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PRESENTATION

Operator

Good day, ladies and gentlemen, and thank you for standing by. Welcome to Portillo's Third Quarter 2021 Earnings Conference Call. (Operator Instructions) Please note that this conference is being recorded today, November 18, 2021. I would now like to turn the call over to your host, Mr. Fitzhugh Taylor, Managing Director at ICR. Thank you. You may begin.

Fitzhugh Taylor - *ICR, LLC - MD*

Thank you, Rob, and good morning, everyone. With me on the call today is Michael Osanloo, President and Chief Executive Officer of Portillo's; and Michelle Hook, the company's Chief Financial Officer. Before we begin our formal remarks, let me remind everyone that part of our discussion today will include forward-looking statements. These statements are not guarantees of future performance and should not be unduly relied upon. We do not undertake to update these forward-looking statements unless required by law, and we refer you to today's earnings release and our SEC filings for a more detailed discussion of the risks that could impact Portillo's future operating results and financial condition.

Our remarks also include non-GAAP financial measures, such as adjusted EBITDA and restaurant level adjusted EBITDA. We direct you to our earnings release issued this morning which is available on our website for reconciliations of these non-GAAP measures to their most comparable GAAP measures. Any non-GAAP financial measures should not be considered as an alternative to GAAP measure, such as net income or operating income or any other GAAP measure of our liquidity or financial position. Finally, after we deliver our prepared remarks, we will open the lines for your questions.

Let me now turn the call over to Michael Osanloo. Michael?

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

Thank you, Fitzhugh, and good morning, everyone. We appreciate you all joining us for what is our inaugural quarterly earnings call as a public company. It's an incredibly exciting time for Portillo’s. We are so proud of the successful completion of our IPO, and we're pleased with our performance so far this year, which has reflected continuing improvement in guest traffic as our business is evolving into a new normal.

Our teams continue to pivot in a smart, efficient way to serve our loyal guests in a safe environment. I couldn't be more pleased with our performance led by our amazing teams and their ability to successfully adjust and continue to improve. And importantly, they're doing all this while living our values of family, greatness, energy and fun.

Before I let Michelle review the quarter results in more detail, since this is our first earnings call since our IPO, I want to take a few minutes to talk about Portillo's and just share what makes our brand so special.

Our story began in 1963 when Dick Portillo invested $1,100 in a trailer in Villa Park, Illinois. The Dog House, as he called it, sold hotdogs, fries and tamales. A few years later, Dick opened his first freestanding restaurant and named it Portillo’s. And that was just the beginning of this great American success story. After gradual expansion over multiple decades, Berkshire Partners acquired Portillo's in 2014 and has since accelerated our growth, adding 29 restaurants across 6 additional states.

Most people think of Portillo's as a Chicago institution. But the reality is we've burst our seams to become a national brand with 68 restaurants today, soon to be 69 across 9 states. Even as we've grown, we've maintained that iconic status with our fans who are truly obsessed. We do this with our unique menu of unrivaled Chicago street food and all American favorites that has something craveable for everyone. We've got Italian beef sandwiches, Chicago-style hot dogs, char-grilled third pound burgers, fresh made salads and much more, all at a remarkable price point.

In addition to this amazing menu, I also want to stress Portillo's operational excellence across numerous order channels. We've been multichannel since before it was even a thing. While other brands have been chasing this, especially since the outset of the pandemic, this is what Portillo’s has done from early on in our history. Just to give you an idea of our business, both pre-pandemic and now, our annual drive-thru sales represented $3.4 million per restaurant in 2019 and $4.9 million in the 12 months ending Q3 2021. That's just our drive-thru.

Our dine-in sales represented $4.4 million per restaurant in 2019 and $2.1 million in the 12 months ending Q3 2021. Although dine-in has decreased because of the pandemic, traffic remains healthy. That's in part because our restaurants are beautiful and they're engaging. They're thoughtfully designed to handle incredible volume while still providing a memorable and differentiated experience with each having its own locally inspired decor.

And then there's delivery. We started delivery in 2017, and it accounted for about $500,000 per restaurant in 2019 and nearly $900,000 in the 12 months ending Q3 2021. Our other channels are also growing. We cater literally tons and tons of food in convenient formats that fit any occasion. I already mentioned that our fans are obsessed. People love catering Portillo’s for their gatherings and events.

We also have a really strong direct shipping business that not only gives us sales but provides key insights into where there's latent demand for our business. This multichannel approach allows us to achieve best-in-class unit economics, including the highest average unit volumes in the fast casual space, and adjusted EBITDA margins that put us in an elite class of restaurants. We are committed to continuing to be a world-class multichannel restaurant brand with incredible sales from all of our channels.

Switching to development. By the end of Q4, we will have added 2 new restaurants to the portfolio, opening location #68 in the Indianapolis market in the city of Westfield, and location #69, opening in about 2 weeks in Madison, Wisconsin. Both new locations demonstrate our strategy to open new restaurants outside of our core Chicago land market. The Westfield location on the north side of Indy adds to an already strong presence as our fourth restaurant in Indianapolis and the seventh in the state. And the new Madison location will be a second entry to Madison and the fourth in the state. Each of these serves a separate and distinct trade area.

