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Portillo's, Inc. (PTLO)

Q1 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings, and welcome to the Portillo's First Quarter 2024 Earnings Conference Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Barbara Noverini, Portillo's Head of Investor Relations. Thank you. You may begin.

Barbara Noverini

Head-Investor Relations, Portillo's, Inc.

Thank you, operator. Good morning, everyone, and welcome to our first quarter 2024 earnings call. Our 10-Q, earnings press release and supplemental presentation are posted at investors.portillos.com. With me on the call today is Michael Osanloo, President and Chief Executive Officer; and Michelle Hook, Chief Financial Officer.

Any commentary made here about our future results and business conditions are forward-looking statements, which are based on management's current expectations and are not guarantees of future performance. We do not update these forward-looking statements unless required by law. Our 10-Q identifies risk factors that may cause our actual results to vary materially from these forward-looking statements.

Today's earnings call will make reference to non-GAAP financial measures, which are not an alternative to GAAP measures. Reconciliations of these non-GAAP measures to their most comparable GAAP counterparts are included in this morning's posted materials.

Finally, after we deliver our prepared remarks, we will open the lines for your questions.

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

Michael Osanloo

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

Thank you, Barb. Good morning, everyone. Thank you for joining us for our first quarter 2024 earnings call. It's an exciting time at Portillo's. During the first quarter, we opened our fifth restaurant in the Dallas market, and then just a few days ago, we opened our seventh restaurant in the Phoenix-Scottsdale area. We're happy with how quickly we're building scale in the Sunbelt, where there continues to be plenty of room for us to grow.

Now in the first quarter, we grew total sales 6.3% and achieved restaurant-level margins of 21.9%. Our comp was negative 1.2% as we got off to a slow start due to some miserable weather across the Midwest. And please recall, we have 69 restaurants in the comp base and 60 of them are still in the Midwest. This means the majority of our comp base felt the impact of that cold snap. That said, we've seen top line trends improve going into the second quarter.

So far in April, our efforts have mitigated transaction declines and comp has settled back into the positive low single digits. For the full year of 2024, we're still confident in our ability to deliver low single-digit comp, 23% to 24% restaurant-level margins and open at least nine new restaurants.

Before Michelle reviews our Q1 performance, I'd like to take a moment to share with you our strategy. Our strategy is predicated on four pillars that provide guideposts for near-term goals and serve as the foundation for quality long-term growth. You can see a graphic of our strategy in the earnings supplemental.

The four pillars are: first, running world class operations; second, innovating and amplifying the Portillo's experience; third, building restaurants with industry-leading returns; and fourth, taking great care of our teams. And of course, our pillars sit on the foundation of a winning culture.

In 2024, we've committed to prioritizing sales and transaction growth. So let's dive into some of the specifics on how each pillar will support our goals in 2024. First, running world class operations is the single most important tool we have to drive sales. It is the core element of our business that's totally under our control and it gives us the right to grow.

Guests who enjoy the taste of our food and have a great experience see the value in our brand and come back time and time again. Those visits may not look the same each time. Whether they want to dine in with their kids, zip through our drive-thrus, enjoy Portillo's at home, or cater for a big event, our strong multichannel muscle remains a competitive advantage that drives guest engagement and traffic.

In 2024, we're specifically focused on improving the drive-thru experience. We're already known for our double lane drive-thrus and friendly order-takers, but speed really matters, throughput matters. Our overall satisfaction scores in the drive-thru have been good, but our service has slowed down a bit and we know we can do better. A 30-second improvement in our drive-thru speed equates to 1 point of comp. So we continue to double down on speed of service by empowering our restaurant leaders with tools and coaching to give real time feedback based on those key metrics at critical time points during the day.

Our second pillar is centered on innovating and amplifying the Portillo's experience through menu innovation, marketing efforts and digital engagement. Each of these avenues raises brand awareness and reaches guests through the consumer landscape. At the end of Q1, we tested a spicy chicken chop salad and a chicken pecan salad. We were so pleased with the initial feedback from the test of these fresh new salads that we accelerated their launch by a month, a testament to our nimbleness as an organization. And already sales of these new salads are the highest of any of our new menu launches over the last five years, and that's without the full marketing campaign behind it.

Starting this month, you'll see our [ph] mix it up (00:06:19) marketing campaign on digital channels, highlighting the freshness of all of our house-made ready-to-order salads. They've also had a positive impact on mix by displacing lower margin items. Simply put, these salads are a win. They are clearly delicious. They add menu variety that appeals to a range of demographics, and they make Portillo's even more veto-proof.

At the end of Q1, we also made a small investment in some traditional advertising to amplify brand awareness in Arizona, really the only other market outside of Chicago where we have some scale. We've seen early signs of transaction improvement in this region in conjunction with that campaign. Given that success and the success in general of our advertising, we're planning on another round of advertising in Chicagoland in the third quarter.

We'll also continue to innovate our digital advertising approach. In Q2, we increased our advertising on third-party delivery sites outside of Chicagoland to generate trial and raise brand awareness. This is a proven tactic and we'll be doing more of it as we assimilate in new markets.

Technology will also continue to play a role in amplifying the Portillo's brand. I'm excited to share that Keith Correia has joined Portillo's as our new Chief Information Officer. A longtime restaurant industry executive, Keith will continue to advance the Portillo's team member and the guest experiences. Under Keith's leadership, we're embracing technology as a business driver in ways that create impact and value at Portillo's.

