

16-Mar-2023

# Portillo's, Inc. (PTLO)

UBS Global Consumer and Retail Conference

## CORPORATE PARTICIPANTS

### Michael Osanloo

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

### Michelle Hook

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

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## OTHER PARTICIPANTS

### Dennis Geiger

*Analyst, UBS Securities LLC*

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## MANAGEMENT DISCUSSION SECTION

### Dennis Geiger

*Analyst, UBS Securities LLC*

Good afternoon, again. Dennis Geiger, restaurants analyst at UBS. And I'm pleased to welcome and excited to have here with us Michael Osanloo, CEO of Portillo's; and Michelle Hook, CFO. Also representing Portillo's today is Barbara Noverini, Director of Investor Relations.

Portillo's is best known for its Chicago-style hotdogs, Italian beef sandwiches, chargrilled burgers and famous chocolate cake, among other delicious menu items. Portillo's now has more than 70 restaurants across 10 states, while maintaining basically the best growth story within the restaurant industry.

So with that, welcome, Michael, Michelle and Barbara. Thanks a lot for being with us today.

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### Michael Osanloo

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

Our pleasure.

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### Michelle Hook

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

Thanks.

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### Michael Osanloo

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

Thanks for having us.

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## QUESTION AND ANSWER SECTION

**Dennis Geiger**

*Analyst, UBS Securities LLC*

Q

Terrific. So for investors maybe that might be a little bit less familiar with Portillo's, can we start – just first off a little bit of a brief overview about the craveable food and sort of the experience that ultimately has helped to drive industry-leading sales volumes, industry-leading margins.

**Michael Osanloo**

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

A

Yeah. It's actually a bit of an American success story, right? So Dick Portillo founded this company almost 65 years ago now. And so he was just a kid who sold hotdogs literally out of a trailer with no running water or electricity and built it up over time, sold it to Berkshire Partners in 2014.

But what's iconic about the experience is, it's Chicago street food. So we have Italian beef sandwiches. Now, it sounds, for those of you who are not familiar with Portillo's, that might sound exotic or strange. It's a roast beef sandwich on crusty French bread. It's amazing. In some places in America, we call it French dip when it's got au jus, but it's really simple.

We have Chicago-style hotdogs, which comes with – it's a very specific thing. It's got tomatoes, a big pickle wedge, chopped onion, pickle relish, mustard, celery salt, sport peppers and never ketchup. And it tastes amazing. We have fries that are unbelievable. We have salads. Like, people don't know this about us. We sell \$900,000 of salad per restaurant per year. That – I mean, we could be a salad concept based on that number. And those salads are not like kitted. They're fresh made every single day. So we have something great for everyone.

We work really hard to have a very sharp value proposition, right? The average person at Portillo's spends about \$10. And we work very hard to have an engaging, inviting environment. So if you're a family of four on a budget, times are tough, you come to Portillo's because you feel like a rock star taking your kids to Portillo's. You have a fantastic meal or probably half the price of what it would cost you with tip at casual dining chains. So we occupy a really unique space on a price value curve. We've got a diverse menu of highly craveable foods at really amazing prices.

**Dennis Geiger**

*Analyst, UBS Securities LLC*

Q

That's terrific. And for anyone that has not been or that has not had sort of the tasting menu opportunity one of each, it is an experience and I would highly recommend it especially next time the beef truck comes to town.

I want to talk about the unit growth opportunity here. One of the leading, if not the leading unit expansion story within restaurants, a targeted 600-plus restaurant TAM over time contributing to at least 10% annual growth per year. Can you talk about some of the drivers that give you the confidence in that impressive algorithm?

**Michael Osanloo**

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

A

Yeah. I mean, it's – and you know this Dennis, and so some of you may know this. The first question that Michelle and I get asked by every investor is, are you really a regional concept or will your food travel, right? That's the best. And that's why both Michelle and I are here, because we're really confident that this food travels and it's going to be a national concept with a ridiculously high ceiling.

So our strategy has been to grow – originally, it was simply to grow in the Midwest. The problem is that doesn't prove anything, right? Because if we are doing well in neighboring states, people say, yeah, sure, your Chicago brand, you're doing well in Indiana or whatever. And those states don't necessarily have a lot of strong macroeconomic factors supporting growth, right?

So we have pivoted and we're targeting largely what I call the Sunbelt. So we're growing across Florida, Texas and Arizona. Why those states in particular? It's because those states have the fastest population growth in the United States. And this isn't like a recent thing. It's been a 20-year trend. America is moving to warmer weather and those states are getting a lot of people.

Those states are very friendly business climate. It's rich in labor, and there's a lot of new development. There's a ton of places being built. So I'm excited. We bragged about this a bit in our most recent analyst call. We went into Texas and we had a lot of detractors by people questioning, well, why do you think a Chicago restaurant chain will do well in Texas? Texas already has a ton of great restaurants. Texas is a barbecue place. Texas has a Whataburger. I mean, and these are all true statements.

