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PRESENTATION

David Tarantino - *Robert W. Baird & Co. - Analyst*

Okay. Good morning, everyone. Welcome to the session for Portillo's. I am David Tarantino, the restaurants analyst at Baird, and very happy to have everyone here at the conference today. Portillo's is a fairly new public company, with 71 locations that generate very impressive average unit sales volumes of about $8 million. The concept, for those who are unfamiliar, features high-quality, cook-to-order, Chicago street style food. It's very good; you should visit one if you haven't. And always in the atmosphere with a good vibe. And we think it's a concept that has a lot of room for growth. So very pleased to welcome two members of the management team here today, CEO, Michael Osanloo; and CFO, Michelle Hook. Welcome.

Michael Osanloo - *Portillo's Inc. - CEO & President*

Thank you.

David Tarantino - *Robert W. Baird & Co. - Analyst*

Thanks for being here.

Michelle Hook - *Portillo's Inc. - CFO*

Thanks, David.

Michael Osanloo - *Portillo's Inc. - CEO & President*

Our pleasure.

David Tarantino - *Robert W. Baird & Co. - Analyst*

So because we have some folks in the audience who might be new or unfamiliar with the concept, I thought it would be good, Michael, if you wanted to share kind of an overview of the story, the brand, what makes the brand so unique. And then we will follow up with a few questions on the growth outlook.

Michael Osanloo - *Portillo's Inc. - CEO & President*

Absolutely. For those of you who don't know the story, it's an iconic American story. Dick Portillo left the military with, I think, it was like $1,100 in his pocket. He founded a hot dog stand with no running water, and he built that into a very, very attractive business that he sold to Berkshire Partners in 2014. It's founded in Chicago. We are at 71 restaurants. We are now across mostly nine states. We have never closed a restaurant in the history of the company; 60 years, never closed a restaurant. I don't know of another restaurant company that can speak to that.

We live in a world of incredible price value proposition. So if you drew a price value curve, I think we are an outlier. We provide tremendous value to our guests, both portion, experience, service levels, at very, very sharp price points. We are somewhere just north of sort of the QSRs, and then well south of the other fast casual companies like Chipotle, Five Guys, Shake Shack, et cetera.

We have a ridiculously loyal fan following. When you open a Portillo's, you open to massive lines. It's not uncommon for us to open a restaurant that does $300,000 to $350,000 in the first week. So for those of you who follow the restaurant, [we had some ridiculous lines]. We have actually had to consciously camp down how we open our restaurants to not overwhelm the restaurant the first week. Demand is very strong. And it doesn't matter where we open: Maple Grove, Minnesota; St. Pete Florida; Gilbert, Arizona. Wherever we open, we opened to incredibly wholesome volumes.

And as David said, our AUVs are right around $8.3 million; our restaurant level EBITDA margins are very, very attractive; we are a cash generating (technical difficulty)

QUESTIONS AND ANSWERS

David Tarantino - *Robert W. Baird & Co. - Analyst*

Great. And then perhaps if you can frame up the long-term growth opportunity. I know you have shared some targets at the time of the IPO. So how big do you think this brand can be, and what's the right pace to grow in the next several years?

Michael Osanloo - *Portillo's Inc. - CEO & President*

Yeah, great question. So we are at 71 restaurants. We opened number 71 about eight weeks ago in [St. Pete]. We went through a process of a [study seat] with help from Form Analytics. They're one of the big analytic data warehouses that look at an algorithm. They've run a multivariate regression on our restaurants to predict revenue. What we said is we want restaurants that generate no less than $6 million of sales, and we want no restaurant that is within 5 miles of another Portillo's. We got to a number that is easily over 600 restaurants just in the US. That's 600, just in the US, full-sized restaurants.

We opened a restaurant in January of this year, a drive-through only concept in Joliet, Illinois. It's a small box with a triple lane drive-through. First two lanes are the traditional Portillo's; the third lane, we call it our fast pass lane. It's for who have ordered digitally. It's for the third-party delivery people, et cetera. That has -- its early. It's very early, but it has thus far exceeded all of our expectations.