Our IT team is actively partnering with stakeholders throughout the business to identify opportunities for optimization and innovation and in particular, we're looking at how to improve our digital ordering experience through our app, and we're planning our first testing of kiosks in California that will enhance our signature guest experience.

Our third strategic pillar is building restaurants with industry-leading returns. We're focused on maintaining our industry-leading AUVs while optimizing our footprint and lowering our build costs. We're also looking to scale in new markets quickly as we lean on replicable development processes.

We're on track to open our first Restaurant of the Future in Texas in Q4. And as a reminder, the Restaurant of the Future is a smaller format prototype with some built-in efficiencies. The early contractor bids suggest that we're well within the estimated build cost range of $5.2 million to $5.5 million. And remember, this saves at least $1 million on each new Restaurant of the Future build, puts us in a very enviable position when it comes to cash on cash returns.

Now importantly, even with a 1,500 square foot reduction, these restaurants will still look and feel like a Portillo's. They will have local personality. They will be led by an experienced GM. And most importantly, we expect them to still produce the same industry-leading AUVs of all our other restaurants. We have a few Restaurant of the Future coming online this year, and we're really excited to see what they do.

We've built a tremendous development pipeline and we feel confident in our ability to continue to expand at a faster pace than we have in previous years. We know Portillo's has a long runway for continued growth.

Our final strategic pillar, and maybe our most important one, is taking great care of our teams. It wouldn't be possible to serve our fresh, amazing food or create memorable guest experiences without our team members. We're proud of our industry-leading team member retention, which average about 20 percentage points better than the rest. We're focused on providing a meaningful work environment, pay and benefits that matter to the team member, and a clear pathway for professional development.

We're especially proud of our Ignite Development program that's been totally built in-house. As you know, a critical component of new restaurant success is having an experienced general manager. I'm proud to share that because of Ignite, we have a deep leadership bench. We have identified experienced GMs for all of our 2024 pipeline as well as most of the 2025 pipeline already. Nearly all of those GMs are Ignite graduates. I'm more confident than ever in the talent pipeline we have built to support our growth.

And beyond the general manager level, we have team members across this organization who see the potential for long-term careers with Portillo's. In the first quarter of 2024, we promoted 64 team members who went through the Ignite program, continuing to develop that in-house talent. We're thrilled with how many folks raise their hands and want to be a part of Portillo's growth. They can envision the exciting future for us, and they want to be part of it. It's our team members who create the Portillo's experience that keeps our guests coming back, and we're focused on making sure that's what we deliver.

With that, let me hand it over to Michelle.

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

Great. Thank you, Michael, and good morning, everyone. Before we discuss our first quarter results, I want to recap our recent secondary offering. This quarter, we completed the offering of 8 million shares of the company's Class A common stock at an offering price of $14.37 per share. All of the shares sold in the offering represented Class A and B shares owned by pre-IPO members. We used the proceeds to purchase shares from Berkshire Partners, the private equity firm that acquired Portillo's in 2014 and subsequently sponsored our IPO in 2021.

As of May 7, 2024, Class A shares represented 84.1% and Class B shares represent the remaining 15.9% of the 73.2 million in total outstanding shares. Since the IPO, there have been four secondary transactions, which have collectively reduced Berkshire's beneficial ownership to approximately 19.3% of the company from over 60% at the time of the IPO. Over this time, we've more than doubled our public float.

Now turning to the results for the first quarter. In Q1, revenue growth was driven by the opening of new restaurants. During the first quarter, revenues were $165.8 million, reflecting an increase of $9.8 million or 6.3% compared to last year. New restaurants positively impacted revenues by approximately $14.4 million, which was offset by a 1.2% decrease in same-restaurant sales. This was primarily driven by a decrease in transactions of 3.2%, partially offset by an increase in average check of 2%. The higher average check was driven by an approximate 5.1% increase in certain menu prices, partially offset by product mix. Comp on a two-year stack basis was 7.8%.

Strong same-restaurant sales growth of 9.1% in the first quarter of 2023, ongoing consumer uncertainty and winter weather give greater context to this quarter's same-restaurant sales performance. In particular, Q1 transactions were heavily impacted by severe weather in the Midwest. This period spanned several weeks, during which transactions declined by double digits.

Same-restaurant sales and transactions subsequently improved. As Michael mentioned, we're focused on several initiatives to drive transactions in what continues to be a choppy consumer environment. We are happy that these efforts supported low single digit same-restaurant sales growth and improved transactions in April versus our first quarter results. For the full year, we are still estimating low single digit same-restaurant sales growth.

Moving on to our costs. Food, beverage and packaging costs as a percentage of revenues decreased to 34.3% in the first quarter of 2024 from 34.4% in the first quarter of 2023. This decrease was primarily due to an increase in our revenue and lower third-party delivery commissions, partially offset by a 4.8% increase in commodity prices. We experienced commodity pressures on beef, pork and produce during the first quarter. We are still estimating commodity inflation in the mid-single digits in 2024.

Labor as a percentage of revenues increased to 26.1% in the first quarter of 2024 from 25.9% in the first quarter of 2023. The increase was primarily driven by lower transactions and incremental wage rate increases for our team members, partially offset by increases in our average check and lower variable-based compensation. Hourly labor rates were up 3.1% in the first quarter of 2024 versus the prior year period. We are currently estimating labor inflation in the mid-single digits in 2024.