But our restaurant in Texas, we opened it a little over two months ago is – and have publicly announced this – is doing \$48,000 a day. It's the number one restaurant in our system. It's annualized to do \$17 million. It's not going to do it. It's going to slow down. But I feel like, okay, so maybe people in Texas will eat Italian beef and hotdogs. And I feel like that's a very important proof point for us. I think it demonstrates that the brand is portable, the food is portable, and we don't need to rely on Chicago expats to build new restaurants.

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**Dennis Geiger**

*Analyst, UBS Securities LLC*

Q

Terrific. Impressive numbers for sure. I want to talk about the visibility that you have into the development pipeline. Sort of whether site selection, et cetera. Maybe we can just touch on that as we kind of look ahead a little bit.

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**Michael Osanloo**

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

A

Yeah. So that's one of the functions when I joined the firm. When I joined the company four-and-a-half years ago, I felt it was candidly not a well-run process. And so I think we've spent a lot of time professionalizing this. I'm a big believer in a combination of data and experience and savvy. So we use both [ph] form analytics and e-sight (06:22) to help us find sites based on multivariate regression data, et cetera. But I don't necessarily just trust that data point. I also want smart people with experience looking at sites.

We're very, very picky outside Chicagoland. In Chicagoland, we can build anywhere. We're going to do well. Outside Chicagoland, we're still a new concept. And so we want great co-tenancy. We want great visibility. We want A-plus sites. Our restaurants are big. They're busy. We need great ingress and egress. We have big drive-thrus.

So we work very hard. I've got a team of great dealmakers, and we hunt down real estate. I personally have committed to my board that I will visit every single site before I approve a site. And even if I like a site, I like what I call a Hegelian dialectic, okay? So that's like take an idea, smash another idea against it, you get a better idea.

So I am not right all the time. Far from it. Ask my spouse. And so we have this real estate committee where I look at Michelle, my CFO, and I say, Michelle, do you buy these numbers that they're pitching to us? Do you think we can do this? I look to the HR leader and say, Jill, can you hire people for this restaurant? Will we be able to hire this? I look to the operator and I say, can you run this and do these now?

So everybody on the team has got to agree. And so it's a very tough screen for us to build our restaurants. We weed out stuff that I might have liked. My team, vetoes me occasionally, which I think is a healthy, smart dynamic. I'd rather them tell me I'm wrong than the market tell me I'm wrong.

And so we have a very deliberate, thoughtful process in picking sites, and I feel we've made tremendous improvements there.

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**Dennis Geiger**

*Analyst, UBS Securities LLC*

Q

On that point, let's talk a little bit about – you talked about Texas just now. Either Texas – that might be an anomaly from a strength perspective, as you mentioned. What has that done to your underwriting expectations now? And more so, just the performance of opens over the last couple of years, which have been quite impressive. Just the added confidence there in what you can do as we think about the importance of that performance?

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**Michael Osanloo**

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

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Yeah, we, I think, are appropriately conservative in what we committed to in our IPO roadshow and to what we say. And I'll let Michelle expound on this a little bit. But we commit to every class of new restaurants that we build. We commit that by year three, they're doing \$6 million of revenue and they're doing 20 – low-20s restaurant-level EBITDA margins. That's our commitment. We commit that it's going to cost us X to build, but we're going to get you 25% cash-on-cash return.

We're kind of sticking with that commitment. But, look, we're not fools. We're making a commitment that I'm 80% confident, I'm going to beat. Within a class, we might have one or two restaurants that don't really perform quite as well. We might have one or two of these restaurants like The Colony in Texas that are spectacular. But by and large, we think that we have commitments that are doable, achievable and that leave room for upside for our investors.

Michelle, do you want to?

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**Michelle Hook**

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

A

Yeah. I think since that point in time Dennis, we've seen some elevation in our build costs, right? And that's a question that comes up frequently. We saw that high inflation in 2022, build costs were not immune to that. And so we're still targeting that 25% cash-on-cash return. So the restaurants that approve, as Michael described, during our real estate committee process, have to hurdle at that rate, right, to still deliver those returns that we promised during our IPO process.

So we feel extremely confident we can do that. Michael and I aren't going to sit here and say we're going to be happy if we just hit those numbers for a class. Our goal is to hit them but outperform them, right? But we're telling you what we're going to do, but meet those commitments and then hopefully have a really good chance to outperform.

**Dennis Geiger**

*Analyst, UBS Securities LLC*

Q

And then, so, Michelle, on that point, it's a great point. Build costs are up for the industry. Obviously, your return is still around that 25% cash-on-cash. So what you're seeing is sort of maybe a bit of strength from a from a top line perspective...

**Michelle Hook**

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

A

Yeah.

**Dennis Geiger**

*Analyst, UBS Securities LLC*

Q

...relative to the [indiscernible] (10:33)

**Michelle Hook**

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

A

Absolutely. And Michael gave the stats on The Colony in Texas. But when we look at our most recent openings as part of the class of 2022, we've talked about opening restaurants in Schererville, Indiana; opening in Tucson, Arizona; opening in Kissimmee, in Florida. That class of restaurants are all outperforming our underwriting expectations.