With these 2, we will have added 5 new restaurants in 2021, including 2 new markets having opened our first, which includes Orlando, Florida, and Sterling Heights, Michigan. As we move into next year and beyond, we're excited about our massive white space opportunity.

As we previously stated in our IPO filings with the SEC, there is potential for over 600 Portillo's restaurants throughout the country. This is obviously a long-term growth number, and we plan to expand at about 10% growth annually. Our current plan is to open 7 restaurants in 2022. And we're targeting to expand our presence in Florida, Arizona, Indiana and Michigan as well as an initial expansion into Texas.

Strategy allows us to tap into our two-pronged approach to expansion. First, continuing to expand our presence in our core market across the Midwest. And second, targeting national markets across the Sun Belt for opportunistic growth. One specific new location planned for '22 that I want to highlight is what we're calling a Portillo's pickup, which will be located in Joliet, Illinois. Unlike our other restaurants, this off-premise-only spot features a smaller footprint than the traditional Portillo's, and it will not have a dining room. Instead, it will feature 3 drive-through lanes as well as a pickup area, catering and delivery. This is the first prototype, and if successful, gives us a great option to fill in mature markets.

Finally, as we grow our unit count, we continue to be focused on our talent pipeline. We will continue to invest in our training programs, develop leaders and live our values of family, greatness, energy and fun each and every day. All of these efforts are reflected and drive our financial performance.

With that, I'm going to turn it over to Michelle to cover more details about our financial results.

Michelle Greig Hook - *Portillo's Inc. - CFO & Treasurer*

Thank you, Michael. Before we discuss our third quarter results, let me briefly recap our recent IPO. On October 25, following the end of the quarter, we completed our IPO by issuing approximately 23.3 million shares, including approximately 3 million shares sold to our underwriters as part of the overallotment option at an offering price of $20 per share. We received net proceeds of approximately $429.9 million after underwriting discounts and commissions and estimated offering expenses, which we used along with cash on hand to: one, repay the resumable preferred equity in full, including the redemption premium, all totaling $221.7 million; two, repay all of the outstanding borrowings under the second lien credit agreement, including prepayment penalties, all totaling $158.1 million; and three, purchasing LLC units or shares of Class A common stock from certain pre-IPO LLC members for $57 million.

Also in connection with the IPO in the fourth quarter, each option under the 2014 equity incentive plan that was outstanding, whether vested or unvested, was substituted for an option to purchase a number of shares of Class A common stock under the 2021 Equity Incentive Plan and the option holders received a cash payment in respect of their actions, whether vested or unvested, in an aggregate amount of approximately $6.3 million. In addition, as a result of modifications to the terms of certain pre-IPO performance vesting awards, we will record a compensation expense based on the fair value of the modified awards. We will expect to recognize a cash compensation expense of approximately $1.3 million and a noncash compensation expense of approximately $23.3 million each in the fourth quarter.

Now turning to our results for the third quarter. Revenues were $138 million, reflecting an increase of $18.3 million or 15.3% compared to the third quarter of 2020. This was driven by a 6.8% increase in our same-restaurant sales combined with the opening of 2 new restaurants in the fourth quarter of 2020 and 3 new restaurants opened the first 3 quarters of 2021. The same-restaurant sales increase of 6.8% was primarily driven by a 7.9% increase in average check, partially offset by a decrease in our traffic. Our higher average check was due to increases in our menu prices, mix of items sold and more items per order.

The decrease in traffic reflected continued pressure from COVID as we have fewer people dining in our restaurants versus pre-pandemic levels. This was partially offset by more people going through our drive-through channels. While all our dining rooms were opened during the third quarter, we continue to be subject to local mask mandates for indoor dining in many of our locations. We aim to continue to provide exceptional service to our loyal guests in a safe environment for both our team members and guests.

Now turning to our cost of goods sold. Cost of goods sold excluding depreciation and amortization as a percentage of revenues increased to 32.1% from 30.6% last year, primarily due to an increase in commodity prices, specifically beef. This was offset by an increase in our average check. We, along with others in the industry, continue to navigate through disruption in our supply chain, and we continue to work hard to maintain inventory. When it comes to supply chain, we're confident in both our distribution partners and suppliers. We have outstanding relationships that we believe will allow us to continue to procure products needed, and we feel extremely confident in our distribution strategy.

Moving on to labor. Labor as a percentage of revenues increased to 26.8% from 24.3% last year, primarily due to an increase in hourly rates, investments made in training costs and discretionary bonuses. All these costs were partially offset by an increase in our average check. As you are all aware, the labor market is extremely tight right now, and everybody is competing for talent. We've made a substantial investment in team member pay in the second quarter as part of an ongoing enhancement to our pay, benefits, training and talent development. And we are seeing the impact flow through in the third quarter labor expenses as our average hourly rates are up nearly 20% quarter-over-quarter.