Other operating expenses increased $1.2 million or 6.2% in the first quarter of 2024 compared to the first quarter of 2023, which was primarily driven by the opening of new restaurants. As a percentage of revenues, other operating expenses remained flat at 12% compared to the prior year. Occupancy expenses increased $0.9 million or 10.5% in the first quarter of 2024 compared to the first quarter of 2023, primarily driven by the opening of new restaurants. As a percentage of revenues, occupancy expenses increased 0.2% compared to prior year.

Restaurant-Level Adjusted EBITDA increased 4.5% to $36.4 million in the first quarter of 2024. Restaurant-Level Adjusted EBITDA Margin were 21.9% in the first quarter of 2024 versus 22.3% in the first quarter of 2023. This reflects a modest decline of only 40 basis points, despite softer sales and the addition of nine new restaurants since the first quarter of 2023. Note that Q1 has historically been our lowest revenue and Restaurant-Level Adjusted EBITDA Margin quarter. We are currently estimating our Restaurant-Level Adjusted EBITDA Margin to be in the range of 23% to 24% in 2024.

To offset the inflationary cost pressures noted above, primarily on food and labor, we did take two pricing actions during the quarter. During January and at the end of March, we increased certain menu prices by approximately 1.5% in each period. To offset the implementation of the FAST Act in California and in connection with our new [indiscernible] (00:17:59), we accelerated the pricing decision we would have made in Q2 to the end of March. These actions, combined with the lapping of previous pricing actions, put us at an effective price increase of approximately 6% at the end of the first quarter.

Subsequently, another 3% of prior year pricing just rolled off last week, which puts us at an effective price increase of 3% today. We will continue to monitor our cost pressures, the competitive landscape, as well as consumer sentiment to inform our pricing decisions in the coming quarters.

Our general and administrative expenses decreased by $0.2 million to 11.2% of revenue in the first quarter of 2024 from 12% in the first quarter of 2023. The decrease was primarily driven by lower equity-based compensation and lower variable-based compensation, partially offset by an increase in wages attributable to annual rate increases as well as increases in professional fees, advertising and marketing expenses.

Pre-opening expenses decreased $0.9 million to 0.9% in the first quarter of 2024 from 1.5% in the first quarter of 2023. The decrease was due to the number and timing of executive – executed and planned new restaurant openings. We continue to expect pre-opening expenses to be between $8 million to $9 million in 2024. Please keep in mind that our reported pre-opening expenses includes deferred or non-cash rent expense as well as actual costs incurred prior to the restaurants opening. All this led to Adjusted EBITDA of $21.8 million in the first quarter of 2024 versus $19.6 million in the first quarter of 2023, an increase of 10.9%.

Adjusted EBITDA Margin also improved 50 basis points to 13.1% in the first quarter versus the prior period. Below the EBITDA line, interest expense was $6.5 million in the first quarter of 2024, a decrease of $0.9 million from the first quarter of 2023. This decrease was primarily driven by improved lending terms associated with our 2023 term loan and revolver facility, which, as a reminder, was refinanced during February of 2023.

As of today, our outstanding borrowings under our revolver are $22 million. Our effective interest rate on the 2023 term loan and revolver facility was 8.4% as of 2024 versus 8.1% for 2023. Income tax benefit was $1.1 million in the first quarter of 2024. Our effective tax rate for the first quarter was negative 27%, driven by a change in our valuation allowance, which was partially offset by an increase in the company's ownership interest. Our future effective tax rate will fluctuate as Class A equity ownership increases and as equity-based awards are exercised and vest. We expect the full year tax rate to be approximately 21% to 24%.

Cash from operations increased by 39.9% year-over-year to $9.1 million in the quarter. We ended the quarter with $13.2 million in cash. We are confident that the strength of our brand and our operational execution will continue to deliver on our long-term growth algorithm.

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

Michael Osanloo

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

Thank you, Michelle. As I close, I just want to thank the more than 8,000 people who work so hard for us every single day to provide a great experience for our guests. It's that in our culture that creates our winning formula. I'm excited to share our strategy with you and plan to update on how we're executing against these pillars in the future.

We're committed to running world class operations, to innovating and amplifying the Portillo's experience, building great restaurants with industry-leading returns, and taking great care of our teams. This is the strategy that we'll execute against. It's how we'll grow our transactions, it's how we'll grow our comp, and it's how we'll deliver industry-leading returns for our investors.

Thank you. With that, let me turn it back to the operator.

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now be conducting a question-and-answer session. [Operator Instructions] Thank you. Our first question comes from line of David Tarantino with Baird. Please proceed with your question.

David E. Tarantino
Analyst, Robert W. Baird & Co., Inc.

Q

Hi. Hi. Good morning. My question starts with the performance for the units that are not in the comp base. So when I look at the first quarter performance, it looks, by our estimates, down quite a bit versus last year. And I just wanted to know your thoughts on why that happened. I know you're cycling some very big openings from last year, but perhaps you can comment on what you're seeing on the recent openings and how those are performing relative to your expectations.

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

A

Yeah, David, thanks for the question. So obviously, you hit the nail on the head a bit when you mentioned certain of our restaurants in early 2023 came out of the gate strong. We definitely called out The Colony specifically and how that was performing. I would say keep in mind, there's two things. One, that as we get into year two with those restaurants, there is the honeymoon curve that we typically have talked about. And so those restaurants that are coming in into that [ph] year two (00:24:16) are going to dip in terms of sales as we've mentioned before with that curve. So that's the first thing I would point out.

The second thing I would say is also keep in mind that weather does have an impact on restaurants that are not in the comp base. And so we did have three new restaurants that were in our core in Chicagoland that did open in the fourth quarter. And so were those pressured by weather? Absolutely. And so there were those couple of dynamics going on that I would call out specifically.