So we feel really good about that. And we're going to continue to provide data points on the performance of our class of restaurants as they continue to mature and get to that three-year mark. And we know we need proof points, right, as Michael said, to prove that we can grow outside of our core market of Chicago. We know that we can. But those proof points are going to continue to come.

**Dennis Geiger**

*Analyst, UBS Securities LLC*

Q

Great. And 2023 will be another proof point year for you. Four restaurants kind of carrying over from last year, plus another seven from the – it's nine...

**Michael Osanloo**

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

A

Nine new ones, yeah.

[indiscernible] (11:24)

**Dennis Geiger**

*Analyst, UBS Securities LLC*

Q

... 2023.

**Michael Osanloo**

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

That's right.

A

**Dennis Geiger**

*Analyst, UBS Securities LLC*

Excuse me. Can we just talk about the confidence there? It's obviously a difficult development environment for the industry with timing delays, et cetera. So maybe we could just touch on 2023 specifically. That'd be helpful.

Q

**Michael Osanloo**

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

Yeah. Like historically, once we made a decision and had a restaurant approved from RESAC committee, it took us roughly a year to get it built. A lot of different reasons for this, but we expanded that to 18 months now, because it's – and a lot of this – a big chunk of that is permitting and dealing with local municipalities, et cetera. A little bit of that is some growing pains. Historically, we were building one or two restaurants and we're self-GC-ing, we're building it ourselves. We've now partnered with very large national GC companies that allow us to have to be able to build restaurants and scale.

A

And so we went from 16 to 18 weeks build cycle to 18 to 22 weeks. So added – call it, a month on the build cycle, but added five months on the permitting cycle. And so in 2023, before – earlier, a year ago this time, I thought 2023 would be better balanced. Unfortunately, it's not. It's all back end this year. So we're targeting, 3 to 4 in the third quarter and the remainder in the fourth quarter.

Going forward, what looks good to me is that, we get all of our restaurants built by the end of October. And that from a new openings standpoint, November and December are dark. Our restaurants are super busy, November to December, as are almost everybody's restaurants. But we don't want to be trying to open new restaurants at the end of the year.

**Dennis Geiger**

*Analyst, UBS Securities LLC*

Okay. As far as new store prototypes go, you have one relatively new pickup and delivery-only location in Joliet, Illinois. Can you talk about what you're seeing at that location and then really what the potential is for that unit over time? I know there's a lot of investor excitement about that potential, so maybe we could touch on that a bit.

Q

**Michael Osanloo**

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

Yeah. It's an exciting thing. The back story of that one is, we had a restaurant about 5 miles away in Shorewood, Illinois, that was just bursting at the seams. It was doing literally too much revenue. It couldn't handle it. And it had started to underperform in terms of guest satisfaction, speed of service, et cetera. So we literally did it as a pressure release valve. And boy, has it done that. And so it's a format – it's drive-thru only. Our typical restaurant requires 2.25, 2.5 acres. This thing is on three-quarters of an acre. It costs about half of what a restaurant cost to build, a full restaurant, and its productivity is more like 80%, 90% of a full restaurant.

A

And so it's a home run on paper. That said, I'm a bit of a perfectionist, and I can tell you like five things that we did wrong in building it. We overbuilt the kitchen, we did this, we did that, so we'll get better. We've committed we're going to build another one in 2023. Part of the 2023 pipeline is the second drive-thru location. The mayor

announced it, unbeknownst to me, in Rosemont, Illinois. So it's out in the public sphere, but – so we're building a second one there. I think it's going to be a home run.

Our strategy on that format, though, is that is a fill-in strategy once you have density and scale. Portillo's, we have beautiful restaurants that are inviting. There's stuff going on. On the one end, in Texas, we've got like an antique Toyota pickup truck hanging from the ceiling, right? Toyota's North American headquarters are a mile-and-a-half from our restaurant. We wanted to be friendly to the Toyota folks. And so they're really cool. I want your first experience of Portillo's to be in a flagship restaurant like that.

But once you've experienced us, you know us, you're used to using us, then we want to be prolific and allow you to use us however you want. So in Chicagoland, there's plenty of people who – they know Portillo's. I just want to get my Portillo's and I like the drive-thru. So imagine, we can do a bunch more of those in Chicago. And then, as we achieve density and scale in other markets, this is a great way of fortifying and fortressing.

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**Dennis Geiger**

*Analyst, UBS Securities LLC*

Q

And just on that opportunity and maybe other nontraditional prototype opportunities relative to your 600-plus targets, what's included there for those that are not as familiar?

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**Michael Osanloo**

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

A

Yeah. So I'll talk about that. But I also then want Michelle to talk about our restaurant of the future. So when I got here four-and-a-half years ago now, I quickly did – I brought in some outside advisors to use form analytics actually to tell us like, what do you think full potential is for Portillo's? I gave them two guardrails. I said, I don't want restaurants within five miles of each other. I don't want to cannibalize ourselves. And I don't want boxes that are going to do less than, I think, \$6.5 million or so.