And so I think on top of the 600, there's another chunk of restaurants that we could open that are drive-through only. I think there's a chunk of restaurants that we could open that are, let's call them, specialty restaurant. We get outreaches from all the airport management companies to put a Portillo's in airports; on university campuses. Well, that does not include the 600.

And then I think Portillo's is an international brand. I think the food, value proposition, what we do, will work very, very well abroad. And so it doesn't include franchising internationally. So I'm a very optimistic -- well north of 600 in total.

And then you asked the question about pace. Though Michelle and I might be a little bit on the conservative side, we don't want to get crazy and try to -- I mean, you guys have covered a restaurant (technical difficulty) restaurant companies that grow 20%, 30%, and then die. We would like to grow at a nice steady 10 -- 10%-ish. And we think that that's very sustainable. We have more than enough cash to build restaurants. There's more than enough great sites for us. The gating factor, and the reason we want to stick right around 10% right now, is we think that when a Portillo's opens up, with an experienced Portillo's general manager, we'd derisk the business.

And so for us, it's about making sure we got the right pipeline and that we have developed people who can open our new restaurants. So TAM of well north of 600, at a steady 10% growth.

David Tarantino - *Robert W. Baird & Co. - Analyst*

Makes sense. And Michelle, how does that translate to the income statement profile if you think about the growth metrics for revenue and EBIT and whatnot?

Michelle Hook - *Portillo's Inc. - CFO*

Yeah. When we talked about our long-term growth algorithms, so this is -- to Michael's point, this is a story about building restaurants and growing that way. However, we still expect to grow our cap sales. And so when we think about that formula, to Michael's point, the 10% new restaurant growth, plus growing that comp in the low single digits, that will translate to low single -- or high single, low double-digit revenue growth. And then we expect to be low teens adjusted EBITDA growth again over the long-term.

And so that's what we put out there as our long-term growth algorithm, David, and we feel very confident about that. And we are on pace this year for our new units. We are opening seven new units this year. We have opened two so far this year, and on pace to do the other five in the back half of the year. So we feel really good about that algorithm over the long-term.

David Tarantino - *Robert W. Baird & Co. - Analyst*

Great. And since unit growth is the key driver of the model, I wanted to ask a few questions about that. So I guess, what's the current environment like in terms of getting projects done, finding good real estate opportunities? Because you need great sites to generate the volumes you do. So I guess, can you talk about your confidence in the pipeline, so to speak, and your ability to actually get it done in this type of environment?

Michael Osanloo - *Portillo's Inc. - CEO & President*

Yeah. It's a great question. And I would actually tell you, first, we have invested a ton of human capital in development. So since I've been here, we have changed out the whole team. We had one person basically working on an island, and we've got two dealmakers that come from [deep] experience, like working at Garden, working at [Simon]. And so we have two great dealmakers actively seeking out sites. And now we are actually -- I'm approving sites for 2024. So the pipeline has gotten better. We brought a world-class construction guy and armed him with two different people, so that they build quickly, adeptly, and a lot faster than [we used to]. So that all the good news.

You guys all know it's crazy out there; it's [spooky]. And so where we find the biggest slowdown is actually not -- it's not contractors, it's not getting the right subs. It's dealing with municipalities and their timelines. A lot of people went to work from home and then they've never come back. And so it's just challenging getting all of the timelines. So that's where we've had to build in a little bit more wiggle room into our building plans to make sure that we are not going to miss deadlines, late, et cetera.

I didn't want to build five in the back half of the year; we kind of wanted three and four. But one slip to the back half, it's still going to open in the back half. But that's how the impact has been. Your follow-up is going to be on cost, right?

David Tarantino - *Robert W. Baird & Co. - Analyst*

It is going to be on cost. Thank you for preempting.

Michael Osanloo - *Portillo's Inc. - CEO & President*

Everybody know construction costs spiked. We've actually seen them starting to flatten, and we have seen them come down. That's the stuff that's out of our control. What's in our control is -- before I got here, we were building restaurants that were 9,500 square feet. When I got here, we went to a 7,800 square-foot prototype, and now the team is working on a 7,200 square-foot prototype. And we're also trying to figure out how to do less with more. We have kitchens in Chicagoland that are pretty tight, but still generate $12 million plus of revenue.