David E. Tarantino
Analyst, Robert W. Baird & Co., Inc.

Q

And Michelle, when you adjust for some of those factors, how would you characterize, I guess, the Class of 2023 openings relative to the targets that you have for new units?

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

A

I'd say we're very happy, David, with the performance in terms of the total class, which, as you know, is eight restaurants. Keep in mind, six of those did open late in 2023. So it's still early innings, I would say, David, in terms of us assessing those restaurants, but they're performing at or above our expectations as a class.

David E. Tarantino
Analyst, Robert W. Baird & Co., Inc.

Q

Great. Thank you very much.

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

A

No problem.

Operator: Our next question comes from line of Sharon Zackfia with William Blair. Please proceed with your question.

Sharon Zackfia
Analyst, William Blair & Co. LLC

Q

Hi. Good morning. I guess I wanted to clarify on the improving trends you're seeing into June. Does that mean that you're seeing lesser and negative – or I'm sorry – into April? I'm flipping ahead to the June quarter.

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

A

Yeah.

Sharon Zackfia
Analyst, William Blair & Co. LLC

Q

Does that mean you're seeing lesser traffic declines? Or have you kind of gotten back into flattish to positive traffic? I was a bit unclear on the text.

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

A

Yeah, I think, Sharon, when you look at specifics, right, as I mentioned, we were [ph] coming out and pricing is – we're (00:26:06) currently sitting at 3%. I'd still say we're still pressured by both mix and transaction impacts. We use Black Box when we look at the industry data. So you can see the industry data as well. I'd say you're still seeing negative trends in that data. We're performing better at the industry, but we haven't gotten quite positive territory when we think of those two metrics.

Sharon Zackfia
Analyst, William Blair & Co. LLC

Q

Can you talk about – I mean, your business is different than a lot of others out there, and you've extremely high volumes and you're also multichannel. We've heard kind of more pressure, I'd say, from traditional QSR in terms of lower-income consumer. Maybe you'd see that more in the drive-thru in your business. I'm just interested from a channel perspective. I also know you've been doing some things on delivery. Kind of how is the channel mix kind of performing and [ph] they're (00:26:59) maybe excluding the weather impact in the first quarter?

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

A

Okay. So it's – Sharon, it's a little bit of a continuation of the same story for us, which is when the consumer – when the lower and the consumer is pressured, it tends to impact us a little bit more in the drive-thru where they are going to QSR. Most QSR is largely drive-thru business. So that's why for us, being incredibly quick, efficient, fast and generating throughput is so important to the drive-thru, and that's why the focus is on speed in the drive-thru. Our dining rooms continue to perform relatively well and crazy as it is, catering and third-party is still very, very strong for us.

Sharon Zackfia
Analyst, William Blair & Co. LLC

Q

Okay. Great. Thank you.

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

A

You bet.

Operator: Our next question comes from line of Dennis Geiger with UBS. Please proceed with your question.

Dennis Geiger
Analyst, UBS Securities LLC

Q

Great. Morning. Thanks, guys. Wanted to ask a little bit more, maybe Michelle, on mix. Any additional color you can provide. I think it was sort of a menu mix that that was the [ph] check mix drag there (00:28:03). But any additional color in the quarter and then maybe on the go forward, how you're thinking about mix through the year at a high level?

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

A

Yeah, absolutely. Dennis. And so we're still seeing less items per transaction, still seeing a little bit more pressure in the drive-thru versus the dine-in business. As Michael mentioned, we believe that that channel gets more pressured when a lower-income consumer is feeling a bit more challenged. I would call out drink attachment specifically. We're seeing a little bit more pressure there, both within the drive-thru and dine-in business. So some of the things that we're doing to combat that.

More recently in April, we relaunched our Famous Five, which is our version of a bundled meal, and we did that specifically because we believe that that can help with our mix in terms of highlighting meals that feature a side of fry and a drink as well. And so that just relaunched on our digital menu boards in April. And I think it also drives awareness, specifically in our other markets for some of the menu items. We're trying to drive those consumers towards in terms of what Portillo's is known for. So those are some of the specific things that we're doing there in terms of looking at how to combat mix. More things to come in the future, but that's what we're seeing, at least in the short term and how we're thinking about it.

Dennis Geiger
Analyst, UBS Securities LLC

Q

That's very helpful, [ph] Michelle. To add (00:29:32) kind of in that line of thinking, just curious on price, and as you think about the go forward, to your point earlier, still kind of thinking through that. I'm just curious if any additional commentary on the customer response to pricing value scores, which I think have been very solid, where those are? Just any other observations around price and sort of the customer response and where the value positioning is right now. Thank you.

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

A

Yeah, Dennis. In the two pricing actions we took, which as I mentioned, we took 1.5% in January and then took the other 1.5% at the end of March. We've seen little pricing resistance on that. I think part of the reason for that too, Dennis, is when you think of the breadth and depth of our menu and our ability to take price in different categories, that's what you're seeing. I mentioned specifically one of the levers for us taking price at the end of

March was the launch of our salads. And so we were able to take some price on salads there and specifically take pricing around the – in California where we have two restaurants to combat the labor inflation in that market.

When you look at the categories, our ability to take price, whether it's on our burgers, our beef, our size, our chicken category, I mentioned salads. When we look at channels, taking price in the catering channel and the delivery channel, I think that we have a lot of optionality and flexibility to pricing. I think we still continue to have that as we move forward. And so we're not committed one way or another to not taking pressure to taking price. We're going to continue to see how things move within the landscape.