And so – by the way, and then I don't want you to include alternative formats, airports, universities, or international franchising. So flagship restaurants at a certain size, certain distance. And they came back with a number, over 600, but we just call it 600. So that was the TAM four-and-a-half years ago. I think something we need to refresh because we are looking at drive-thru. We are considering other formats, and eventually, we will franchise internationally. But one of the other formats I'm excited about is the restaurant of the future.

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**Michelle Hook**

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

A

Yeah. So one of the things – so the drive-thru-only concept is exciting. But actually what's more exciting for this brand moving forward is we're working on a project Michael asked me to lead with our Head of Marketing, which is our restaurant of the future. So it's basically you take a whiteboard, and say, how would you build a full-sized Portillo's in the future?

So for those that probably have not been in our restaurants, our kitchens are very linear. They're very long kitchens. They're big kitchens. Our restaurants were built for a very robust dine-in business. Pre-COVID, we were doing 50%-plus dine-in business. Today, a third of our business is dine-in.

So COVID accelerated the trends we all knew were happening in the industry, which is more people are dining off-premise, right? And so how do we build that restaurant of the future for where the guest is and also, where we can get more efficiencies in our kitchen, because there's opportunities to use more standardized equipment. A lot



of our equipment in our kitchens today are very customized. And so there's opportunity to get the kitchens more in line, to have more efficient use of [ph] durable (18:01) labor, also I think shrink the dining rooms as well, build some dedicated entrances for the delivery folks to come into your restaurants, for pickup shelves, things like that, that I think can significantly reduce the size of what we're building. We build about 7,800 square feet today for a full size Portillo's. I think we can get that size down and not hinder the guest experience, still deliver the Portillo's experience to our guests.

And we're doing that work as we speak, Dennis. The goal would be to at some point during the class of 2024 to build a restaurant of the future. And I think when you think about what we just talked about in terms of build costs being elevated in 2022, we're not seeing significant easing on that. It's not getting any worse, which is good. But I think that could provide massive opportunity for us to build the Portillo's of the future – to Michael's point, that could be more than 600 restaurants.

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**Dennis Geiger**

*Analyst, UBS Securities LLC*

Q

Very exciting. I want to shift over to sales drivers and maybe start with satisfaction metrics. So across the industry, we've probably seen in a lot of cases those going the other way. For you folks, though, earlier you talked about it, Michael, but your satisfaction metrics look very good. What does that tell you about the momentum in the business, how the brand is positioned right now?

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**Michael Osanloo**

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

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Yeah. Look, maybe I'm a caveman in my mindset. But I think in the restaurant industry, the best marketing you can do is give people a great experience when they come to your restaurant, right? Think about when you go – when you visit a restaurant, are you going to a restaurant? I've got the data, by the way, on this but you're not going to a restaurant because there was an ad or a coupon or marketing op. You're going because, man, the food is really good and had a good experience last time. That's why people go to restaurants. And so I'm a huge believer that you take care of every single guests like it's – like your life and business depend on it. And so we have aggressively worked to delight our guests. Our guest satisfaction scores – and this is we work with SMG. Many of you are probably familiar with it. They do all the customer surveys, et cetera.

Our guest satisfaction scores are at three-year highs. Our speed of service scores are at three-year highs. Our value perception scores are at three-year highs, and our order accuracy is three-year highs. Now, those are all sort of auto-correlated metrics, right? If you're accurate and fast, you're going to get good scores. But that gives us a lot of confidence that things are tracking well for us.

I also – Michelle and I also talked about this at our earnings call. But year-to-date in 2023, we're positive transactions and we're positive sandwich count. I talk about sandwich count because I think that's the truest barometer of people are coming to your restaurant or not. Transactions can get noisy, right? One transaction might be multiple people, but our sandwich count is up year-to-date as well as our transaction count. So we're very excited about the momentum of the business.

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**Dennis Geiger**

*Analyst, UBS Securities LLC*

Q

Great. On value, you touched on it kind of with some of the metrics there. The value scores look good. Maybe we could talk about the solid relative value that the brand provides, particularly as investors are so focused on a

tougher macro right now, what kind of resiliency does the brand and all brands have? So if we could touch on that value proposition, I think that'd be helpful.

**Michael Osanloo**

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

A

Yeah. So we're just under \$10 per person on average. And then, we look at our pricing relative to our competition in a lot of different ways. So we like to compare ourselves to a number of other high-quality fast casual chains. We pick an indicative restaurant. We look at our competitors within 5 miles, see how they price. And so we price our most popular bundle against their bundles. Our most popular bundles are beef sandwich with peppers, fries and a drink. And we compare ourselves against – I think, I've said it before...

**Michelle Hook**

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

A

Yeah, yeah.

**Michael Osanloo**

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

A

Against like Chipotle, Panera, Five Guys, Shake Shack, Potbelly. And against that group, we're anywhere between \$1 and \$6 less on a like-for-like best bundle. We feel really good about that positioning. We consciously have followed a price laggard strategy. So commodity costs are up 15% for us. Labor costs are up 11%. We price 8%. In a normal year, 8% sounds like a lot. Last year, 8% was on the low end for restaurants and food in general.

