units at the build costs that we believe we can get to with those AUV numbers being a little bit higher, we feel comfortable that we can deliver those returns as well in the future.

Joshua C. Long
Analyst, Stephens, Inc.

Q

And just for perspective, those are amazing returns. Those will put you in best in class against your peers. There's always a little bit of difference in terms of how people account for leases and accounting, but if you normalize it all...

Michelle Hook
Chief Financial Officer, Portillo's, Inc.

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If you normalize it with – we lease the land and then we build the buildings. So if you normalize it and said, well, what if you lease the buildings like you had someone else build the buildings for you, you paid rent on that. If you did the math and we gave these stats at the [ph] deck (00:37:16) that's out there, if you all want to access it at our September Development Day, the class of 2022 would have had an 80% cash-on-cash return. And we compared that to all the peers. And to your point, Josh, you can see that would have been best-in-class.

But to your point, we've never closed a restaurant in the 60-year history of Portillo's. The restaurants are built to last, and so, we believe that the profile of how we build today works for us and our restaurant concept.

Joshua C. Long
Analyst, Stephens, Inc.

Q

So impressive the flexibility that you have. Again, core economic model, very strong, puts your best-in-class versus peers. Operational complexity has been managed from just human capital investments and optimization of that store-level model. Can we talk a little bit about the environment? We saw it – we talked about construction cost inflation. Obviously, for those that are familiar with the menu, you've got some key concentration in beef proteins. And that's something that has been somewhat of a pressure point across the industry. But that seems to be normalizing, and you've been able to weather that while still maintaining the value proposition overall. So, what have you seen there? How have you managed that? And as you think into 2024, what's kind of the outlook from a food cost perspective?

Michelle Hook
Chief Financial Officer, Portillo's, Inc.

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Yeah. I mean, it's been no secret everyone's been pressured on the beef costs this year. We knew that coming into this year. So for context, when you look at our overall commodity basket, about 35% is beef. And then, when you mix in chicken and pork, those three proteins are about 50% of our commodity basket. So, as those proteins move, right, that's going to have an impact on Portillo's.

But we put a number of mitigation tactics in place this year to de-risk the beef. And so, we do forward buys on our beef and we were able to lock in a price that we were comfortable for this year. And so, all year we've been guiding to mid-single-digit commodity inflation for 2023. We feel very good with that. We feel that's how we're going to end this year.

And as we go into 2024, Josh, I think it's going to be sitting here today mid-single digits as well. I think beef will still be pressured, but I think we'll continue to do the things that we do to de-risk that as much as we can. We'll look at other opportunities as they exist. This year we were significantly pressured on our French fry cost. I know that's been out there as well. That will step down next year. So I think we'll get some relief on some other line items. But mid-single digits is what I view the world for both food and labor as we go into next year.

Joshua C. Long
Analyst, Stephens, Inc.

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And what's exciting is, at least from our side in terms of the visibility and your opportunity to kind of capitalize on this is, I mean it seems like those forward buys are relatively new in terms of just your ability to forecast and maybe lock in a little bit of visibility on top of just the overall environment normalizing a bit going forward. So there's a couple different ways that you've got an opportunity to manage the cost side.

Michelle Hook
Chief Financial Officer, Portillo's, Inc.

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Yeah, I think one of the new things we even did this year was we ended up buying. So one of the primary inputs into our beef cost are beef flats. So think of it as big roasts of beef that we bring in, we slow cook, slice up to make our Italian beef sandwiches. We actually were able to buy those flats from Australia, import them in, put it into our freezer program, get it into our commissary, slack the beef out as we process it. And that was actually cheaper than buying beef here in the US. So that was a new thing that Portillo's explored this year as part of our supply chain strategies that we feel really good about, as helping to again de-risk that line item for us. And it's something that, again, we're looking into in 2024. We think that opportunity's still out there to buy that beef at a cost that makes sense for us and keep our commodity basket in that mid-single-digit range.

Joshua C. Long
Analyst, Stephens, Inc.

Q

When you think about the new unit profile, I think it's not lost on me having seen a lot of the units. I mean, we go from something again, 12,000 square foot-ish historically to something that's far more optimized. You've mentioned minimizing the kind of impact of new stores by doing soft openings. Can you talk a little bit about the back of the house just with the time we have remaining? I mean, that production facility in that line moving from over, I think 100 feet down, nearly 50, I mean, kind of a 50% decrease over time. That has to reduce some complexity. But you've been able to do this while also maintaining food quality, the brand heritage. I mean, that's got to be a meaningful unlock for the brand over time. But just, yeah, how do you think about that and what get you most excited about some of the new unit development on that model?

