10-Jan-2023

# Portillo's, Inc. (PTLO)

## ICR Conference

# CORPORATE PARTICIPANTS

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

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

# OTHER PARTICIPANTS

**Andy Barish**
*Analyst, Jefferies LLC*

# MANAGEMENT DISCUSSION SECTION

## Andy Barish
*Analyst, Jefferies LLC*

Good morning, everyone. We're pleased to have Portillo's kicking off the day here. They don't serve breakfast, but they serve a lot of great food. As you see up on the screen here, we have Michael Osanloo, the CEO; Michelle Hook, the CFO and various other management team members in the audience with us today. I think Michael and Michelle are going to run through a few slides that the company released in terms of an update, and then we will dive into some discussion here.

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

Great. Thank you, Andy.

## Andy Barish
*Analyst, Jefferies LLC*

Go ahead.

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

The cautionary note, don't take anything we say literally are forward-looking. For those of you who are new to the story, I think this is probably the single most impressive slide we talk about. This is a company founded in 1963. It's worth noting that since 1963, Portillo's has never closed a restaurant, not one. We are relatively new IPO. We're part of the Class of 2021, got almost $600 million in revenues, AUVs of $8.4 million per restaurant. I think that's a fairly gaudy number, but it's dwarfed in some ways by the restaurant level EBITDA margins at 23.6% and nearly $2 million a box that we generate.

We are now – a lot of people think of us as a Chicago brand, certainly it's some – a lot of truth to Chicago as our core and our roots and the genesis of where our food comes from. But as you can see, we have expanded our footprint. We are now across 10 states, opened last night actually in Texas, opened a new restaurant in Kissimmee, Florida, we're just down the road. If you haven't seen that one, it's spectacular. We're super, super excited about our growth trajectory.

Little development update just mentioned this, we – this is the Class of 2022, as I think you've heard from a number of people, there were some leakage and delays in 2022. We got the first four opened. We opened The Colony in Texas yesterday. Next couple of weeks, we should open Tucson. And then quickly after that, Gilbert, Arizona. Candidly, we're all a little disappointed about the six to eight week lengthening of this process. It's largely a result of governmental entities, permitting processes, getting certificates of occupancy. We have been very thoughtful and will show in the next slide we've budgeted even more time, we started this process budgeting a certain amount of time for every build, having a lot of experience doing it. We then budgeted more time.

We just recently budgeted even more time. And that's why 2023 looks fairly back-end loaded. We're going to build four to five restaurants in the third quarter, four to five in the fourth quarter. You can see 70% of our restaurants are coming along what we call the Sunbelt, Texas, Central Florida, Arizona. It's where we see a lot of growth, a lot of population growth, a lot of demand for our business. Our restaurants along the Sunbelt open up very, very strong. They comp strong. There's actually kind of a relatively minimum honeymoon period for those restaurants. So it's a very exciting place for us to grow. And we are committed to 10% unit count growth annually.

---

## Michelle Hook

*Chief Financial Officer, Portillo's, Inc.*

So as we look at our 2023 outlook here, as Michael mentioned, on an annual basis, we expect to grow 10% plus. And so for the Class of 2023 that's the nine restaurants that Michael talked about on the previous slide. From a commodity standpoint, what we're seeing right now is that mid-single-digit inflation on commodities in 2023. Now, if I sat here last year at this time, I would have told you, I expected commodities to be up, 6% to 8% and they were up 15% for us in 2022. So this is the snapshot that we're seeing today from a commodity standpoint.

G&A, we expect to be in that range of $72 million to $77 million. Pre-opening expenses, as Michael mentioned, we do have some openings from the Class of 2022 coming into 2023. So those pre-opening expenses will be for those remaining Class of 2022 restaurants opening in Q1 of this year and then the nine restaurants we expect to open in 2023 go into those pre-opening expenses.

When we think about CapEx, you see our outlook there for 2023, we had elevated build costs in 2022. We may see a slight moderation in 2023 on the build cost, but I don't expect that to be significant. I think will still range in the neighborhood of $5.5 million to $6 million per restaurant from a build cost standpoint but still targeting the return profile that we've laid out there, which is 25% by year three.