And we think that that positioned us very, very strongly against our competition. We think that whether or not the company is technically in a recession or not, there's certain segments of the population that feel a recessionary bite. And we want to be a value oasis for those customers. And I think it's working. Our strategy is working.

**Dennis Geiger**

*Analyst, UBS Securities LLC*

Q

Can I get a salad for less than \$18 at Portillo's?

**Michelle Hook**

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

A

You can.

**Michael Osanloo**

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

A

You get a really good one that's fresh made to your specifications.

**Dennis Geiger**

*Analyst, UBS Securities LLC*

Q

That works pretty well then.

**Michelle Hook**

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

A

And you can add a drink on for under \$18.

**Dennis Geiger**

*Analyst, UBS Securities LLC*

Right.

Q

**Michael Osanloo**

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

Yeah. How about a chocolate shake, Dennis.

A

**Dennis Geiger**

*Analyst, UBS Securities LLC*

That's great. I want to touch a bit more on the operational improvement potential. I think, Michelle, you touched on a lot of it with the restaurant of the future. Beyond that, biggest opportunities to improve operations within the four walls of the restaurant, if you could just touch on that a little bit.

Q

**Michelle Hook**

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

Yeah. I think one of the exciting things we're doing in 2023 is, we are tweaking the kitchen a little bit. We have an initiative called Kitchen 23 where I described that linear kitchen, right, where we've shrunk that by about 60 feet in the restaurants we're going to – most of the restaurants we're going to build in 2023. We've changed around some of the flow of the equipment. Like these things all sound small, but they mean something. Like just simply turning the fryer station to where you're expediting to both drive-thru and dine-in and pick-up. Just it creates this labor efficiency within your kitchen that we believe can reduce two FTEs of labor within our kitchen just by making this kitchen more efficient.

A

Today, we're – our drinks are served to you. So we're taking the drink station, putting it into the dining area, having self-serve drinks. We're creating a grab-and-go area, where – as you walk in and order, you can see the great desserts that we make fresh daily. You can grab some beverages. You can have some Portillo's swag. So there's a lot of things that we're doing within our 2023 builds that are tweaking some of the design elements of what we're building today that are going to get us some labor efficiencies.

We'll build on top of that as part of restaurant of the future. But those are some efficiencies that we have going for us this year. We put a lot of efficiencies in our kitchen flash here. Again, just little things like buying pre-chopped onions and sausages, et cetera, that weren't any more expensive, but provided those efficiencies for our team members within our restaurants. And we saw that come through. Michael mentioned labor rates were up 11%. We took 8% price. But some of the efficiencies we got on our labor allowed us to buffer some of those cost increases a little bit more within that 2022 timeframe.

**Dennis Geiger**

*Analyst, UBS Securities LLC*

Great. I want to shift over to omnichannel. You've got sizable businesses across multiple channels, strength and good momentum in several of them. Can you talk a little bit about that – the advantages that plays in your business?

Q

**Michael Osanloo**

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

A

Yeah. And this is one of the magic of Portillo's. We were multichannel before it became a thing, right? So we have obviously dine-in, takeout. We have drive-thrus that are not the traditional QSR drive-thru. It's a double-lane drive-thru. Somebody comes up, helps you curate your order, put a sticker on your car, a food runner comes and runs out your order to you. In that way, if you're five cars back but you just wanted a shake, you can pop out into that second lane and leave right after you get your shake. So it allows much faster service, a more curated experience, et cetera.

We have a big delivery business and it keeps growing. We partner with all the third-party delivery people. And despite the price deltas, that business keeps growing. We're margin-neutral on that business. We charge more obviously. We have our own delivery mechanism, Dennis. So anybody who orders over \$100 of delivery, Portillo's delivers on its own. Our team members love doing that. They're certified. We train them. But they love doing it because they're getting a big tip on a delivery. And the guest loves it, because it's much more of a white-shoe delivery experience for them. We have a very robust delivery catering business.

And then, we have a shop-and-ship business where – I mean, if you're not in Chicago, you won't appreciate this. But like shipping Portillo's to people at holidays is a thing. And so we have a very big business where we ship Portillo's.

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**Dennis Geiger**

*Analyst, UBS Securities LLC*

Q

Great. And then, how about from a digital perspective, thinking about the contribution there, where that can go ultimately, the opportunity that still exists for the brand on digital?

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**Michael Osanloo**

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

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About 30% of all of our sales are through a digital channel. I'm going to sound a little snarky about this. I think those people who tout digital as the be-all-and-end-all because it's – digital is a great way to access off-premise. So if you don't have a drive-thru, if you don't have a good delivery mechanism, if you're losing money with the third-party guys, then, yeah, you should brag about digital.

But we have so many different ways for a consumer to engage with us and take the business off-premise that it's not like – we don't need to be pioneers in digital. We have a fantastic app. It's the low-cost way of using Portillo's. We've been really smart about managing the app, so that anybody who goes on, now they're like 70% likely to get to a sale as opposed to there's some industry standards on start and finish that are lower.

So I like to think we're fast followers on the technology stuff, but it's because we already have so many great mechanisms to engage with us and take the business off-premise, take the food off-premise.