And I've continued to say and Michael has that we look at pricing as a lever to offset the inflationary pressures. That's how we're going to continue to view it. But we've seen little resistance within the first couple of pricing actions we've taken this year. But we understand that the consumer is getting to a boiling point, so to speak. So we have to be very surgical on how we take price.

Dennis Geiger
Analyst, UBS Securities LLC

Q

Very helpful. Thank you.

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

A

Yeah.

Operator: Our next question comes from line of Chris O'Cull with Stifel. Please proceed with your question.

Q

Great. Thanks. Good morning, guys. It's [ph] Patrick (00:31:43) on for Chris. Michelle, I had a quick follow-up on the quarter-to-date comp. And I just was hoping you can maybe give a little bit more color on the traffic improvement versus the price contribution and how we should be thinking about sort of the confidence level of continuing that low single digit level with that 3% pricing rolling off more recently?

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

A

Yeah, [ph] Patrick (00:32:04), I mean, you saw the quarterly comp and we definitely have some impacts from traffic. Specifically in that, we were looking at down just over 3%. We did see – intra-quarter, we saw improvements from the weather event in January, specifically on transactions, and then as we moved into February and March, we saw improvements on that. We saw improvements going into April on that. But as you know, I answered the question of share and we're still seeing pressures on both transactions and mix. So those have not flipped positive as we sit here today and we're at 3% pricing. But it's definitely mitigated, which, as Michael mentioned.

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

A

Yeah.

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

A

And so we feel really good about the trends and our ability to continue to mitigate what we're seeing because we've seen those trends improve since that point in January into the latter half of Q1 into April. So we have some strategies in place. As Michael mentioned, we are going to invest in advertising in our Chicagoland market in the third quarter. We made a little bit of investment in Q1 into Arizona. So we are continuing to use those tools in our toolkit to combat the trends that we're seeing today. But we're still not out of the weeds, so to speak, and we're still seeing some impacts there from just the macro environment as a whole.

Q

Great. That's helpful. And then, Michael, I know you mentioned excellence in the drive-thru as one of the key strategic pillars this year, at least one of the underlying points of the key strategic pillars. So I mean, what are the real pinch points you believe you have right now in the drive-thru? And what are those key areas of focus for your GMs that are going to result in better throughput in that drive-thru channel? Is it a focus on training? Is it something else that you guys have identified that you can really center them in on and allow that to improve the throughput [ph] period (00:33:56)?

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

A

Yeah. You actually answered the question yourself, which is it is a focus on training. I think we got a little complacent in how well we are performing based on guest satisfaction scores. But the reality is that when you actually see what's going on in our drive-thrus and very carefully monitor them, we're being a little slow in deploying that next person as an outside order taker. We're being a little slow in getting food to them.

So the focus for our teams is throughput, make sure that we're getting people in and out of the drive-thrus as quickly as possible. And it does really begin with appropriately staffing and making sure that our folks know what great looks like and what the expectations are.

Q

Great. Thanks, guys.

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

A

You bet.

Operator: Our next question comes from line of Sara Senatore with Bank of America. Please proceed with your question.

Sara H. Senatore
Analyst, BofA Securities, Inc.

Q

Oh, thank you. I wanted to – I guess, two clarifications. The first is that you noted that the second year normalization is perhaps pretty meaningful. Should we be expecting then that that gap between unit growth and comp growth between that and overall revenue growth should remain pretty wide over the course of the year?

And specifically, what are you seeing in the Sunbelt? I know you said that you're seeing a lot of room for growth, but trying to understand how to contemplate the second year normalization in that context.

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

A

Yeah, I think, Sara, it's – we've given some metrics in the past when you look at how year one and year two performs and how that honeymoon curve dips for a class of restaurants. I'd point to those metrics before in terms of for you to get a sense for how that curve dips. Keep in mind that there's only three restaurants this year that are going to enter the comp base. And so we had one under the comp base in Q1, we'll have one under the comp base in Q2 and then we'll have one under the comp base in Q4.

So still largely speaking, we're going to have a class of restaurants that are going to be in that non-comp window that are going to be in that honeymoon curve. And so those are the dynamics I'd point out in terms of as you think about revenue moving forward and what's comp versus non-comp, that there's still going to be that dynamic that exists. But I point to the prior numbers in terms of the dip of the honeymoon curve.

In terms of the performance in the Sunbelt, I would say we continue to be extremely happy with their performance. And as you know, we've mentioned before that those restaurants generally outperform the restaurants in the Midwest outside of Chicagoland. So that dynamic still continues to exist. And we continue to be extremely bullish on restaurants as we move forward in Texas, Arizona and Florida.

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

A

Yeah, [ph] I'll just recall (00:36:57) that at this time last year, The Colony was the only restaurant open in Texas, and it was trending towards like an outrageous number. I think I quoted [ph] $70 (00:37:08) million at this time. That's what it was trending towards, which was, we said it's an unsustainable number. It was generating enormous amounts of trial and awareness, which is great because it's part of the reason why the next four restaurants in the DFW market performed so well, because you had so much trial and awareness coming out of [ph] The Colony (00:37:28), but it was never going to sustain that performance. That was not a – it's going to have a natural curve. It's going to be a fantastic restaurant for us. It is a fantastic restaurant, but it was never – it's got to come back down to closer to Earth after that first opening start.

Sara H. Senatore
Analyst, BofA Securities, Inc.