Michelle Hook
Chief Financial Officer, Portillo's, Inc.

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Yeah. No, I'll give a shout out to Derrick Pratt, our Chief Operating Officer, has just done a fantastic job with managing the labor component within our restaurants and he talks about conveyance, right? And if you think about that, that's waste, right, within a restaurant. And so, how our team members move within the restaurant, how the product is conveyed I think is super important. So reducing that line and working with more adjacencies I think has benefited Portillo's.

And then we're doing a number of different things that are small wins. It's not one big thing, Josh, right? I know some concepts are going away from self-serve drinks, but we're actually running towards them. 40% of our business is dine-in. And so this is going to maybe sound crazy to some, but actually having self-serve drinks reduces labor in the back of house because you're not making the drinks anymore for the dining guests. It's actually a better experience for the guests because you order your food, you walk down the line, you're waiting for it. You have a little bit of anxiety. You get a drink in someone's hand, they automatically relax. That's what we found. So that's a win-win.

And then when you look at some of the other things we've done in terms of reducing back of the house complexities, whether that's chopping onions versus getting them precut, some of the things that we're working with our supply chain on, I think, has helped to reduce some of the complexities on back of house, and Derrick and the team have done a – the ops team have done a great job of deploying labor appropriately as well. We have a very robust labor scheduling tool. And so working on forecasting what the sales are going to be on the restaurants and then how you deploy labor is something we're very surgical on as well. And I think there's plenty opportunities too, Josh, as we move forward and look at again as we get a more efficient kitchen design, how we deploy labor, not just at peak periods, but that minimum labor deployment as well.

Joshua C. Long
Analyst, Stephens, Inc.

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That's a great point. And particularly when we think about, again, just the importance in the underlying piece of the thesis here, it's new unit development and you're going be opening up a lot of units that also do really high volumes. And so, [ph] remember (00:43:43) having an opportunity to talk with Derrick about just the new unit opening teams, how you've been able to streamline that kind of special forces out, parachute them into new markets, be able to get everyone set up for success and all while really maintaining the experience or component of the brand, right?

So all those boxes getting smaller, like you mentioned, whether it's the self-filling drink station or kind of customer managing that process, which I think is a key element that's not lost on me as I think back to being younger and going into the restaurants and being able to kind of mix and match, that's important. You've added some grab and go elements to there as well and then further just really just solidified the connection to the local communities. I mean feels like from a kind of restaurants 101, not really that complex of an idea, but tough to do at scale and you've really kind of invested in the key places where that needs to happen.

Michelle Hook
Chief Financial Officer, Portillo's, Inc.

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Yeah, I think if you go to our legacy restaurants in Chicago, you would see Derrick called it the triangle of confusion, which is when you think about it and the complexities. So if you walked into a Portillo's, you'd walk to the front register, you'd place your order. If you ordered a beef sandwich or a salad, you would have to go to two different areas to pick up that beef sandwich in one area, the salad in the salad bowl area we called it. And then if you actually wanted a beer, you would have to go to another area to order the beer and fulfill that order.

Well, you take all that away and you say, okay, I'm going to move the salad prep area to the front main line, I'm going to get rid of that saleable area, well, what am I going to do with that empty space now? Great. We put in this grab and go section where as you walk into the queue, you now see the homemade desserts we make every day. You can grab a water. You can grab some Portillo's retail items. You engage with the brand before you place your order. We move the beer taps to the front register where you can order it there, receive it there and then you get all of your food at the one expo area. Reduces complexity within the kitchen, but then also again getting back to a better guest experience. Those are the restaurants we're building today.

We're working to retrofit about 40 restaurants in our core market in Chicago. So we've done or we'll have done 18 this year within the remainder we're going to retrofit in 2024, which then is going to provide efficiencies in existing restaurants. Again, all this sounds simple, but it's to your point, it has to be done. It removes the complexities and, frankly, it makes the restaurant even look fresher and creates the better guest experience.

Joshua C. Long
Analyst, Stephens, Inc.

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And again, not lost on us, to be able to do it at scale at the volumes and the margins you're generating while self-funding growth, I mean, it's an impressive story to say the least. And I know we're going to have an opportunity later in the day here in Nashville to have a conversation with Mike and that leads the development team, that's going to be really exciting to dig into because, again, all these things maybe sound simple, but to be able to do them at scale in new markets and plan for the next several years is very impressive, to say the least.

Joshua C. Long
Analyst, Stephens, Inc.

So appreciate the time today and being able to introduce the Portillo's story to everyone here in the room. Thanks so much, Michelle.

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

Thanks. Appreciate it.