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Portillo's, Inc. (PTLO)

ICR Conference - Fireside Chat

CORPORATE PARTICIPANTS

Michael Osanloo

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

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

OTHER PARTICIPANTS

Sharon Zackfia

Analyst, William Blair & Co. LLC

MANAGEMENT DISCUSSION SECTION

Sharon Zackfia

Analyst, William Blair & Co. LLC

Hi. Good morning, everyone. I'm Sharon Zackfia with William Blair. I'm really glad to have with us today one of my hometown favorites, Portillo's. We have Michael Osanloo, who's President and CEO; Michelle Hook, CFO. I think there are a few slides that we're going to go through before we get into the fireside chat.

Michael Osanloo

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

Is it rude to have all this delicious looking food up before people eat? Yeah. I'm sorry. There's a little video. We want to just get you excited about the brand.

[Video Presentation] (00:00:29-00:01:30)

Good. Yum. Disclaimers. So, as exciting as the food is, as investors, I think this is probably even more exciting. And I'll just highlight a few of the things. We are a 60-year-old concept. We've never closed a restaurant in our 60 years. Fact. We are now in 10 states. We have 84 restaurants open. But I think some of the most gaudy statistics are the fact that we – last 12 months, our AUVs were \$8.9 million. We generated 23.6% restaurant level EBITDA margins. And we are at our infancy in terms of growth. We think this is 800, 900 restaurants in the US. We have just gotten to the tip of the iceberg.

Last year, we said that we were going to open eight restaurants. We actually had four that carried over from the class of 2022. We had six that we needed to open in the fourth quarter. And the great news is we did it. We opened restaurants in Allen, Texas; in Cicero, Illinois; Arlington, Texas; Clermont, Florida; Queen Creek, Arizona; Algonquin, Illinois. We opened in Rosemont, and that's our second prototype of a pickup-only location. It's a drive thru restaurant, no dine in, and it's an infill strategy in dense markets, working incredibly well. Fantastic box economics. And then we opened in Fort Worth, Texas, to another great restaurant that we're thrilled about. We are super excited about the growth potential for this concept.

We have guided historically to 10%, but we've just recently said, look, we're going to grow 10-plus-percent. So, this year, at least nine restaurants you can expect from Portillo's. 80% of them are going to come along the Sun Belt. So think Texas, Florida, Arizona. Everybody asks why. It's really simple. It's where the population growth is in America. We like that 1% to 2% comp tailwind. When we grow where population is growing, it's really as simple as that. And the pacing will be one restaurant in Q1, two to three in each of the successive quarters. Michelle?

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

So we don't typically give short-term guidance, but one of the things we do like to do is give some, what I'll call, certain guides on what we think are key for this coming year. So this – as you see, this is a pretty consistent message for Portillo's in terms of what some of the outlooks are for us in 2024. So, as Michael just said, we're estimating nine new units in the class of 2024. So that's just over 10% new unit growth. We think commodities will be in that mid-single digit range, that 4% to 6%. You don't see it on this slide here, but we actually think labor, which is the other key input cost for us, will also be in that mid-single digit range as well, that 4% to 6%.

When we look at G&A, we're a high-growth company. We're continuing to invest in the organization. So that's the range we see G&A coming in at. Preopen expense as we continue to open new units, you see the \$8 million to \$9 million guide there. And when you think about the CapEx at the guide there, think about how we deploy CapEx in three big buckets. So, as we look at that CapEx outlay, think of it as 80% of that generally is going into the new restaurants, about 10% goes into our existing restaurant base investments we need to make. And then we have 10% that's call it other discretionary CapEx. Think of if we need to make technology investments. We have two commissaries in Chicago that manufactures all of our beef, pepper, and gravies – gravy that we use. And so that's other CapEx investments we need to make. So, as we sit here today, this is how we see these numbers play out in 2024.

And then if you look at the next slide, over the long term, which we think about that, think about a three-year to five-year time horizon, you can see the guides that we have there with the unit growth. We're very comfortable with dialing up growth outside of the 10% that we're guiding to in 2024. So think about 2025 is more in that 12%-plus new unit growth range. And then as we get to 2026 and beyond, we expect to be in that 12% to 15% range. We think low-single digit comp growth is very reasonable for our brand and that just translates into mid-teens revenue growth and then flow that through to low-teens adjusted EBITDA growth.

No, again, commentary that we're making on the fourth quarter necessarily. But one of the thing – messaging points we did want to get across, just in the spirit of us talking about inflationary pressures and food and labor, is the question we always get is around how do you offset that. One of the levers as a restaurant company that we use is pricing. And so when you think about that dynamic mid-single digits, we expect in 2024 to use the pricing lever to offset those inflationary pressures. So as we sit here today, we did have about 2% of pricing that we took in January of last year that will roll off. And we are announcing today that we are taking another pricing action in January of this year about 1.5%. So 1.5% pricing will roll into effect into our restaurants here in January. And so that's the one point that you don't see on the slide that Michael and I wanted to make sure that we got across to the group as well today.