Q

Okay. That's helpful. And just to sort of drill a little bit further down into that, Michelle, you said like look at the previous data presentations. I guess so Colony, we should be thinking about the honeymoon curve as like percentages as opposed to dollar values and inflow. So something, instead of opening at [ph] 6%, 6.2% and going to 5.8%, it opens at 17% (00:38:09) and goes down a similar percentage or is the issue that the honeymoon plus you have intentional sales transferred for these new restaurants?

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

A

No, I would say the best way for you to think about it, Sara, is that percentage decline specifically of the class. I know obviously individual restaurants are going to vary, as Michael mentioned, The Colony, but I think the best way to think about it is that percentage decline as a class.

Sara H. Senatore
Analyst, BofA Securities, Inc.

Q

Yeah. Thank you.

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

A

No problem.

Operator: Our next question comes from line of Brian Harbour with Morgan Stanley. Please proceed with your question.

Brian Harbour
Analyst, Morgan Stanley & Co. LLC

Q

Yeah. Thanks. Good morning, guys. Michelle, the kind of change in margin we saw in the first quarter, is that something you'd expect to be similar as we move through? I know we're lapping the extra week in the fourth quarter, but is that something you'd kind of expect to be similar or any sort of like lumpiness from a margin perspective we should think about?

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

A

There's nothing I'd call out specifically, Brian. I think, yes, we – as I've called out before, is as we continue along 2024 with the restaurants as we've been talking about that are not in the comp base that naturally have lower margin profile than your other restaurants. Through that alone, you should see natural margin degradation. But in terms of as we go quarter to quarter and as we compare, I think that, yeah, I wouldn't expect anything – any specific quarter to be impacted more than another.

The only thing I'd call out is, Q2, we do expect a little bit more pressure on the commodity side, but not beyond the mid-single digits that we've mentioned. Outside of that, though, you might get some lumpiness just based on those input costs that come in each quarter, but nothing significant that I would call out. We still feel confident that for the full year we're going to be in that 23% to 24% range.

Brian Harbour
Analyst, Morgan Stanley & Co. LLC

Q

Okay. And then G&A, it's, I assume still on track or maybe you expect more of the year-over-year increase in the third quarter, is that fair?

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

A

Correct. Because we are going to start to do some advertising again in Chicagoland in that third quarter and that will pressure G&A specifically in that quarter as we spend those dollars on [ph] net (00:40:37) advertising.

Brian Harbour
Analyst, Morgan Stanley & Co. LLC

Q

Okay. Thank you.

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

A

But still expect as we said here today to be in that range of $85 million to $87 million for the year.

Brian Harbour
Analyst, Morgan Stanley & Co. LLC

Q

Yeah. Okay. Thanks.

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

A

Yeah.

Operator: Our next question comes from line of Andy Barish with Jefferies. Please proceed with your question.

Andy Barish
Analyst, Jefferies LLC

Q

Hey, good morning, guys. Just a clarification on the Famous Five. I think last quarter you talked about some Portillo's pairings that you were looking at [ph] value test (00:41:08). Is that basically the same thing or am I remembering something different there?

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

A

No, you're remembering correctly. We ended the year last year using having Portillo's pairings on our outside menu boards and inside the restaurant. And we were trying to highlight, specifically for guests [ph] great, great duos (00:41:28) that got you under close to $10. Good news, bad news. The good news is that it had an effect on how guests order. The bad news is it brought down mix and then the number of items they ordered. And so we think that we're better off with the Portillo's Famous Five, highlighting our absolute best dishes, which we think work really well, is accretive to the guests and also hopefully picks us up a little bit better mix.

Andy Barish
Analyst, Jefferies LLC

Q

Got you. So those are value, but a little bit higher than that $10 price point maybe?

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

A

Yeah. And they typically have a beverage with them where the pairings did not.

Andy Barish
Analyst, Jefferies LLC

Q

Yeah. Perfect. Thanks. And then where are you thus far this year? I think there were going to be another [ph] 20 or so, kicks in 23 (00:42:22) remodels in the Chicagoland area. Have those begun in earnest or is it a different time of year that you plan to roll those out?

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

A

Yeah, Andy, we had done 17 of the retrofits last year and we have 23 untapped for this year. I'd say the vast – it's gotten started. It's underway. The vast majority of those will come in the back half of the year. So they haven't rolled out fully yet. And most of those – a lot of those will be in our outer markets as well as some in our core. But most of those will come in the back half.

Andy Barish
Analyst, Jefferies LLC

Q

Got it. Got it. And then let me – I just wanted to level set. I think just kind of adding everything up, this year's EBITDA growth is going to probably be a little bit below the long-term algo. Maybe thinking of it in a way like, yes, it's a tough consumer environment, but what would have to go right to kind of get to the low teens, I guess, especially with the 53-week lap?

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

A

I think we got to continue to push top line growth, Andy. I think when you look, obviously, as you know, the flow through on the incremental revenue is going to be very powerful on that bottom line. I think outside of that, continuing to look for efficiencies within our kitchens, we continue to do that. That's just something that's in our DNA in general. The retrofits in the back half of the year, as I mentioned, do provide some form of labor benefit. But then as we continue to look for that, I think as Michael mentioned, throughput through the drive-thru continues to be a focus. That, we believe, has the ability to drive that top line growth, to drive that transaction growth.

And so as we continue, as I mentioned, to drive that top line, we believe that that could provide incremental benefit. But that to me would be what would have to happen. We don't believe we're – as you know, we're a growth organization. We don't believe that we're going to cut our way to greatness. So we're going to continue to invest in the business. We're going to continue to make good decisions to drive this business forward. But those are some of the things that I would call out.