And so for us, that is the benchmark. How much can we reduce the footprint of the kitchen, which is the most expensive cost in building, and still have a restaurant that can do $12 million-ish of revenue. So we're taking a lot of costs out of build. And we're also, I think, being very adept and agile in how we build.

So we have two fundamental styles: a diner and a garage concept. Right now, we are seeing that steel prices are coming back. And if the garage has gotten a little cheaper to build, we're going to build more garages. If there is volatility between steel and other building materials, we will flip. So we are being smart at doing that, and that's also causing us to bring our costs back.

David Tarantino - *Robert W. Baird & Co. - Analyst*

Where do you think -- I guess maybe, Michelle, can you just maybe level set everyone on where you think the right prototype return model is from a sales and margin, and what the investment cost should settle to once you add everything together?

Michelle Hook - *Portillo's Inc. - CFO*

Yeah. So for those that don't know Portillo's, I'll start with us being multi-channel before really multi-channel was a thing, so to speak. So all Portillo's are equipped with double drive-throughs. We do have the three lane drive-through in the Joliet model that you see there. And so our drive-through business is very robust. We have a robust dine in business. Pre COVID, 50% of our sales were dine in, and then 50% was off-prem. So drive-through, delivery, pickup, et cetera.

Today, we are just over 30% dine in, with the rest being drive-through, delivery, off-prem, et cetera. So the point being, David, that when you look at the footprint that we are building, we have to understand where the customer, the consumer is going. So as we look at do I think dine in is going to get back to 50%? No, I don't. But I do think that it definitely has a chance to get into the 40% range.

But I think we have an opportunity, to Michael's point, build kitchens that can do $10 million AUVs, shrink the footprint inside, create a little less dining space. And we are also building in warm weather climates, in the Sun Belt, so think Arizona, Texas, and Florida. And we're building more patio space, more outdoor flexible space that has less cost to build.

So historically, before we saw this elevated cost, our restaurants were in the $4.5 million to $5 million range to build. And we have seen that elevate and come close to a $6 million range. But that, to Michael's point, has started to level off and come down. The restaurant -- he mentioned St. Pete recently we built; it was just over $5.2 million. And so I think that $5 million, $5.5 million range is where we currently see that today. But again, to Michael's point, we're looking at smaller prototypes and if we can continue to get those costs down.

David Tarantino - *Robert W. Baird & Co. - Analyst*

Got it. And then the numerator of the equation. So what would be the return profile if you invested $5 million to $5.5 million?

Michelle Hook - *Portillo's Inc. - CFO*

Yeah. When we look at the AUVs that we are doing, and our expectation that a restaurant by year three is going to do $6 million AUVs, we expect to get close to a -- over a 20% return on the investment. And so that's what we are currently looking at today, closer to 25% as we get those build costs down.

David Tarantino - *Robert W. Baird & Co. - Analyst*

Got it. Yep. Makes sense. And then, I guess, a lot of the growth is predicated on entering markets where the brand has lower awareness. I guess, can you -- you built some in new markets. So can you talk about your experience as you've entered these new markets, and what's giving you the confidence in growing outside of the core Chicagoland part?

Michael Osanloo - *Portillo's Inc. - CEO & President*

Yeah. So if you think about our growth going forward, we are largely targeting these Sun Belt states, and three in particular. We are targeting central Florida, Arizona, and Texas. And here's why. Those are the three fastest growing states in the country in terms of population growth. We're building a restaurant in Gilbert, Arizona that opens up in the fall. Gilbert has a population growth forecast of 12%. So being inherently late, wake up in the morning, and I have a 12 comp just when I open the restaurant, right? That's a really fun dynamic. And so we are targeting these growth states.