QUESTION AND ANSWER SECTION

Sharon Zackfia

Analyst, William Blair & Co. LLC

Q

Thanks for that. I think before we go into some bigger picture dynamics about Portillo's, I did want to – just because, Michelle, you just have the slide up, we get asked a lot, why is it mid-teens revenue growth but low – I think it was low-double digit revenue. Can you – I don't know the slide exactly, but there's the delta where the EBITDA growth is lower than the revenue growth. And we get the questions like why aren't you leveraging G&A? What's happening? Why is that a slower pace? So it might be a good thing to touch on while it's fresh on people's minds.

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

A

Yeah. Fair questions. As we put out guides early on in our process, our IPO, post-IPO journey, we were generally guiding to G&A growth that was about 75% of our top line growth. And so Sharon, I think as we look at these numbers, we expect that we'll come in line or under that. And then we look to continue to leverage G&A over time as a percent. That's the goal of Portillo's as we move forward. So I will just make that commentary on G&A, but we're not going to – we're going to invest in areas of growth that we see that we need to make those investments. And so that's the point I would make on G&A.

To your point on the flow through on the mid-teens, when you think about our restaurants and the amount of the volume of the new restaurants coming into the base, it takes a little bit of time. The first couple of years, the new restaurants open at, call it, high teens margins and then the target is by year three. We're targeting 22% restaurant level margins. And so in those early time frames, Sharon, you see a little bit of labor headwinds, right? We're not getting the full flow through from that top line growth.

And so Michael and I feel very comfortable with what we believe conservative guides on the long-term growth algorithm, which our plan is obviously like, as him and I sit here today, we're two very competitive people that we have a chance to outperform this. But that is what we feel comfortable is conservative targets for Portillo's.

Sharon Zackfia

Analyst, William Blair & Co. LLC

Q

Yes. Thank you. As a Chicago native, I believe in Chicago street food because I grew up on it. But there – during the IPO and subsequently, there's always the questions, I think, that come inherently with a concept that has a high degree of regional concentration on that regional to national journey.

So can you talk about your confidence in that regional to national journey, the proof points you're getting? I think there were some really good proof points you've gotten over even the last 12 months. And you're – where you think Portillo's can go over the long term in terms of number of units. You alluded to it, but I'd love to fish that out more.

Michael Osanloo

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

A

Yeah. Great. Great question. And I think it's interesting because it's probably one of the most relevant things that we talk to investors about. There's this – there's always this question and I get it sometimes in a really comical

way. So please don't take offense. But I get a lot of New Yorkers saying, what is this Italian beef and why anybody eat Italian beef? So if you haven't had an Italian beef sandwich, there's a restaurant 15 minutes away and the beef truck will be here tonight in the porte-cochere. So try our food. But the proof – it's a roast beef sandwich. It's unbelievably delicious on delicious bread. We call it beef and gravy, but some people call it roast beef. It's a French dip. It's au jus, what have you.

If you go look across our business, we have restaurants outside our core, Arizona, Florida, and now Texas, that have all done \$10-plus million. You're not doing \$10 million revenue at \$12 per person average check. You're not doing that based on a bunch of Chicago expats. You're doing that because local communities have adopted your food. They like your food. We opened a restaurant a year ago tomorrow in Dallas, Texas, that will have eclipsed \$13 million in sales. It's not a gimmick. People like Italian beef.

People have asked me, like, why do you think Texans like your Italian beef sandwiches? It's beef and bread. Check, check. That has worked in Texas. And so I think our food has a universality to it that is sort of undeniable and it's delicious. And so I think it's a fair question, like, does your food transfer? I think yes. And it perplexes people because we're a bit of a unicorn, right? There's no other national brand that does this. The core or the logical corollary to this debate is if you're so worried that our food translates because it's so unique, then if I can prove to you that it translates, it must deserve the best multiple in the restaurant industry because we're a unicorn.

Sharon Zackfia

Analyst, William Blair & Co. LLC

Q

I think one other interesting dynamic that came out of your recent development was not only the acceleration in unit growth, but the potential for units to have improving ROIC or unit level returns. And I'd love to flesh out what you're doing with those units to bring costs down and make those units more efficient, more customer-friendly, faster, more labor simplification, all of that because it's a big topic. And we don't normally see the next chapter be a higher returning chapter than the first chapter.

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

A

Yeah. And what – I love the story, Sharon, because there is a journey that Portillo's is going through and we're really – Michael and I talked about in the infancy stage, in a certain respect, even though we're a 60-year-old brand. So, if we look at what we laid out at our Development Day, so everyone knows that build costs have been elevated, right, during the high inflationary period, particularly in 2022. So when you look at our average build cost for our class of 2022 restaurants with just seven restaurants in that class, we were averaging about \$7 million to build those boxes, those units.