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

A

Yeah. And I just – I don't know if you're getting at G&A. I mean, like, obvious – G&A is you got to – Michelle and I have committed to generating G&A leverage, right? And so – and we have goals in mind, but we absolutely need to be leveraging G&A. It's still – I think we're trying to be smart in how we spend. We're spending in things that are revenue-driving and transaction-driving activities. So that's an area that we need to be continue to be focused on. But Michelle is right. The marginal contribution from revenue growth is so attractive to us that extra guests that we can get through the drive-thru or through dine-in is so attractive for our investors that that's really the best way for us to expand our margins.

Andy Barish
Analyst, Jefferies LLC

Q

Very helpful. Thank you.

Operator: Our next question comes from line of Brian Mullan with Piper Sandler. Please proceed with your question.

Brian H. Mullan
Analyst, Piper Sandler & Co.

Q

Thank you. [ph] Just a follow up (00:45:38) on some of the drive-thru commentary. I don't want to belabor this, but just so I understand. Do you think the drive-thru speed of service today is slower than at other times in Portillo's long history? So you're able to see that in your data and you kind of know there's a high watermark that you're running below. Or conversely, is this just not about being slower than before? It's just you just believe there's opportunities to get better? Just clarification on that.

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

A

No, it's factually slower. It's – when I look back to 2019, it's slower. It's undeniably slower than we were in 2019. And so that's what gives us goals in mind. That's what gives us confidence that we can get our swagger back a little bit and make sure that our drive-thrus are moving as quickly as we would like them to.

Brian H. Mullan
Analyst, Piper Sandler & Co.

Q

Okay. Thank you. Understood. And then just want to ask about the catering business. You highlighted that last call it's an area of opportunity, particularly outside of Chicago and maybe something you were going to invest resources behind. So just where are you with that now? What's the plan for this year? And how do you envision that starting to build over time?

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

A

Yeah, we have a catering team now that's fully deployed doing both inbound sales, but also outbound, reaching out to customers. For example, around Mother's Day, people who ordered in the past, who haven't ordered, they're getting calls from our sales team saying, hey, you ordered last year, are you interested in doing something? So we're doing that.

I think it takes on almost two flavors of performance. In outer markets, it's a lot of generating trial and awareness. Catering is great for that. And so the sale itself is fantastic. But getting customers acclimated to how to use Portillo's is even a bigger win for us. Inside Chicagoland, it is – it's much more about making sure that we're reminding people that we help them facilitate that order and that we execute flawlessly. So it's a great – to me, it's not a huge business. I'm not going to pretend it's a huge business, but it's a – it punches over its weight because of its ability to generate trial and awareness and put a lot of our food in a lot of different people's mouths who may otherwise not have been customers.

Brian H. Mullan
Analyst, Piper Sandler & Co.

Q

Thank you.

Operator: Our next question comes from line of Jim Salera with Stephens. Please proceed with your question.

Tyler Klaus
Analyst, Stephens

Q

Hi. This is Tyler Klaus on for Jim. My question was around the permitting environment. Are you seeing any improvement on that front? And additionally, you've talked in the past about smoothing openings throughout the year compared to previous years. Can you talk a little more high level about the steps you're taking behind the scenes [ph] to smooth the early (00:48:20) opening between quarters? And I had one follow up.

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

A

It's a great question. What I would tell you is that we're not seeing a ton of improvement on the timelines for permitting and silly things like getting lots of silly things that are sort of outside of our control. So what we've done for that is our development pipeline has extended dramatically. And so when we have – we target a restaurant in Texas to open in the fourth quarter of 2024. That's a restaurant that we started the entire process 18 months prior. So our build cycle now is 18 months in advance and we begin the permitting way in advance so that we have a more predictable pipeline.

My – our Chief Development Officer likes to say, it's a lot easier for him to slow things down and to speed things up. And so we have a very, very fulsome pipeline for 2024, 2025 and beyond. And it's much more predictable for us because we just have so much extra time built in.

Tyler Klaus
Analyst, Stephens

Q

Very helpful. And just one follow-up. You gave some great color at the Investor Day regarding shaping the demand curve in new markets. Can we get an update on how this is trending in the five Texas locations as far as activating delivery and catering?

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

A

Yeah, we're – I don't want to get into the specifics of each restaurant, but we feel like one of the things about Texas is The Colony was an extraordinary success early on. It does do everything that we want. It introduces Portillo's to the DFW community. It has an extraordinary catchment for the first six months because it's the only restaurant we have. So people were driving from everywhere. As we have now started to fill in, we have five restaurants in the Dallas-Fort Worth area. And anybody who's spent time in Dallas-Fort Worth knows five is not scale. We still need to keep building in that market. There are – you can spend an hour driving from one Portillo's to another still.

But what ends up happening is you start to build latent demand. You start to see as – and as we turn on alternate channels. So in the company now we're [ph] humming (00:50:32) with every channel open. We started to do the same tactics in Arlington, in Allen, in Fort Worth. And then Denton that we just recently opened, is a little more constrained right now because we want to make sure that we're executing flawlessly inside and in the drive-thru. But you can imagine that the first restaurants are a little bit more staged, but we get a little bit more aggressive opening the alternative channels in restaurants 3, 4, 5, 6 through 10, et cetera.

Operator: Does that complete your question?

Tyler Klaus
Analyst, Stephens

Q

Yes. Thank you.