We actually have a lot of [latency]. I think people are surprised by how much [demand we have]. We have a fairly robust shipping business. The three states we ship the most food to are Florida, Texas, and Arizona. We have a large Chicago Midwest diaspora that when people finally get sick of the Chicago winter, they go to Florida, Arizona, and Texas, and then (technical difficulty) So it's not surprising that we are building in this market.

When we do it right, when we pick the right real estate, when we have the right build, the restaurant works exceptionally well. Perfect example is Orlando. We built in Orlando. We opened that restaurant up almost a year ago now, and we picked a location that's 1.5 miles from Disney's front door. We picked a location -- I mean, it sounds quirky, but we are on the right side of the road as you're going to Disney. And so it's a great pitstop; you can't help but drive by us. We opened it with an experienced general manager who have opened Portillo's before and know what he's doing, and the assistant general manager, [Taz], is a Portillo's veteran. That restaurant is (technical difficulty). That's a great outcome, but we modeled it -- to Michelle's point, we modeled it sort of mid $6 million, but it's going to do $10 million.

And philosophically, she and I are very much aligned that, when we model restaurants, we want to model them at a conservative number that we think we are likely -- 80% likely to build. We want an asymmetrical risk profile on our restaurants. And so Orlando is a perfect example. There is not a ton of brand awareness in Orlando, but the restaurant works, it builds local demand, and it builds to the tourist demand. This exact story is similarly true in Arizona, where we now have scale, and we have restaurants that are approaching Chicagoland AUVs and Chicagoland margins.

And I think that's the nature of our business, is we go into these markets that are very, very healthy from a macro perspective, build scale, and then get to very attractive economics.

David Tarantino - *Robert W. Baird & Co. - Analyst*

Great. Maybe shifting gears to the current environment and talking a bit about same-store sales. So Michelle, maybe you can give an update on where you were in Q1 as you think about comp sales maybe relative to 2019. And then, overall, as you think about all the crosscurrents of the environment, with the gas prices and presumable pressure on the consumer, just how you're feeling about the current ability to navigate this backdrop.

Michelle Hook - *Portillo's Inc. - CFO*

Yeah, no. We feel really good. So we put up an 8.2% comp in Q1. We were rolling over a 0.8% in 2020, and we are on a three-year stack within a, I think, healthy 6%, 7% range data. So we feel good about where the comp is and where it is heading as well. But to your point, the current environment is different, right? We all know that. We all know we are in an environment of extreme high inflation, and so people are pulling back their spending and they are deciding where they're going to put their dollars.

And so I think as we look at our traffic -- we gave a stat during Q1, when we measured traffic, we looked at number of entrees sold by person. So when we count the number of sandwiches, salads, et cetera, quarter over quarter, we were up 1.7%. So we know that we are selling more food to people at Portillo's, which I think is a good sign in this environment, but there is no doubt about it that people are pulling back spending; there is less discretionary spending out there.

And for us, I think it comes back to Michael's point of us being a good value proposition, and making sure that, when people want to spend their dollars, that Portillo's is the restaurant of choice for them. And so I think in this typical environment -- remember, we are a 59-year-old brand. So although we are a new public company, we have data that shows the resilience and durability of this brand. Going back, even when you look during COVID times, we were not as impacted as other brands. And then we looked at the data going back to other recessionary times, or times of crisis, et cetera, and this brand has proven to be resilient and durable. And I think it comes back to that value proposition.

When you look at us offering craveable, high-quality food at an extremely good price point, when we benchmark our price points -- and we actually do this -- we look at bundles. So the most popular bundle at Portillo's is a beef sandwich, fries, and a drink. When we benchmark that against popular bundles of other fast casual brands, whether it's Shake Shack, Chipotle, Panera, we are the cheapest. And it could range anywhere from $1 to $6 cheaper when you look at those bundles. And so I think in that environment, David -- I think, again, we are a brand that can play well in a recessionary type environment, and we have proven that in the past.

David Tarantino - *Robert W. Baird & Co. - Analyst*

Do you think about any initiatives or tactics that you can employ if we were to see a bigger consumer pullback? Is there certain things around marketing or promotion that you might think about doing differently? Or is it pretty much focusing on the core operations and more of an everyday value type of approach?