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**Dennis Geiger**

*Analyst, UBS Securities LLC*

Q

Great. You touched on the impressive traffic and entrée momentum to start the year.

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**Michael Osanloo**

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

A

Yeah.

**Dennis Geiger**

*Analyst, UBS Securities LLC*

Q

Can we talk a little bit about how you think about that moving through the year? Maybe we talked about mix a little bit within that context, again, particularly given the macro that's out there and thinking about pricing, just how you're thinking about that as we move through the year.

**Michael Osanloo**

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

A

I think – Michelle and I talked about this last year, and we've reemphasized this, last year – we have three constituents. I've got my team members, our guests, and our investors. And you have to balance the needs of three constituents at all times. And so last year, we did really well by our team members, we did really well by our guests, because we lagged on pricing, but we eroded a little bit of margin.

And so this year, I think it's got to be more balanced, and we're committed to – we already have great – a restaurant – we're embarrassed that we ended the year at 22.6% restaurant-level margins, which is kind of silly, but we think we can improve it. And so I think that we're going to balance pricing but still maintaining traffic momentum, and we're going to make sure that we're improving margins while doing our best to maintain that traffic momentum.

**Dennis Geiger**

*Analyst, UBS Securities LLC*

Q

Great. And then, just on pricing, you've spoken to this on earnings calls in in recent quarters. What have you seen as it relates to the pricing levels, as it relates to resistance from the customer? And then, how that's kind of guiding what you've kind of talked about for the year so far from a pricing perspective?

**Michael Osanloo**

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

A

Yeah. I kind of go back to where I start – we talked about with the guest satisfaction metrics. Guests are telling us that they're more satisfied with us than they have been a long time. The value perception is as high as it's been in three years. And keep in mind, we price 8%, we price, whatever, 6%. There's a lot of pricing embedded in that. And our value perception scores have improved. And we're \$1 to \$6 cheaper than our competitors. So I think we have – and we have positive traffic and positive transaction count. So I think it goes without saying, we feel like we have a lot of pricing power.

**Dennis Geiger**

*Analyst, UBS Securities LLC*

Q

Great.

**Michelle Hook**

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

A

Yeah. I think the one thing, Dennis, that we do see in this environment, which – it started for us in the second quarter of last year and continue to trend is we are seeing a little bit of negative mix and you mentioned that in your commentary. And we're still getting people to come into Portillo's, but you're seeing maybe they're not adding that side of cheese sauce or maybe that extra drink. And that dynamic has not changed as we come into like the first part of this year. But what Michael and I want is traffic growth...

**Michael Osanloo**

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

Yeah.

A

**Michelle Hook**

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

...right? That's the healthy way to grow this business. Yes, we see a little bit of negative mix. That will obviously work its way through. But we're going to continue to pull the pricing lever in 2023...

A

**Michael Osanloo**

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

Yeah.

A

**Michelle Hook**

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

...to offset the inflationary pressures and grow margins. That's going to be the primary lever.

A

**Dennis Geiger**

*Analyst, UBS Securities LLC*

And again, traffic in entrée growth, which, Michael, you spoke to, which some might have the positive traffic now, but maybe not the right trade. So I think that's an encouraging data point and an encouraging trend for sure.

Michelle, another one for you. Maybe as we think about margins shifting over there for 2023, despite costs pressures, macro pressures, you've talked about expansion for the year. Can you talk a little bit about what goes into that? Unpack that a little bit for us.

Q

**Michelle Hook**

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

Yeah, absolutely. As most of you know, our biggest costs are going to be food and labor, right? And as Michael mentioned, food was up 15%, labor 11% on our hourly rates last year. We think both of those are going to be mid-single-digits this year as we have visibility, to the extent that we do, on our commodity costs.

Our biggest input costs are going to be beef, chicken, and pork, primarily beef. Those three proteins are about 50% of our commodity basket. So we think mid-single-digits on both those input costs is reasonable inflation this year, and we can pull that pricing lever down as to – not just offset those inflationary pressures but continue to grow margins.

That is despite the fact, as we talked about earlier, we have 13 new restaurants coming on line into the Portillo's portfolio in our fiscal year 2023. And so those restaurants don't immediately start doing low 20%, right? The first couple of years are in the high-teens in terms of margin, and then the goal is, by year three, that low-22 – that 22-ish-percent. So despite that, mixing those into the portfolio, Michael and I are very committed to growing margins 2023 versus 2022.

**Dennis Geiger**

*Analyst, UBS Securities LLC*

Q

And obviously, with a little bit of a back-end-weighted year that – it probably puts a little more pressure on that margin number, perhaps, as you talk about the pressure from new store inefficiencies, to some extent.

**Michelle Hook**

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

A

Yeah.

**Dennis Geiger**

*Analyst, UBS Securities LLC*

Q

As it relates to food, just remind investors, if you could, where you're locked there as it relates to the visibility that you have on the basket right now.

**Michelle Hook**

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

A

Yeah, no problem. So our basket is about a third locked for the full year. Most of that is going to come in that beef line item. So beef is about 35% of our total commodity basket. We've taken fixed pricing positions on our beef flats, which are the big roasts essentially that we use to make our Italian beef and some other positions on some other line items.