While the current labor market challenges have hindered our ability to be fully staffed, our restaurants have not had to limit service channels or hours of operation, and we are proud of our committed team members that service our guests each and every day. We remain committed to investing in our Portillo’s family, and as a result, would expect elevated year-over-year labor costs to continue in the near future. Even with increases in food and labor costs, we continue to produce strong margin results when you look at both restaurant level margins and the adjusted EBITDA margins within the quarter.

Now turning to our other operating expenses. Those expenses increased $2.5 million or 19.5%, which was primarily due to the opening of 5 new restaurants since the third quarter of 2020 in addition to incremental costs for cleaning and utilities as dine-in capacity has expanded since the third quarter of last year. All this was combined with an increase in our direct marketing expenses as well as repair and maintenance costs.

Looking at our occupancy costs, those decreased as a percent of sales primarily due to the year-over-year sales increase previously described and is inclusive of the opening of the 5 new restaurants since the third quarter of 2020.

When you look at our restaurant level adjusted EBITDA, that metric decreased 1.1% to $34.2 million, largely a result of the impact of commodity and labor inflation. We did not take any incremental pricing during the third quarter and have increased certain prices to reflect an approximately 3% price increase in the early part of the fourth quarter to combat both the commodity and labor headwinds we're seeing.

Our G&A expenses as a percentage of revenues increased to 8.5% from 8.1% versus last year's third quarter primarily due to higher wages resulting from annual rate increases, filling open positions, higher training program cost for future restaurant leadership and higher costs associated with becoming a publicly traded company. When you roll all of this up, it led to adjusted EBITDA of $24.2 million versus the prior year of $26.4 million, a decrease of 8.4%.

Now from a balance sheet perspective, as I previously mentioned, we used the proceeds from our IPO, along with cash on hand, to repay the redeemable preferred equity in full, repay outstanding borrowings under our second lien credit agreement and purchase LLC units or shares of Class A common stock from certain pre-IPO members. After making those payments, our cash on hand today is over $40 million and remains healthy. Additionally, our debt has decreased by $155 million, and the full balance of redeemable preferred equity has been extinguished in connection with the completion of our IPO.

With that, that concludes our financial results. I'll now turn it over to Michael for closing remarks.

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

Thank you, Michelle. We've talked a lot about Portillo's growth. Across the landscape of fast casual and quick service restaurant chains, Portillo's really is a standout when it comes to unit economics. But there's one major component that makes our brand so special. It is our people-centric values-driven culture.

Our premise is central to everything that we do. And we use our values of family, greatness, energy and fun as our guiding principle. We care for and invest in our team members. And they, in turn, care for and invest in Portillo’s. For example, when Portillo's completed its IPO last month, we awarded all restaurant managers onetime restricted stock unit grants. We know our over 500 managers work hard every single day, and I am proud that we take care of our leaders. By nurturing our connections as a family of team members, our teams are motivated to work even harder for one another and to take amazing care of our guests. It's palpable to our guests. It's why they are obsessed. They aren't just coming to Portillo's for the craveable food at a fantastic price point. They're coming for the experience, and that's an experience that translates across the country.

Thank you. Operator, back to you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Andy Barish with Jefferies.

Andrew Marc Barish - *Jefferies LLC, Research Division - MD and Senior Equity Research Analyst*

Just a quick question on trying to sort of conceptualize the near-term margin challenges and how much we should be looking at third quarter being a base? Or do you expect some near-term pressures as the industry has been talking about and then sort of seeing things reach more of an equilibrium as you move through '22? Just trying to get a sense of some near-term color on the margins there.

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

Yes. First, nice to hear from you, Andy. I hope you're doing well. Before I turn it over to Michelle, there's one thing that I think I don't want anyone to gloss over is that the Q3, we kind of took the full brunt of all of the commodity and wage inflation, and there was no pricing to mitigate some of that. So keep in mind, we took pricing at the very beginning of Q4. And obviously, we think that, that will mitigate some of the margin pressure. But I'll let Michelle expand.

Michelle Greig Hook - *Portillo's Inc. - CFO & Treasurer*

Yes, Andy, I think when you look at the pressures we're seeing in the back half of this year, we expect them to continue into the fourth quarter. And when we think about '22 as well, I don't think we see an end in sight in terms of commodity inflation. But to Michael's point, I think I mentioned the pricing action we took at the beginning of Q4, which was around 3% pricing. And we're going to continue to evaluate that as we look into '22 based on what that outlook continues to look like, and we'll make decisions on if we need to look at adjusting pricing further. But we know that the healthy way to grow this business is through transaction growth, but we'll continue to evaluate both those key lines of food and labor and see if we need to again adjust price as we move into '22.

Andrew Marc Barish - *Jefferies LLC, Research Division - MD and Senior Equity Research Analyst*

And just as a follow-up on pricing, when is your typical kind of annual price increase? And how do you look at that, as you mentioned, over the next few months or so?