So that's what we expect to do in 2023. And Michael and I are still very comfortable with our long-term growth algorithm that you see here, which is at 10% new unit growth per year. You see our comp or same restaurant sales growing in that low single digits that'll translate to the revenue growth you see here of high single to low double digits and then ultimately flowing through to low teens adjusted EBITDA growth is what we expect to do over the long-term.

So Andy, we can go into some Q&A.

# QUESTION AND ANSWER SECTION

**Andy Barish**
*Analyst, Jefferies LLC*

Q

Yeah, thanks. Thanks for that overview, guys. And I think the number on the first slide that $8.4 million that is kind of the eye popping figure. Can you give us a sense of sort of channel for those not as familiar with the brand and how that's evolved and sort of stabilizing here post-pandemic?

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

A

Yeah, I'm not sure it's stabilized yet, I guess it continue to evolve. So prior to the pandemic, we were right in the neighborhood of 50% dine-in, call it 40% drive-thru, and then the rest of that was catering, delivery, et cetera. It's flipped a little bit, so now we're a little over 50% on our drive-thru. We're about 35% on dine-in and we have a very healthy third-party delivery business, self-delivery business and catering business, which makes up for the other 15%.

And it still befuddles me a little bit because I think there's some pent-up demand for dine-in, but I think that it's just some jurisdictions where people have been slower to reengage in the restaurant experience, et cetera. The reality is that the drive-thru is the most attractive channel for us. It's the highest margin channel. So we're not fretting the mix of our business. It's good for our investors. But we do think that there's some pent-up demand for dine-in, which is largely incremental to what we're doing.

**Andy Barish**
*Analyst, Jefferies LLC*

Q

And can you give us an update on sales, but just the tone of holiday season last year, catering is an important part of your business, particularly in the fourth quarter. We've been hearing about good holiday sales trends in general for those that have released hopefully people were celebrating with Portillo's as well, just any high level thoughts on that front?

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

A

Yeah, it was – I'd actually describe it more of a mixed bag for us. So catering is a very big business for us and catering did awfully well. So we're very pleased with the way the catering business bounced back. We were lapping the onset of Omicron last year, so that was a great thing. But as a lot of you know, anybody from the Midwest, we had some real extreme weather over the last couple of weeks in the Midwest, which did negatively affect us. And so, good news is that's a great lap for us next year. But it was a little bit of a choppy end to the quarter for us.

**Andy Barish**
*Analyst, Jefferies LLC*

Q

And how do you approach value on the menu and check average these days and maybe that rolls into kind of your pricing philosophy as we look forward.

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

Yeah. I'll give you our philosophy, I'll let Michelle add a little bit more detail. We want to be a value, right? Like – look, we spend less than 0.5 point on marketing. Our marketing is guest coming to a restaurant, having an amazing experience, getting a hot, fresh, fast, abundant meal at a very sharp price point. The average person at Portillo's spends $9.75. I mean, just pause and think about that and compare that to every other fast casual, even some QSRs today, $9.75 is a [ph] smokin' hot deal (08:37). So that's one thing. We want to provide amazing price points.

We believe in great quality food. Our food cost is high is because we invest in the guest. They get great meals at Portillo's. We don't play games with shrinkflation. We're not taking fries out of the fry basket. You're getting a third of a pound of beef. Any time we touch our menu items, we're actually increasing quality. Look for a new and improved bacon in May timeframe for us. But so, we think that the guest notices these things. We think that the guest is very value conscious and we think whether or not the country tilts into a technical recession, the guest is challenged for 2023.

And so we think being in a value oriented position is very, very good for us. And we're going to keep strengthening that. As you guys can see, we don't really have a margin problem. So we can have very sharp price points. We can price slightly behind our peer group, although we have a ton of pricing power, still generate 23%, 24% restaurant level EBITDA margins. And we believe we're taking guest share and guest count.

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

Yeah. And when you look at the pricing that we took in 2022, so I mentioned that commodities were up 15%, labor was up double digits as well in 2022. Our pricing average, just under 8% that we took in 2022. And so to Michael's point, we felt like we did need to fully pull that pricing lever because of our margin profile in 2022. So as we go into 2023, I think we have plenty of pricing power to combat the inflationary cost pressures, whether that's commodities or on the labor side, because as Michael said, one of the stats we put out there that you can go see on our investor site that we talked about in Investor Day is we benchmark our most favored [ph] most (10:25) ordered bundle which is a beef sandwich, fries and a drink, against other concepts, most ordered bundle.