What we're building now is we're averaging about \$6.2 million to \$6.5 million for what we built in the class of 2023. And that what we're building right now in 2024. We are and have been working for the last year and a half on a prototype that we call Restaurant of the Future and that we're going to start building in the fourth quarter of this year. And that we believe, Sharon, we're reducing the footprint, et cetera. We believe we'll shave \$1 million off the build cost. And we're estimating to be building in, in a range of \$5.2 million to \$5.5 million, which, to your point, just bolsters the cash on cash returns of our restaurants in that class that we're looking at. And the things that we're doing, Sharon, are – it's things that make a lot of sense.

When you look at our traditional Portillo's in Chicagoland, you're going to see a 10,000 square foot restaurant. It's going to have a kitchen, a linear kitchen line that's about 100 feet. The evolution to Restaurant of the Future and what we built in 2023 and what we're building in 2024 is about 7,800 square feet. Kitchen line has shrunk to about 67 feet. Restaurant of the Future, about 6,000 square feet or under, 45-foot kitchen line. So we talk a lot internally

at Portillo's about conveyance in the kitchen, which is just movement. Think about moving product from 100-foot line to having a space that you're conveying less product. It just creates efficiencies in labor. And I know Michael can talk about a host of other things. And I'll let him jump in on.

Michael Osanloo

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

A

Yeah. This is a great topic. And it's wonderful to hear Michelle talk about it because she comes at it from the perspective of our – as our CFO, who's going to make sure that every single penny that we spend is wisely spent, is creating great shareholder return. But she's co-leading this project with our head of marketing who's going to make sure that we're still an experiential brand and that the guests that come into Portillo's are having an amazing experience. There's no art in shrinking a restaurant. Anybody can shrink the box. The question is, can you do it while you still give guests a wonderful experiential brand? And then we can turn to our operators and I tell the operators, hey, this kitchen, we mock up the kitchen. We have it done in one of our facilities, one of our commissaries. And I asked my operators, can you do \$10 million of revenue in this kitchen? First time, they like puked all over it. Like, there's no way. This is too small. We tweaked the kitchen.

So, now, I've got my CFO who says, yeah, the economics makes sense. The marketer who says that, yes, this is a brand-enhancing, people are going to love this. It's a great experience for guests and our operators will say, we can do \$10 million of revenue in this kitchen. Those were the guardrails, right? We can – you can shrink a box really easy to do that. What's really hard to do is shrink it, not give up revenue potential and not give up a branded experience for your guests. So I think we've cracked the DNA, but it's iterative. We're going to figure it out. We'll probably make some small mistakes, but we're really close to something magical that we can then step the gas on on development.

Sharon Zackfia

Analyst, William Blair & Co. LLC

Q

Thanks for that. I think when I talked to investors about Portillo's, at this point, everyone's all excited. They're very interested. And then I always get the negative traffic question which has happened I think over the last six months-ish. Now, to be fair, when you're opening at these volumes, it's herculean just to keep the traffic even during the comp period.

But can you talk about what you're seeing with negative traffic and the impacts there? I know there's an impact from Chicago where the population is declining. I know there's some cannibalization. But I think just to put it into context that that isn't necessarily the end-all and be-all number when you think about Portillo's.

Michael Osanloo

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

A

Yeah. I want to be thoughtful about how we say this because what we did say at the end of our third quarter in our earnings was that we're seeing very positive trends on traffic and we feel really good about that. I think there are two phenomena in Q2 and Q3 that negatively affected the entire restaurant industry. Some of the nonsense with the GLP drugs and restaurants, which I think has no factual basis in it, but was a cute trade for six months. I think that kind of negatively affected us a little bit.

But I also think that the other dynamic was that there was a lot of very, very aggressive pricing by QSR. And we wanted to pivot a little bit. So, if you go through a Portillo's drive-thru, what you see right now, we don't discount. We don't want to ever be in the business of discounting. I think it's brand corrosive to us. But if you go through our drive-thrus, our digital menu boards now have Portillo's pairings. There are some amazing things – you can get a

hotdog and fries at Portillo's for under \$8. You can get an Italian beef sandwich with a small drink for like \$10, \$11. So there's amazing pairings at Portillo's that really emphasize what a value we are without discounting.

And so we've pivoted to that. And we saw an immediate response by consumers once they remember that, hey, Portillo's is a really good deal. You pay for what you get. The value proposition is exceptional. And I think just that little pivot has helped us mitigate some of the traffic concerns.