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

Yes. What we like to do, Andy, as part of our strategy is typically be price laggards versus the rest of the industry. We carefully evaluate what the rest of fast casual and QSR is doing and we try to make sure that we maintain an exceptionally strong value proposition, but we also feel that we have very, very sharp price points, and we have some pricing power at our disposal. And we evaluate it on an ongoing basis. I don't think we live in a typical environment right now when it comes to commodity inflation. So we're treating this year as somewhat idiosyncratic and we're looking at pricing constantly. And we're evaluating where we need to be. We're evaluating where the rest of the market is, and we're evaluating what the consumers' appetite is.

Operator

Our next question is from John Glass with Morgan Stanley.

John Stephenson Glass - *Morgan Stanley, Research Division - MD*

Michael, you gave some color around the drive-thru performance pre-COVID and post COVID in the dine-in business. As you look through the first 3 quarters of 2021, how has the dine-in improved? And what I'm trying to get at is -- as dine-in does improve, are you seeing any diminution in the drive-thru sales? Or do you think you can hold those. When you think about volumes in the future, is it a possible state where you've got the dine-in back but those elevated drive-through levels remain relatively constant.

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

Yes. Great to hear from you, John. I hope you're well. It's an interesting dynamic. As I think you know, our dine-in used to be low 50% of our mix. And right now, it's about 32% of our mix, and it's been slow in coming back. I think there's 2 factors to that. I think one is that dine-in in general across America has been a little bit slow in rebounding with COVID. But also our restaurants in Chicago, which are still under a mask mandate, have, I think, been even more affected by that. Now the good news is that our drive-through traffic actually remains incredibly strong and resilient. And so as our dine-in has slowly eked back up towards mix, it has not negatively affected our drive-through channel. I don't know where this will stabilize. I think that there's a lot of opportunity for us, but it would be foolish of me to hazard a guess on how much of it is incremental versus how much of it is shifting.

John Stephenson Glass - *Morgan Stanley, Research Division - MD*

Can you talk about -- you mentioned Texas as a next year event. When do you think the timing of that is? What's the city you selected? Why did you select that city? Or was it maybe just location based, not necessarily city based. How did you think about Texas?

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

Here's what I'll tell you. Everybody in the room is vigorously shaking their head, no, that I can't tell you the city. But I -- we are super excited about the location, about where we're going. I am so eager to talk to you and others about where we're going because I think it's going to be a flagship restaurant that should be a really, really strong performer for us. It's obviously -- it's going to be our first foray into the great state of Texas, and we want it to be a home run. And we believe that that's what it is. So it will open in the fourth quarter. When I can, I will certainly tell everyone exactly where it is and build up excitement and momentum. But unfortunately, John, I can't tell you specifically where it is.

Operator

Our next question comes from Dennis Geiger with UBS.

Dennis Geiger - *UBS Investment Bank, Research Division - Director and Equity Research Analyst of Restaurants*

First, just wondering if you could share or maybe remind folks sort of what you're seeing in the most recently opened stores in some of the newer markets, Michael, perhaps highlighting the performance of those stores on comp or profitability or other metrics relative to the rest of the system? Or just any kind of commentary you could share on how you've been feeling about those new stores in those newer markets?

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

Yes. I'll tell you -- I'm going to let Michelle give you the specifics. But qualitatively, we're thrilled with them. We think that as a class, the 5 restaurants that we have -- actually 6 now that we've opened up are all meeting or beating our expectations. So we feel exceptionally good about them. There's a nuances to other than just the financials. What I really love is that we open these restaurants up 100% with values-based hires, right? We hired people who represented our values of family, greatness, energy, fun. And the experience that they are providing our guests from the get-go is exceptionally good. And so from a qualitative perspective, that thrills the heck out of me. That's setting up a restaurant for long-term success that's taking great care of our teams, great care of our guests. And Michelle can highlight for you the financials.

Michelle Greig Hook - *Portillo's Inc. - CFO & Treasurer*

Yes. And Dennis, I think this was outlined in the F-1 as well. So when you look at the 5 restaurants that we've opened since the third quarter 2020, they're performing above our expectations. So typically, what our expectations are in year one for a new restaurant would be around averaging 6.4 million AUVs. The restaurants, the 5 that I mentioned that we opened since the third quarter are performing roughly 35% above that metric. So to Michael's point, we're extremely proud of the performance. Most of those restaurants are outside of our Chicago land market. So our flagship restaurant in Michigan and Sterling Heights, a restaurant in Arizona and Glendale and then our first restaurant in Orlando, Florida. So we're proud about that performance and the fact that they're, like I mentioned, roughly 35% above what we were targeting in that year 1 AUV.

Dennis Geiger - *UBS Investment Bank, Research Division - Director and Equity Research Analyst of Restaurants*

Great. And then just a second question. Just as it relates to supply chain, labor shortages, et cetera. Any thought there with respect to impacting opens over the next 12 months or so? It doesn't sound like, and I think, Michelle, you spoke to the strength of your relationships. But just curious if there's anything to note there as it relates to challenges opening stores over the next 12 months? Or any impact on build costs, et cetera?