Operator: Our next question comes from line of Gregory Francfort with Guggenheim. Please proceed with your question.

Gregory Francfort
Analyst, Guggenheim Securities LLC

Q

Hey. Thanks. Thanks for the question. My first is just maybe going back to the advertising and the decision to increase it.

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

A

Yeah.

Gregory Francfort
Analyst, Guggenheim Securities LLC

Q

And I think you also made a comment about advertising on third-party delivery sites. I don't know if you've been doing that before or if that's just an increase. What did you see that made you make that decision? And then kind of what was the advertising historically for the brand, if you can remind me?

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

A

Greg, great question. So we're not – we're just historically not big spenders on advertising. It's just not – our best marketing, and I still believe this is outstanding operational execution, right? When you give people great experience, they come back. But the – our finance team will say undeniably that the advertising we did in the back half of last year worked, undeniably that the advertising that we did in Arizona worked and improved traffic trends. In both instances, improved traffic trends and is – it pays for itself in a very quick timeframe.

And so it gives us a little bit more confidence that we can start to spend a little bit more on advertising and not blow up our P&L that it will return, it drives traffic, it drives comp, and it creates a positive return on investment. So we're intrigued by that and we'll continue to test that selectively. We're not going to do anything crazy. We're not doing $50 million ad campaigns. It's not who we are. But can we spend a little bit on advertising in a very targeted way? Yeah, I think we can do that.

We know that the advertising in Chicago works and with the scale of restaurants in Chicago, that advertising covers a lot of restaurants. So we're eager to do that. And there's some, I think, fun angles that the marketing team has on what we can do in Chicago to drive to drive just awareness, presence and frequency. Outside of Chicago, we're seeing really good success with some relatively modest advertising in the digital channels, particularly with our third-party delivery partners.

We actually think that what ends up happening is that we have guests who maybe we were not in their mindset that convert to a Portillo's, that think about Portillo's and then become a converted Portillo's guest. So we're going to test that more aggressively and we're going to more aggressively use digital channels, particularly third-party delivery channels as a way of generating trial and awareness and think of like markets like Arizona and Texas and Central Florida, places where we're starting to build up scale, but candidly, we still [ph] will (00:54:06) have the awareness that we want. And it's a great way of building awareness in a very targeted fashion that we think pays dividends.

Gregory Francfort
Analyst, Guggenheim Securities LLC

Q

Got it. Thanks for that perspective. And maybe, Michelle, just can you remind us – there's been very different situations in the beef markets between maybe hamburger meat and steaks.

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

A

Yeah.

Gregory Francfort
Analyst, Guggenheim Securities LLC

Q

And I just don't have an appreciation for where beef flat [ph] is sitting there (00:54:31). Can you just give me an understanding of maybe are those inflationary right now or just any thoughts on the overall contracting? Thanks.

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

A

Yeah. No, it's a good question, Greg. And obviously, as you saw, we were up 4.8% in Q1. But our beef products, our hotdogs, our burgers, and then the beef flats, which we use to make our Italian beef sandwiches. We're seeing inflation in all those line items. The burgers in particular are a little bit more pressured because that's going to use a leaner cut. And so that lean market, we do feel a little bit more pressure on the burgers, which is what I called out as part of the Q1 headwinds.

We are hedged on our flats, though, about 60% for the full year. And so I feel good about de-risking that line item. We continue to look at ways to mitigate costs on the other beef products, on our burgers, our hot dogs. But our other line items as well, we saw a little bit of pressure on pork and produce in Q1. But some other items are helping to mitigate some of those pressures. But beef in particular, as we called out at the beginning of the year, we think will be a pressure for us all year.

Gregory Francfort
Analyst, Guggenheim Securities LLC

Q

That makes sense. Thanks for the call, Michelle.

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

A

No problem.

Operator: Our next question comes from line of John Zolidis with Quo Vadis Capital Please proceed with your question.

John Zolidis
Analyst, Quo Vadis Capital, Inc.

Q

Hi, good morning, and thanks for taking my question. When we look at the restaurant-level margin guidance for this year, it implies a modest decline from 2023 and inclusive in that decline, I imagine, is the impact of a larger number of immature restaurants in the base compared to a year ago. So I was wondering if you could help us by quantifying how big of a headwind those new restaurants are in the restaurant-level margin. And then as we look multiple years into the future and think about the complexion of the restaurant base changing outside of Chicagoland into newer markets, do you still anticipate restaurant-level margins in that 23% to 24% range? How are you thinking about that? Thank you.

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

Yeah, John, we haven't and we're not going to quantify the impacts on those newer units on that margin for this – any specific year or in this specific year in general. I think ideally, yes, our goal is to keep our restaurant-level margins within generally that range. How we do that is, as Michael talked about, getting to scale quickly in markets that we're operating. And so that's the goal, is to continue to build that scale quick within those markets, to buffer against the natural margin degradation that you have as the new restaurant when the new restaurants open up, because we know that scale matters and that there's benefits on the distribution cost.

Michael mentioned leveraging the marketing, getting more awareness and just getting in people's decision sets early on and having that scale so that you become part of their routine within those markets. That's the strategy on how we believe we can keep margins within that range. But absolutely, that's – that continues to be the goal.

John Zolidis
Analyst, Quo Vadis Capital, Inc.
Q

Thanks very much.

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

No problem.

Operator: Thank you. We have reached the end of the question-and-answer session, and with that, the conclusion of today's teleconference. You may now disconnect your lines at this time. Thank you for your participation and have a wonderful day.