And we're generally floating with the market on chicken and pork. We think we'll actually see deflation on chicken and pork this year with beef seeing increases but not as much as we've seen in the prior year. So a little bit of pressure possibly in the back half of this year on beef. And then, we think we'll see some pressure on our French fries, and that's about 7%, 8% of our total market basket.

So when you blend all that together, that's where we get to the mid-single-digits. As I mentioned, we feel good about where we're at today, the visibility that we have. Again, you never know what the world is going to bring. I didn't think we would be up 15% early part of last year, but things happen. But that's what we think as we sit here today.

**Dennis Geiger**

*Analyst, UBS Securities LLC*

Q

It's great. How about staffing a bit more on where you are staffing-wise versus where you were in 2019 versus maybe where you want to be? And then, you've talked in recent quarters about investment in staffing given the importance of your employee to the overall experience. So maybe we could touch on that a little bit.

**Michelle Hook**

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

A

Yeah.

**Michael Osanloo**

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

A

I mean, this is going to sound crazy, but we're thrilled we're overstaffed. We're better staffed today than we were in 2019. Now, we have – I feel like we've earned this because we've worked very, very hard on culture. We have values. We're values-based – we hire people based on values. We evaluate them based on values. We pay above average now. For our hourly folks, we pay at the 68th to 75th percentile. We have a great benefits package

for our hourly team members, right? Like, me, I want health insurance. They want pet insurance and gym pass memberships. It's like, okay, you can – well, use your benefits however you want.

We have great training programs. We're in an industry that in many ways is a transitional industry.

But, look, you can make a great living in this industry. I've got GMs that make well darn close to \$200,000, right? They make a lot of money. And it's an industry that you can make a great living at. And so we will train you. We will help you get successful. We will help you be the best version of you.

And so we work really hard at all that. That's why, when you compare our hourly, according to Black Box, when you compare our hourly turnover to the rest of fast casual industry, we're about 40 percentage points better on turnover than they are. And that's improved. It was 30% last year. So we've gotten better.

Our management turnover has become exceptionally low. It's like 8% right now, which is 20-plus-percent lower than the rest of the industry. So – and by the way, those turnover numbers, right, there's hard costs, but there's a lot of soft costs associated with that. When you're constantly churning hourly staff, they're just less efficient. They don't know, it negatively affects the volume. You're constantly churning management. It negatively affects the restaurants. So we feel really good about where we are from a team member standpoint.

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**Dennis Geiger**

*Analyst, UBS Securities LLC*

Q

That's great. Michelle, another one for you. Just given all the focus on balance sheet over the last week or so, maybe we could talk a little bit about balance sheet leverage, how you're thinking about it and maybe highlighting your most recent transaction – refi transaction, which unlike I think expectation that most are going to be see – you seeing expenses go up from an interest perspective. You guys got a nice little benefit there.

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**Michelle Hook**

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

A

Yeah. We were excited that we were able to get a refinancing done in this environment. So we completed that on February 2. And we currently are at \$310 million of debt. But, basically, the old debt that we took out, Dennis, was at 550 basis points plus LIBOR. And so the new debt is at 275 basis points plus SOFR. And so we feel really good about when you take like-for-like rates at the closing, saving \$8.5 million annualized interest expense, which we can put towards building more Portillo's restaurants.

So I feel really good about getting that done considering the environment that we sit here today. And so we feel good about the capital structure that's in place for the next five years, if we so choose. I see us refinancing that at some point – not in the near future but in the future. And our leverage ratio sits probably at around 3.5 times right now. We were at a much higher leverage ratio before our IPO. And I know you know this, but for those that don't, we use the proceeds to pay down debt from the IPO and de-lever.

So I feel good about our ability to service the debt, invest in our business, and it just provides even more opportunities to do that. We increased our revolver from \$50 million to \$100 million. So it gives Michael and I and the rest of the company a little bit more financial flexibility that – look, if we want to dial up growth, I feel comfortable doing that. We're funding our growth right now through free cash flow. I don't expect that we're going to need to take on more debt, raise capital to fund our growth. But, look, if we want to dial up growth a little bit and I need to tap into the revolver, I have plenty of now flexibility on that to do that.

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**Michael Osanloo**

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

And our restaurants cash flow immediately.

A

**Michelle Hook**

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

Yeah.

A

**Michael Osanloo**

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

So it's not like, when you're building new restaurants, Portillo's, you don't need to wait a couple of years to get the cash on them. They literally cash flow immediately, so the engine keeps getting stronger.

A

**Michelle Hook**

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

Yeah.

A

**Dennis Geiger**

*Analyst, UBS Securities LLC*

That's great. A couple from the audience. One that I want to work in. Just one LTO philosophy, how you think about that? I have a good sense, but if you can kind of share that.