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

There was a lot in that second question of yours, Dennis, so let me tease out some of the different parts. We just recently opened in Westfield, Indiana. We're opening in 2 weeks in West Madison, Wisconsin, and we're in the process of training those teams up. I'm knocking on wood because we were pleasantly surprised at the relative ease of attracting talent and hiring up for both of those restaurants. We are opening those restaurants fully staffed. There are -- I don't know if this is a canary in a coal mine dynamic that the labor markets are freeing up, but we're thrilled with our ability to open those restaurants fully staffed, get those folks trained and get going. While there are certainly some supply chain hiccups, and that's how I would describe it, it's in no way negatively affecting our business or our ability to run our business. It's just we see some idiosyncratic spikes in cost and they come back down and something else spikes and then it comes back down. And so I think the next 6 to 9 months requires us to just be super agile and responsive to the supply chain dynamics. But also keep -- and when it comes to labor, we're just going to keep doing what we do, which is we provide a differentiated opportunity for people. We hire people based on values. We provide them a lifetime of opportunity if they so choose. And I know you know this, Dennis, but we don't pay minimum wage in any of our restaurants. We're significantly above minimum wage across the country because we truly believe that people are at the heart of our business, and we take care of our teams.

Operator

Our next question comes from Nicole Miller with Piper Sandler.

Nicole Marie Miller Regan - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Labor costs are challenging. But if you flip it around and think about efficiency, how is labor efficiency? I think you measure that by items sold per labor hour.

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

Yes. First of all, Nicole, nice to hear from you. You are 100% right. It's one of the things that we take a lot of pride in. And I think -- I don't know if everybody remembers this or is aware of this, but during the pandemic year, we did not lay off a single person. We actually invested in our people, and we saw a massive increase in 2020 in labor efficiency. And you're 100% right, we look at it in terms of items per labor hour. And so we -- 2020 was an incredible year. It was probably too much, to be honest with you. Our people worked a little too hard. But the good news is, is that the investments that we've made in our people, the love that we've showed them and the learnings and the cross training that we did yields for us about a 10% improvement in IPLH in 2021 versus 2019. And so it is absolutely part of what's mitigating some of the cost pressures is that our folks are just more efficient and they work incredibly diligently. And so -- and we think that that's a learning that we got in the COVID year that will continue to bear fruit for us, our team members and our investors for years to come.

Nicole Marie Miller Regan - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

And can you just run through where you stood on a debt-to-EBITDA ratio at the end of the quarter and why you're comfortable with that level? And ideally, does the ratio taper as EBITDA increases? Or would you be proactively paying down debt?

Michelle Greig Hook - *Portillo's Inc. - CFO & Treasurer*

Yes, Nicole, I'll comment on our post debt structure, which after we paid off the second lien, the $155 million, we're roughly around a 3.5x debt-to-EBITDA ratio. And so our expectation is, is that as we continue to grow that EBITDA line, we're naturally going to delever. But the capital structure is in a stronger position post IPO. At the end of the quarter, that ratio is obviously higher, just given that the payoff of the second lien occurred post Q3 as part of the IPO proceeds.

Operator

Our next question is from Sara Senatore with Bank of America.

Sara Harkavy Senatore - *BofA Securities, Research Division - Analyst*

I have a question about labor and then just a quick follow-up on the pricing comment. The labor investments you made were partially offset by you said lower staffing levels, but also increased productivity as you were just discussing. I guess, can you talk about the extent to which not having as much staff as you would like might have hindered top line? I know you said you didn't have to close restaurants, but presumably, lines were longer and perhaps you lost some sales from that perspective. So any insights you might have on whether that actually affected your sales? And also to the extent that there's more productivity, can you just remind me, is that some of the technology that you've invested in? Or what's been driving that in terms of systems.

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

Great. First, great to hear from you. Thank you very much. There's a lot again in that question of yours. So there is -- when you think about the labor algorithm, there's a bunch of things going on. So the first thing is that we are sort of slightly understaffed versus ideal, right? And so that has flexed a little bit, but think of it as we're roughly 10% understaffed versus ideal over the course of the third quarter. The second element of that is we are more productive than historical during that quarter. And then the third component is that the hourly wage is -- in the third quarter was significantly higher than the third quarter of the prior year. So there's 3 different elements working against one another.

Intuitively, you're absolutely right that when you are understaffed, you are providing a less-than-perfect experience to guests and it slows things down. It slows down your drive-through, it slows down your line. So intuitively, it would be hard to argue with your premise that better staffing results in better performance, which results in better guest repeat and frequency. So we certainly plan on staffing fully as those opportunities avail themselves because we intuitively believe that fully staffed restaurants perform better and that there's some comp opportunity there. So 100% agree with the way you're thinking about it and that logic.

Sara Harkavy Senatore - *BofA Securities, Research Division - Analyst*

Great. And then just on -- you mentioned on pricing, I know you talked about really being cognizant of your customer and thoughtful about it. As I think about going forward, though, should I be thinking about kind of stable trends? You've added some price, maybe you give some of that back in traffic. If I think about kind of the 2 year, I know there are all kinds of puts and takes. But as I think about elasticity, is the right way to sort of see it as just sort of a one-to-one traffic price trade-off? Or you think you have the ability to take price, and again, hold more of that traffic so we might actually see an acceleration in comp?