And we were anywhere from $1 to $6 cheaper than those. But it's – to Michael's point, it's not just about price. It's also about the quality and abundance of food that you get. And one of the metrics that we really track, which is a true traffic metric for Portillo's is we count the number of sandwiches and salads that we sell to say, okay, how much do we – are we really feeding more people at Portillo's? That number was positive in Q1 of 2022, it was negative in Q2, it was positive in Q3 and trending in a good direction as we headed into Q4. So we feel really good about that traffic metric at Portillo's even in the face of all the headwinds and the macro environment we saw in 2022.

**Andy Barish**
*Analyst, Jefferies LLC*
Q

Obviously, the core menu and quality you've talked about, you mentioned bacon, the brand hasn't really been one that does discounting or LTOs. But talk to us about how you kind of excite the consumer with new menu items and anything in the pipeline you're looking at for this year, in addition to the change on the bacon spec, it sounds like?

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

Yeah, first who doesn't love bacon, come on. So, we call our menu evolution a Darwinian exercise. We have a robust menu. And it's a great advantage because it makes us a little veto proof. It also makes it very, very hard to mimic, knock off a Portillo's. Obviously, the downside to that is you inject a lot of operational complexity. So during COVID, we took anywhere from 80 to 100 skews out of our business. I haven't noticed it, went from 11 salads to 3 salads. We actually sell more salad today. So that's been a great dynamic.

The other thing that we do is we look for things that are low [ph] p-mix (12:18), low guest satisfaction, and then we kind of intellectually force that product to justify its existence. And I have two great examples. We had a chicken sandwich, a mini – on a mini croissant. For those of you who know bread, the croissant was made with margarine, it was disgusting. It was mushy. It was gross. No one liked it. My investors didn't like it because it was a relatively high cost sandwich with low margins.

We replaced that with a Portillo's Spicy Chicken sandwich. Not a me too sandwich. It's got a spicy patty, but it's got this unique giardiniera blended sour cream sauce, which if you haven't tried it, we have it up in Orlando and Kissimmee, you should give it a shot. It is a knockout sandwich. Guests immediately loved it. It immediately became our number one selling chicken sandwich. Investors love it because it's got a higher [ph] rank (13:11) and better margins. So that's the kind of innovation we love.

The other good – great example of food innovation is we had one vegetarian offering and it was a portobello mushroom sandwich, which candidly when done right it was actually very good. Sadly, it was done right like 20% of the time because it was a very complicated sandwich with four unique skews, unique bread, unique mushroom, unique dressing, one other unique skew. We have replaced it with what we call our Garden Dog. It's a commercially prepared, uniquely for us, vegan dog with a very clean ingredient list, it's pea protein as a starting ingredient. It tastes fantastic. It's one unique skew. It's better margins. It's a better [ph] rank (14:00) and it wins on every count. That's the kind of innovation that we like. We don't want to just, I don't like LTOs. It's a nightmare for operators. It teases guests. We believe that if something is good enough that you want to put it on the Portillo's menu, it should go on the menu, and it should kill something that doesn't deserve to be there.

---

**Andy Barish**
*Analyst, Jefferies LLC*
Q

Helpful. Michelle, you mentioned the 8% pricing. How should we think about that rolling through 2023, and do you have a number you're willing to share as to kind of a net pricing number for the full year?

---

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

Yeah. I can – from what we did in 2022, so we took three different pricing actions. We took a 1.5% of pricing in mid-January this time last year. We took another 3.5% mid-May, and then we took another 3% to 3.5% that's TBD based on mix at the beginning of Q4, 2022. So those were the three actions we took in 2022. As we're rolling into 2023, I can tell you that we are going to take our pricing – as the 1.5% rolls off mid-January, we are going to take another 2% of pricing mid-January this year. So that hasn't gone into effect yet, but it will go into effect here in the next week or two as we start to roll that out.