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

A

And I was just going to add on to that, Sharon, that one of the things I love about our brand is the multi-channel nature of it. And so to Michael's point, when QSRs get aggressive with discounting or promotions, what you see in this environment, Portillo's sees a little bit of an impact in the drive-thru business, as Michael mentioned. But then, remember, we have 40% of our business that's in dine-in. You actually see a trade down from casual dining, right, into Portillo's because you can still have a fantastic experience, great value and not have the outweighed impact of paying the tip, et cetera. And so it's a little bit of a buffer, right, as you think about the multichannel nature of Portillo's that you see that dynamic come through.

And the only other thing I'll mention at topic is we did make an investment in Q4, just over \$1 million into marketing in our core market of Chicagoland, specifically because it's a tool we have in our toolbox to combat the negative traffic that the entire industry is seeing. And part of that, I think, led to some of the improvements that Michael mentioned that we have seen into the fourth quarter.

Sharon Zackfia

Analyst, William Blair & Co. LLC

Q

Sorry. I'm starting to lose my voice because it's day 2. Can you talk about scaling in new markets as well? Because you built these kind of beachheads in Texas, Arizona, and Florida, and you've scaled Texas much more rapidly than Arizona or Florida. And how we should think about that as you enter or explore markets like Denver, Vegas or Atlanta.

Michael Osanloo

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

A

Yeah. Great question. So we – well, we don't want to build islands, right, one-off, onesie-twosie restaurants. The economics just never work as well. And so for us to achieve a minimum efficient scale, we got to get to six to eight restaurants. We saw this in spades, and Michelle's talked about it in terms of the margin improvement. When we went from two restaurants to even four in the Phoenix metropolitan area, we saw a massive improvement in margins. It keeps getting better. So, our vision in Texas, when Mike, our Chief Development Officer, comes to me with Dallas, it's not, hey, here's a restaurant in Dallas. It's here's the market map for DFW. We think there's 16 restaurants in DFW. Here are the first five I want to build.

And so a year ago tomorrow, we built our first one in Dallas, Texas. We now have four. Number five will open at the end of this quarter. Number six will open in the middle of the year. Six restaurants for us, you start to get to some minimum efficient scale. The scale affects you in your cost structure. I get distribution savings. I leverage some labor. I leverage my multi-management. And so it's really good there. But there's a revenue synergy that is – it's really important.

When you become part of the DNA of a market so that if somebody has a craving for Portillo's, I'm not 35 minutes away across town. We're 15 minutes away for your nearest Portillo's. And you see a revenue pickup once you

achieve that minimum efficient scale. So six to eight is how we want to get to. We're only going into markets right now where we have a real comfort that he's mapped out six to eight restaurants. And our goal is minimum efficient scale within 24 months [indiscernible] (21:02). We don't like building islands. The economics are just not good. So for now, we're just going to keep banging away and building scale and then densifying as we do that.

Sharon Zackfia

Analyst, William Blair & Co. LLC

Q

Michelle, can you talk about the balance sheet and how you're funding development?

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

A

Yeah. So we fund all of our own growth. So the great thing about Portillo's and our restaurants is they cash flow immediately from day one that they open. And so when we look at the free cash flow, as I mentioned earlier, how we're deploying capital, we're funding all of our own growth. We do have a \$100 million revolver that you'll see us tap into on occasion, depending on the timing of growth. But it's – there is needed and I feel good about that. We refinanced our debt early part of 2023 before things went a little crazy. And so I feel good about where we sit in this, even this environment, Sharon. We get a lot of questions about high interest rates, et cetera. But if rates start coming down, that's just good for us. We're just going to have more cash to deploy in the best interest of our shareholders. So I feel good about continuing to fund our growth even when you see the 12% to 15% and Portillo's ability to do that with our own internally generated cash flows.

Sharon Zackfia

Analyst, William Blair & Co. LLC

Q

And in terms of site selection, are you becoming very well-known amongst developers as a draw given the traffic that you do generate?

Michael Osanloo

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

A

Absolutely. I think that we have a deeply experienced development officer, deeply experienced real estate partners. And so we actually find like we have – our developer in Florida, not only does this person love us, but they're going and identifying sites for us now and they want to buy the land and then lease the land to us. And so we have, I think, some preferred partners, but we're getting to a scale where we have preferred partners on real estate, preferred partners on the build who know us now, know how to build our restaurants in a costly and time efficient manner.

Sharon Zackfia

Analyst, William Blair & Co. LLC

Okay. We are exactly out of time. So...

Michael Osanloo

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

Perfect.

Sharon Zackfia

Analyst, William Blair & Co. LLC

...better.

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

Great.

Sharon Zackfia

Analyst, William Blair & Co. LLC

And I guess we'll see everyone at the Beef Bus later.

Michael Osanloo

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

Thank you.

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

Yes.

Michael Osanloo

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

Thank you, everyone.

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

Thank you.

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