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

It's -- I'll tell you, this is a remarkable business in that as we -- as I've looked at it, our pricing does not have the same elasticity effect as I've seen in other restaurant businesses or consumer businesses. We have more inelastic demand than I think people would expect. So I think there's a lot of the pricing that is incremental. But that being said, we also need to be really, really careful and smart about how we price. Michelle said it earlier and I want to reiterate it. Our business, we believe, is healthy when it's driving transaction growth. That's hugely important to us and our team. We want more people coming through our restaurants. That's healthy. I think pricing is an important lever to deal with what I will describe as idiosyncratic cost increases, right? So some of the craziness that we saw in the last 12 months on commodities and the labor markets, you really have no choice but to price some of that away. But our healthy business is run by driving transaction growth. That is our intent. The good news is that we have a very sharp value price proposition. We are pricing after most of fast casual and QSR have priced. And so there's -- from a cross elasticity effect, we look really good. And we will continue to make sure that we're managing that great value proposition while still covering idiosyncratic cost increases in commodity and labor.

Operator

Our next question is from Alton Stump with Loop Capital.

Alton Kemp Stump - *Loop Capital Markets LLC, Research Division - MD*

Just wanted to ask in restaurant 5, which you talked about a target of a 25% cash on cash return by year 3. But clearly, you've outperformed that with your openings over the last couple of years, even amidst the pandemic outbreak. And so is it simply be as a conservative? Or is there some reason why we should see cash on cash returns kind of going forward below what you have been able to do over the last couple of years?

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

First, very nice to hear from you, Alton. I feel like you're jinxing us with that comment. Look, we're really -- we're cautiously optimistic that the performance that we're generating from these last couple of classes of restaurants are exactly what we expect going forward. And we are -- we expect to beat our -- as a management team, as a leadership team, we are building restaurants where we feel like there is a lot of upside and very little downside. So it's certainly our hope and our expectation, but I would not tell you to necessarily bank on it. Is that fair?

Alton Kemp Stump - *Loop Capital Markets LLC, Research Division - MD*

Yes. No, absolutely. That definitely makes sense. And then just as my follow-up, I was kind of thinking about actually building outside of what you call your Chicago land market, Indiana, Michigan, et cetera. If I assume that probably the average cost of those is a bit lower than your existing builds that you've done in your core market, obviously, AUV is, of course, a bit lower but still awfully high industry-leading of course. But I'm just a color on kind of how the average returns in your core versus noncore markets are trending.

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

Yes. There's so much noise in that. I mean it's a great question. The problem is there's so much noise in answering that question because, yes, historically, Chicago was more expensive to build, no doubt about that. But if I'm comparing historical Chicago build to the cost today to build outside Chicago, it's kind of a wash because everything has gotten so much more expensive. So what we're spending today to build is probably what we would have spent in Chicago a couple of years ago to build. So that's why there is noise. But your intuition that as we go to places like Florida and Texas and Arizona and Michigan and Indiana, fundamentally, the cost to build is less than it is in dense Chicago market. And so the -- there's a good argument to be made that we can perform from a cash return standpoint, really, really well outside Chicago.

Operator

Our next question is from David Tarantino with Baird.

David E. Tarantino - *Robert W. Baird & Co. Incorporated, Research Division - Director of Research & Senior Research Analyst*

My first question is about staffing levels, Michael. I think you mentioned this third quarter, you were 10% below where you'd ideally like to be. And my question is whether you're starting to see progress on narrowing that gap in the fourth quarter and whether you've set any goals internally on getting back to fully staffed by a certain time frame?

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

Great question, David. What I would guide you towards is that the 2 new restaurants that we just opened up that -- we just opened up in Westfield, Indiana, and will open in 2 weeks in Madison, Wisconsin, those 2 restaurants are fully staffed. And we are all -- like we've got our fingers and toes crossed, we're pleasantly surprised, and we're hoping that that's an indication of staffing in general. We are staffing up across the system in general. For us, the holidays are really a big deal. We do a ton of catering. We have a lot of seasonal staff, a lot of kids who've gone off to college that come back and want to grab a few hours. And so we are seeing some staffing improvement, but I'm not ready to declare victory or even -- I'm just not ready to declare that yet. I think there are certainly positive -- I would say there's more positive signs than negative signs, but in no way do we feel confident to declare victory on labor.

David E. Tarantino - *Robert W. Baird & Co. Incorporated, Research Division - Director of Research & Senior Research Analyst*

Got it. And then I had a question about how you're thinking about prototype design on a long-term basis. I mean you've seen a very big change in the mix in your business, and I realize that may not have fully settled out yet. But to the extent you have a lot less dine-in business going forward and more drive-through and digital and delivery business. Are you thinking about changing how the prototype is designed and is there an opportunity to optimize the cost of the box when you're building out new units? So any thoughts on that would be great.