So we do know that for sure, Andy, in terms of what we're doing in 2023, taking that 2%. And then really Michael and I remain fluid and flexible in our pricing approach. We're going to see how those input costs, those prime costs, food and labor behave. And then we'll decide if we're going to take more pricing actions as we move forward. So as we come into the year, we were at just over that 8% pricing, which is where we were at in Q4, and that's where we'll generally be coming into the year and taking the other 2%. And then it's TBD, Andy, just based on those input costs that we see coming in. But if it goes according to plan that you likely will see some more pricing actions from us later in the year.

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

Andy, let me just add on that too, that we are not seeing any elasticity impact with our pricing right now. So our pricing is being well accepted by the guest. And so we feel that – we feel we have a lot of latent pricing power. A lot of it is the cross elasticity dynamic of what's happened to everybody else. And then when we do price just a little more detail that we're not – we don't price willy-nilly. We have eight different tiers of pricing. You pay a different price in downtown Chicago than the Cook County, than the other collar counties versus in Florida.

We don't price a basket at any one time. So Michelle mentioned our number one basket is beef sandwich, fries and a drink. So we don't price beef sandwich, fries, drink. We might price sandwiches. We might price drinks. We might price third-party channel. We might price catering. So we're very surgical in where we price and how much we price to get our pricing. So in a lot of markets, consumers may actually not see any pricing impact.

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

I'll just to add on to that in terms of value, because I know we've talked a lot about that. Our value scores are the highest they've been in three years. When we think about that and that comes from the customers. So to Michael's point, we feel good about not seeing a lot of pushback.

**Andy Barish**
*Analyst, Jefferies LLC*
Q

And you mentioned earlier the historical spike in commodity inflation that pretty much everyone saw, except for chicken wings last year. How much visibility do you have on that mid-single digits at this point where – what do you do? What is the business do from a contracting perspective in terms of percentage of the basket, if you can share that with the audience?

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

Yeah. Absolutely. I think the most pressure that we are going to see are going to be on French fries and onion rings, which is a big side item for Portillo's. And so we think that's going to be pressured in 2023. When you think about our protein, so beef, chicken and pork make up about 50% of our commodity basket with beef being 35% of the basket, chicken about 10%, and then pork the remaining percent. And so I think beef started to come down towards the back end of 2022 and we see that being lowered into 2023. I think that will be pressured in the back half of 2023.

We've entered into some fixed pricing arrangements for our beef flats, which is what we used to make our Italian beef into Q1, so that's pretty much locked in Q1 of 2023. And then we're doing some forward buys into Q2 right now on the beef flats. Otherwise, we're floating right now, Andy, in terms of the chicken and the pork from a protein standpoint, but those have come down substantially from the highs that we saw around Q2, Q3 timeline in 2022. So that's the visibility we have right now. But I think most of the pressure, at least that we're seeing today will be on those fries and onion rings with a little bit more of beef coming in the back half.

**Andy Barish**
*Analyst, Jefferies LLC*

Q

And what percentage of the basket is that those kind of items?

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

A

Yeah. Fries and onion rings are about 7% to 9% of the basket in total when you combine those two.

**Andy Barish**
*Analyst, Jefferies LLC*

Q

Yeah. I think one of the things that's been really impressive over the last couple of years has been some of the productivity and efficiency. As you've made investments in labor and COO, Derrick Pratt, who's in the audience has helped evolve some of the hours and items per hour. Can you give us some examples of sort of what's taken place and what may still be to come down the pipeline in terms of continuing to manage the efficiencies in an obviously pretty complicated business.

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

A

Yeah. I'd actually start with I believe that the root cause of efficiency is actually employee satisfaction. Keep people happy, treat them well, say thank you for a good job, pay them fairly, give them a good benefit package. And so the culture at Portillo's is paramount to us. Great culture drives team member engagement, which then drives this entire virtuous cycle. But we've had a number of things. Derrick – one of my favorite quotes from Derrick is we used to prep in the morning 27 different things. We have now gotten into the business of prepping just 11 and it's a lot of little – it's a lot of little things. We used to come in the morning put on a cut glove, sharpen knives, cut red onions. And those red onions may or may not be cut perfectly or accurately. We now buy red onions, precut vacuum sealed. They're super fresh. They're perfect when you use them.