Michael Osanloo - *Portillo's Inc. - CEO & President*

I'll give my perspective and will let Michelle chime in. I think we have been doing that; like we have been very thoughtful about the consumer backlash with all price [in place]. So we've said this in earlier quarters: we have price just behind inflation. We are not price leaders. We are letting everybody else go crazy and price as high as they want. We are following, and our goal is to not overshoot. And so I think that we have been consciously positioning ourselves to value. And Michelle talked about the bundle value. We see that our value has improved [over] the competition.

So we know we have pricing power. The last couple of times we have taken pricing has been essentially no elasticity impact. And so our belief is that we want to be positioned as a value (technical difficulty) because, to your point, if you overshoot the consumer in pricing, it's really hard to unwind that. Then all of a sudden, you're discounting. You're doing some sort of something that causes irreparable brand harm. And so we don't want to overshoot the consumer. We're taking bite-sized pricing multiple times a year, and we are slow to do so.

David Tarantino - *Robert W. Baird & Co. - Analyst*

Let's talk about that, given the type of inflation you're facing. So I guess, Michelle, can you remind people on what your guidance is for commodity inflation and labor inflation, and what you're doing to address that?

Michelle Hook - *Portillo's Inc. - CFO*

Yes. So we have said we expect commodities to be up 13% to 15% for each of the quarters in 2022 and for the full fiscal year 2022. I'm not coming off of that yet, David, although some people say there could be some easing in the back half of the year. I'm not seeing that. 50% of our basket is made up of proteins, so think beef, chicken, and pork. So if there is some easing that is coming with that, then I would expect that number to vary, but I'm not seeing that right now. We have about 80% of most of our beef locked for the year. And our total basket, about 55% of that is locked for the year. So I feel, right now, good about sticking with the 13% to 15% range.

Labor has started to -- we still expect it to have rate increases this year, but not at the levels that we saw last year. We took significant wage increases in June of last year, and so we are starting to roll over that. And so I do expect a little bit of rate increases this year, but call it probably low -- high single to low double-digit labor increases this year. And to combat that, we are doing what Michael said, which is, one, we know we have pricing power, so we take in pricing already to combat that. In Q1, we took about -- we were at about 7.1% of price that we were taking, which, to Michael's point, is below that inflation number. So we feel good about that.

The other thing that we are doing is we're putting in operational efficiencies on our restaurants. So I think labor efficiencies and how we can work to control what we can control and see some efficiencies on that line. We put -- a lot of that was in towards the tail end of Q1, and we're seeing the benefits of that in Q2. And so I think -- and what I said in our Q1 call, too, David, was I expect to see sequential margin improvement from Q1 to Q2 for Portillo's because of those reasons.

David Tarantino - *Robert W. Baird & Co. - Analyst*

Got it. And I wanted to ask specifically about that, because, if you take pricing of 7% and you have inflation in the solid double digits, you're obviously given some margin up. What is, I guess, your viewpoint on getting back to where you were in kind of pre-pandemic levels? Is that important to you that you recover the margin? Or how do you encourage investors to think about that?

Michelle Hook - *Portillo's Inc. - CFO*

Yeah. Very important to me to recover those margins. And so we were at -- Q1 of 2021, we were at just over 25% margins. Q1 of 2022, we were at 20.8% restaurant level margin. And so I want to get back up to that -- the levels that we were at. And I think the way that we do that is through a combination of pricing and operational efficiencies. So that's what we're working toward.

But remember, we believe the commodities to be short-term, so short-lived. I don't expect them to stay elevated at this level forever. However, when we get relief, I think we're going to see the benefit of that. But again, I don't think that is likely to come this year. I think that's more of a 2023 that we see some easing there, but we are ready to combat that with the efficiencies we put in place for this year to try and hold the line.

But the good thing about Portillo's is we've been blessed with, and Michael mentioned this earlier, a fantastic financial profile. So our margin profile gives us an opportunity to take some short-term hits without giving up the long-term growth of this company and losing those customers. That's super important to us.