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

It's another great question. You're going to allow me to wax on about one of my favorite topics. So we are going, to quote the great one, we're going where the puck is going, not where the puck is. And so -- and where the puck is going is exactly what you described, which is a bigger percentage of our sales will continue to be off-premise versus on-premise. And so the prototypes that we are building, including what we built in Glendale and Orlando and Addison and Kimball in Chicago and Sterling Heights, they're, they -- we are gearing towards increased off-premise sales. So what you see in these restaurants is less formal dining space. The dining rooms are getting a little smaller. Now we're kind of cheating a little bit because we're supplementing them with outdoor patio spaces that are really highly desirable from guests and very flexible. But we're being very thoughtful in creating dedicated entrance and vestibule for third-party delivery. We're creating special format, special access for off-premise. I mean we've done a bunch of things where curbside is now -- I think we've cracked the code on it. We're doing this racking system right by a door, right by parking spots so people can come in and get out super quickly. And then as we've mentioned, we're building that drive-through-only concept in Joliet. And I didn't say this, but West Madison has a third lane drive-through lane. It's essentially -- we're kind of toying with the idea of calling it a fast pass lane, and it's for people who have ordered via the app or want a curbside-type experience where you don't have to get out of your car, you can zip through that third drive-through lane and the food gets brought out to you. So kind of my long-winded way of saying, 100%, we are moving towards where the consumer is, which is the consumer says, we want more off-premise access and availability and the need to sit into the restaurant is coming down. And so that's how all of our new prototypes are being built.

Operator

Our next question is from Chris O'Cull with Stifel.

Christopher Thomas O'Cull - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Senior Analyst*

Now that we're in mid-November, I wanted to ask about catering and large group orders. I know the holidays typically provide or bring a sizable volume lift. So I was just curious what kind of visibility you have at this point into how that's shaping up for the year? And then I had a follow-up.

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

Yes. Right. And you get this, right? There's this whole e-commerce and catering business that is just a monster for us in the fourth quarter. A lot of people won't know this, but Christmas Eve is our single biggest day of the year. It is a massive date, all hands on deck. We have team members from the restaurant support center out at all of our restaurants helping because catering Portillo's is a thing. And it's a huge thing in the Chicago area on Christmas Eve. So catering, the e-commerce business take off during the fourth quarter. I would tell you, we have -- I'm not going to tell you anything on a forward-looking basis, but I would tell you that the last few weeks have been extraordinarily strong from a catering business, significantly a positive comp over last year. I would be loath to tell you the numbers because I don't want you to plan on those numbers. But we feel really, really good about the way our catering business is performing right now. We're cautiously optimistic and think that it should be a really nice bounce back from last year for us.

Christopher Thomas O'Cull - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Senior Analyst*

Great. And then can you speak a little bit more about the third order-ahead drive-through lane that's being tested. I was just wondering how that's being received by consumers. And if you think that's a format or I guess a design change that you'd look to implement going forward?

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

Yes. Just to be precise, I'm sorry if I misspoke, but it's going to be in West Madison, which opens in 2 weeks. So it's anybody -- it's -- your guess is as good as mine on how it will be received by consumers. I honestly think it's going to be received really well because more and more consumers are asking for restaurant companies to be flexible in how consumer interacts with you. And there's all kinds of almost micro channels, right? There's like a need for somebody who wants -- if you're a mom with 3 screaming kids in the back, you don't want to wait in line, you've ordered ahead on the app and you paid, you just want to pick up your food. We have made that super easy. And we're going to see how that performs in West Madison, and we'll see how that performs in Joliet when we open that up in the first quarter of '22.

I think it's a very, very important learning for us because if consumers continue to ask for and require the sort of nuances and how you engage with them, I think the restaurant companies that respond to that and can acquiesce to that kind of consumer demand are going to be in a better position. And I think that's us. I think we -- as I said in my opening remarks, we were multichannel before it's a thing. We're always going to be super responsive to what the consumer wants and how they want to interact with us. And if there's a way of making that third lane work institutionally, then heck yes, we'll do that.

Operator

Our next question is from Gregory Francfort with Guggenheim Securities.

Gregory Ryan Francfort - *Guggenheim Securities, LLC, Research Division - Director*

I had 2. Just the first one, just on pricing, I think historically, you guys have taken pricing once per year, and this year, you're basically taking it twice. Can you maybe talk about when you evaluate that and when you normally take it just as we think about next year and what might happen?

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

So I think, Greg, first of all, good to hear from you. I would tell you the last couple of years, we've been a little bit more, and I'd like to think of it as agile on pricing. So yes, we certainly do a pricing event late in the third quarter, early in the fourth quarter, and that's sort of the primary annual rhythm on pricing. We like to look at pricing late in the third quarter, early in the fourth quarter, set the price and then go through the year. But in the last couple of years, where there has been either a need or some sort of inflationary demand, we've also done a smaller pricing in the late spring, early summer. And so I don't think I want us tied down to a specific rhythm on pricing. We look at pricing on a weekly basis. We scrape competitor data. We look at what the elasticity impact is of our existing pricing. We are analyzing it on a regular weekly basis. Now we're not going to price that frequently. But I think it's really important to know what your competition is doing. It's really important to know what consumers are experiencing. And it's really important to gauge consumer response to ongoing pricing. So it would not -- I mean I don't think it should surprise anyone if we take a small pricing sometime in next year, right? Because as Michelle mentioned, we're looking at commodities, we're looking at labor. Where we see idiosyncratic issues, we may need to price. Where we're seeing pockets of inflation, we may need to price.