We used to cut, our Italian sausages and we trim the ends off and we throw them away. They come now precut. The vendor keeps the ends. The vendor uses that for a soup product. It's a win-win. They can – we actually pay less for product that we don't have no labor content. And then we're getting smart about kitchen design. We have a new kitchen initiative, got a team working on called Kitchen 23 and Michelle and our marketing lead are leading an initiative called The Restaurant of the Future, which designs a new kitchen. But we've taken 18 linear feet out of our kitchen.

It's a great CapEx savings. But 18 linear feet is a lot of walking. It's a lot of conveyance if people constantly moving back and forth, and 5 steps from the guy from fries having to go put the fries over at Expo or that person having to take 10 steps to go pick up fries at the freezer and bring it back done countless times in a restaurant, done countless times over 80 restaurants. It adds up. It becomes numbers of FTEs. And so we're getting really thoughtful and surgical about fixing the flows, making sure that we're doing things the right way. The restaurant was designed in the 1960s.

And so, it's great to have somebody like Derrick with 30 years' experience at Starbucks and McDonald's, who can say, hey, here's now how to do things differently at Portillo's, but just how to be more efficient and take a couple of steps out and make life easier for our team members, because again that's where it starts. If your team members are happy and you've taken work away from them that they don't like to do anyway. It's a beautifully virtuous dynamic.

**Andy Barish**
*Analyst, Jefferies LLC*

Q

Yeah. And just finally on development, I mean, understanding the complexities in the environment here over the past year, year and a half, how confident are you on the back half of 2023, at this point, how much flex have you built in? And then if you could just for the audience help level set you talked about in Investor Day the Class of 2021-2022, just kind of where those stores are shaking out versus the pro formas being better on the top line and then kind of core versus non-core, Chicagoland versus outside Chicagoland. And just to kind of give people a sense that this is a brand that has a lot of growth in a lot of markets. It's not just a Chicago brand.

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

A

Yeah, let me start with that. So, if I was telling you about the Class of 2023, six months ago, I would have said it's much more balanced. You know, three restaurants in the first quarter, it would have been four in the – and so we're much more balanced given some of the delays in the processes and so we've literally just pushed it all back. And so I have a lot more confidence because we've built in significantly more cushion. And so that makes me feel very confident about the nine we're targeting in the back half.

I don't actually like it that way. We don't – we as a team do not like having to open restaurants in the fourth quarter. I'm hopeful and optimistic that the Class of 2024 will be much more front-end loaded with – I'd like to see no restaurants in the fourth quarter. I'd like to see them in the first, second and third quarter. So I feel really good about that. A fun anecdote about how well our restaurants open. We opened The Colony in Grandscape north of DFW, just a [ph] hair west (24:10) of Frisco, last night it was a soft opening. We didn't tell anybody. There was no signs, nothing.

Somehow people found out there was a line outside the door and we did [indiscernible] (24:22) almost $20,000 in four hours. That is a restaurant in four hours. No – we didn't tell people it was open. People saw and once they saw people coming to the restaurant, they just kept lining up. I have personally never experienced that at any other restaurant concept. It's insane. And so, Michelle will give you the stats about how well we perform in Arizona, Florida and California, but our restaurants come out of the gate hot. My biggest concern for Texas and Kissimmee is it comes out of the gate so hot that it's hard to execute.

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

A

Yeah. And just to close it out, Andy, I know we're out of time. The Class of 2022 is still TBD. Our third restaurant Schererville in Indiana opened up mid-November, as Michael mentioned was Kissimmee, opened up a few weeks ago, a grand opening today. And then the other, The Colony just opened and then the two in Arizona were to be open. So more to come on the Class of 2022 in performance. But to Michael's point, most of that class is outside of the Midwest. And generally, when you just take out Chicagoland restaurants, the restaurants outside of the Midwest generally perform better than those in the Midwest and that's the stat we gave at Investor Day. And so we think that they have a good chance to outperform expectations, but TBD.

**Andy Barish**
*Analyst, Jefferies LLC*

Okay. Thanks. We are definitely out of time. Appreciate it.

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

All right. Thanks.

---

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

Thank you.