David Tarantino - *Robert W. Baird & Co. - Analyst*

Makes sense. And can you maybe just elaborate on what some of the operational efficiencies are?

Michael Osanloo - *Portillo's Inc. - CEO & President*

Yeah. I have a couple of favorites. This is going to sound ridiculous, but, if you haven't eaten with us, you got to try our Maxwell St. Polish and our Italian sausage. I think (technical difficulty) It's fantastic. Here's the crazy thing. So we were buying Maxwell St. Polishes and they come in a full length sausage, [we're hand trimming it though]. We cut the ends off, we throw away the ends, and then we cut it. And you know, when a human being is cutting it, somebody's sausage might be slightly bigger than the other person's sausage. We work with our supplier. All of our sausages come precut, at no incremental cost to us because they keep the trim and they use it for other reasons. It saves a ton of prep hours in the back of the kitchen.

We are buying red onions that are machine cut, vacuum sealed. They are delicious tasting, they retain moisture. I mean, the whole chemistry to how to cut an onion to make it taste great. We are saving money; we don't have to do the prep.

During COVID -- I don't know if everybody knows this -- we laid off no one. We supported and invested in our hourly team members, and we cross trained the heck out of them. So that if you were working in the meat station, we taught you how to work at the [table] which is where the hotdogs are produced. And so the benefit of that now is part of the labor leverage. If the restaurant is slower, it's 2:30, 3:00 o'clock, we don't have to staff as aggressively because people are cross trained; they can slide from one spot to another spot. Lots of little things like those, and there's a whole army of other little ideas like that, are helping us with our labor leverage right now.

David Tarantino - *Robert W. Baird & Co. - Analyst*

Great. Good examples. I got one from the audience here. Can you talk about your older units comp and margin performance versus the newer units?

Michael Osanloo - *Portillo's Inc. - CEO & President*

Yeah. It's one of the things about Portillo's when I was doing my diligence to join. When you join a 59-year-old brand, am I inheriting a bunch of restaurants that are old, and tired, and need a bunch of capital? And I'm stunned at the productivity of some of our older units. We have -- our restaurant number three, which is in Elmhurst, is a restaurant that produces $9 million plus of cash, $3 million-ish of -- a lot of EBITDA, and has seen no material -- the last thing that we did is replace the booth covers and polish the floor.

These restaurants -- the lifespan of a Portillo's restaurant is frankly kind of untested. We don't know when they die. And they pay back, and then they just keep generating an obscene amount of cash for a very long time.

David Tarantino - *Robert W. Baird & Co. - Analyst*

Great. And I have one last question on the balance sheet and cash flow. I think by our estimates, you're going to have slightly negative free cash flow this year that might not -- may or may not be right. But I guess can you, Michelle, talk about your expectation for free cash flow over the next few years, and whether the business can be self-funding and whatnot?

Michelle Hook - *Portillo's Inc. - CFO*

Yeah, yeah. Absolutely. We expect the business to be self-funding. So when we looked at our core restaurants in Chicagoland, those are significant cash generators. You're talking $10 million AUVs and 30% plus margin profiles for those restaurants in Chicagoland that give us the opportunity to grow outside of Chicagoland. And so when I looked at that, David, and I looked at the restaurants we build outside of Chicago, these restaurants cash flow immediately. So the profile of those restaurants are generally $6 million AUVs and low 20% margins.

And so we feel good about the margin profiles of the older restaurants in the core and the newer restaurants. And so that cash profile that we generate allows us to self-fund our growth. I feel good about our debt profile. With our IPO proceeds, we used all that to delever. And so we have a revolver that's untapped today, $50 million, so I can tap into that as needed. We have $30 million plus of cash today on the balance sheet. So I expect to self-fund growth for years to come.

David Tarantino - *Robert W. Baird & Co. - Analyst*

Great. With that, I think we are out of time. So please join me in thanking Michael and Michelle for being here today.

Michael Osanloo - *Portillo's Inc. - CEO & President*

Thank you.

Michelle Hook - *Portillo's Inc. - CFO*

Thank you.