Q

**Michael Osanloo**

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

I hate them. Here's the problem with LTOs, right? Yeah. The problem is, from an operator standpoint, I got to learn a whole new thing that you're going to do for a short period of time, and then it goes away. It's a pain in the [obscurity] (39:15). I find that guests are frequently frustrated by an LTO. It's like, hey, I came in for that, I'm back two, three months later and it's gone. And so we believe – I believe personally in a more Darwinian exercise on the menu. If it's good enough to get on your menu, then put it on your menu and kill something that's not as good. So we have great examples of that, right? We had a vegetarian/vegan dish. It was a portobello mushroom sandwich. Okay? When executed perfectly, it was really good. We executed it perfectly like 10% of the time.

A

And so we replaced it with a vegan hotdog called the Garden Dog. It's a fantastic product. It's clean ingredients. It's pea protein and spices. It tastes great. So guests love it. They're buying it up at like 5, 6 times the rate of the other thing. My investors love it, because I removed four unique SKUs with the portobello thing that were slow moving. I replaced it with one SKU. My operators love it, because it's the exact same motion. The other reason my investors love it is I improved my penny profit significantly. So that is the kind of innovation, food innovation that makes sense to me.

**Dennis Geiger**

*Analyst, UBS Securities LLC*

That hotdog is a great product. I think I had it three times at [indiscernible] (40:38).

Q

**Michael Osanloo**

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

Yeah.

A

**Dennis Geiger**

*Analyst, UBS Securities LLC*

I mean, it was it was delicious.

Q

**Michael Osanloo**

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

Most people can't tell the difference between that and meat.

A

**Dennis Geiger**

*Analyst, UBS Securities LLC*

It was really good. When asked about dine-in and sort of where that sits now versus where it was, where it's going perhaps, I know it's a little bit of a tricky question where it's going, but how you think about it.

Q

**Michelle Hook**

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

Yeah. Yeah. And I think I mentioned this before. We were over 50% dine-in before COVID hit. Obviously, our dine-ins has got shut down. So we were at 0% at one point during COVID. It's gradually bounced back to what we're at I'd say around 35% dine-in mix today, Dennis. It started to really stabilize in 2022.

A

And I think what we've already talked about, which is the trend towards more off-prem dining, was definitely accelerated, and we're seeing that. I don't expect we're ever going to get up to 50%. It's the reason why as we look at restaurant of the future, I think we can do some things in the dining room to shrink that a little bit.

But could it get up above 35%, somewhere in the 35%, 40% range? Yeah, I think it can. I think that would be largely incremental for us. I will say, this about one of the dynamics that does exist for Portillo's, and Michael talks about people experiencing Portillo's for the first time coming into our restaurants.

We do actually have a higher dine-in mix in the outer markets than we do in our core market because people do want to come in. They want to see the brand. They want to see us make the food, experience us that way. And so that is a dynamic we have noticed in outer restaurants, and they learn that our drive-thrus actually move quickly. They need to learn that as we go into some of these newer markets. And so a little bit heavier mix on outer market.

**Dennis Geiger**

*Analyst, UBS Securities LLC*

That's great. Any other differences Chicagoland versus non-Chicagoland markets, customer behavior-wise, how the customer uses the brand? You touched on something a little bit there, but anything else you would highlight from that perspective?

Q

**Michelle Hook**

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

I would just say that it's not surprising to us, but it's surprising to other people that how our menu mix is eerily similar. So as an example, Italian beef, the number one seller in every market that we operate. Texas is actually more heavily out-weighted on Italian beef sandwiches in the beginning. I mean, these are – it's only been open two months. Our Italian beef, our hotdogs, our French fries, one, two, and three, with our hamburgers to follow.

A

The menu mix is about the same in outer markets. I think the channel mix varies. And Michael said this publicly, for The Colony, our restaurant in Texas, we don't even have any digital capabilities turned on right now. The only way that you can access Portillo's in Texas is by coming into the restaurant or going to the drive-thru because we're doing [indiscernible] (43:21). It's already meant to handle \$17 million. So could you imagine, if you turned on delivery, digital pick-up, you just can't do it right now.

There are those things like channel mix that you see on outer markets that are different than the core just because of those unique dynamics.

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**Dennis Geiger**

*Analyst, UBS Securities LLC*

Q

And as far as turning that on – that or those channels on, that'll just be something, let's see where the sales volumes are and what the staff can handle at the end of the day.

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**Michael Osanloo**

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

A

Yeah. That's a best practice that we learned in Orlando. Our Orlando restaurant opened up it did – I've said it publicly like the \$10 million it's first year, without any of those channels turned on. We recently – and now it's almost finishing its second year and we recently turned on digital, et cetera. And so – and we're seeing – we've seen immediate pop there, but we think it can handle a certain level of volume. But early on, when it's flooded with guests inside and the drive-thru, you don't want to distract the team from taking care of the people coming in.

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**Dennis Geiger**

*Analyst, UBS Securities LLC*

Terrific. I have a couple more, but you know what I think, we're out of time, so I'm going to leave it there. I want to thank all of you very much for sharing your insights and your time with us today. Much appreciated. I'm sure investors know how to get in touch with you if they need to. But this has been great. Thank you, guys.

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**Michael Osanloo**

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

Thank you for having us.

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**Michelle Hook**

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

Thank you. Appreciate it.

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