Gregory Ryan Francfort - *Guggenheim Securities, LLC, Research Division - Director*

Got it. Got it. And then it seems like the 2 companies -- or the 2 sort of themes investors most focused is on that labor, the ability to kind of staff restaurants as well as the price increase. Can you maybe talk about why you like Portillo's has greater pricing power than some of your competitors out there? Is it just the absolute level of check or kind of what -- how you're thinking about why Portillo’s is a differentiation on that ability?

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

I mean, I think, Greg, it starts with the fact that the average ticket per person at Portillo’s is $9.60. I mean let's just start with that. Compare -- and we've -- you obviously know, right? That number is not like pulled out of my rear end. That is a number that is validated. It's vetted. It's gone through SEC scrutiny. That's a real number. And that is a surprisingly low number for the quality of our food, for the abundance of our food and the experience that we provide. And so I think it starts with we have an incredibly sharp value proposition. And so that is one of the reasons why we perform as well as we do and why we have the revenues per unit that we do because we have an incredibly sharp value proposition. We -- it certainly seems to me like we have latent pricing power. I see where our competitors are pricing. I see how aggressively they're pricing. Our pricing, if you go through all the details, we continue to be price laggards, right? We don't price as much or as frequently as our competition. And I think it means that when we need to price, people accept it, and they've already been inured to the price points that have gone up everywhere else.

Operator

Our next question is from Sharon Zackfia with William Blair.

Matthew James Curtis - *William Blair & Company L.L.C., Research Division - Associate*

It's actually Matt Curtis on for Sharon. I have a question on your menu evolution. You've recently done a lot of menu simplification while you were private. And I was just wondering about going forward, how you think about the menu evolving in terms of new products or specific categories you may be looking to expand?

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

It's a great question. And yes, we have been deciduously simplifying the menu. On average, we took, I think, 75 SKUs out of each restaurant during the pandemic. There were some restaurants that we took 150 to 200 SKUs out. We have taken menu items out. We have dramatically improved menu items. We had -- if -- we constantly are evaluating our menu and seeing what sells and what do guests like. And if there's stuff that sells but guests don't like, we've worked hard to improve them, right? We've -- I mean, I'll tell you, we've improved our Caesar salads. We had a cold chicken on it that just wasn't really good. I was embarrassed. We dramatically improved the quality of the chicken, the salad is better. We dramatically improved the quality of our fish sandwich. And so I think the first priority for us is to always make sure that every single item on our menu is amazing. And we're kind of ruthless in that sense that we look for things that we don't think are as good as they should be, and we either make them much better or we replace them with something else that's much, much better. And a perfect example of that is our spicy chicken sandwich, right? We had a chicken sandwich, a broiled chicken sandwich on a croissant. It just wasn't very good. And so we killed it. And we brought in the Spicy Chicken Sandwich which was amazing. It's actually pushed up our chicken category by 27% year-over-year. And that is awesome. It's a great win for our guests because they love it. The chicken sandwich is unique because it's got a spicy jardiniere sauce on it. I'll give you free Portillo’s if you can all pronounce jardiniere correctly. But it's really -- it's a unique thing that's ownable to us. It's not like what any other restaurant company does. We're not trying to be like everybody else, we want to be Portillo’s. And so -- and I think that's a perfect example of menu innovation. There are other things on our menu that our culinary team is taking a hard look at. And I tease because I call it a Darwinian exercise with the menu. We have the strong kill the week, and that's what we do.

Matthew James Curtis - *William Blair & Company L.L.C., Research Division - Associate*

Okay. Great. And then, I guess, just another question on G&A. Obviously, you're going to have the incremental public company costs for the next little while. And it also sounds like some of your investments in training and things like technology perhaps are likely to continue. But I'm just wondering if you could talk about the company's ability to leverage G&A that is on an underlying basis going forward?

Michelle Greig Hook - *Portillo's Inc. - CFO & Treasurer*

Yes. No, it's a good question. And I think when you look at, to your point, in the future quarter and years to come, we're going to have incremental public company G&A. I also mentioned in my prepared remarks, we're going to have incremental stock-based compensation expense as a result of some of the modifications and changes to our equity incentive plan. And so you're going to see that come through. And once you strip out, I'd say, those 2 big buckets, we do expect to leverage G&A as we move forward. But it's not going to be at the expense of not investing in the training, particularly around the folks that we need to run our restaurants in the future. So we're going to continue to make investments in training our future restaurant leaders. But I can tell you that Michael and I are committed to definitely leveraging that line as we move forward when you pull out those 2 line items.

Matthew James Curtis - *William Blair & Company L.L.C., Research Division - Associate*

Terrific. Congratulations on the IPO.

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

Thank you.

Michelle Greig Hook - *Portillo's Inc. - CFO & Treasurer*

Thank you.

Operator

This concludes today's conference. You may disconnect your lines at this time, and we thank you for your participation.
