27-Feb-2024

Portillo's, Inc. (PTLO)

Q4 2023 Earnings Call

CORPORATE PARTICIPANTS

Barb Noverini
Director-Investor Relations, Portillo's, Inc.

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

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

OTHER PARTICIPANTS

Sharon Zackfia
Analyst, William Blair & Co. LLC

Sara H. Senatore
Analyst, BofA Securities

Chris O'Cull
Analyst, Stifel, Nicolaus & Co., Inc.

Brian H. Mullan
Analyst, Piper Sandler & Co.

Andy Barish
Analyst, Jefferies LLC

Dennis Geiger
Analyst, UBS Securities LLC

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

Brian Harbour
Analyst, Morgan Stanley & Co. LLC

Gregory Francfort
Analyst, Guggenheim Securities LLC

MANAGEMENT DISCUSSION SECTION

Operator: Greetings, and welcome to the Portillo's Fourth Quarter and Year End 2023 Earnings Conference Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

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

Barb Noverini
Director-Investor Relations, Portillo's, Inc.

Thank you, operator. Good morning, everyone, and welcome to our fourth quarter and full year 2023 earnings call. Our 10-K earnings press release and supplemental presentation are posted at investors.portillos.com. With me on the call today is Michael Osanloo, President and Chief Executive Officer; and Michelle Hook, Chief Financial Officer.

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

Today's earnings call will make reference to non-GAAP financial measures, which are not an alternative to GAAP measures. Reconciliations of these non-GAAP measures to their most comparable GAAP counterparts are included in this morning's posted materials. Finally, after we deliver our prepared remarks, we will open the lines for your questions.

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

Michael Osanloo

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

Thank you, Barb, and good morning, everyone. Thanks for joining us for our fourth quarter and full year 2023 earnings call. I'm happy to share that we had a great fourth quarter and ended the year on a high note. In the fourth quarter, total sales increased 24.5% to approximately $188 million. Same-restaurant sales grew 4.4% on the back of transactions increasing 1.3%. Restaurant-level adjusted EBITDA grew 42.7% to $46 million and restaurant-level adjusted EBITDA margins expanded by 310 basis points to 24.3%.

For fiscal year 2023, total sales increased 15.8% to approximately $680 million. Same-restaurant sales grew 5.7% and we ended the year with average unit volumes of $9.1 million per restaurant. Restaurant-level adjusted EBITDA grew 24.7% to $165 million. And for the full year, we expanded restaurant-level margins by 170 basis points to 24.3%. And importantly, we grew operating cash flow by 24.4% to a record level for Portillo's.

Let's dive in to the factors that drove the success. First, we were operationally on point. We believe the best way to drive revenue and traffic in a sustainable fashion is to give our guests the outstanding experience we're known for and they have come to expect. In the fourth quarter, we did just that. The result was strong revenue and margin performance, multi-year highs in overall guest satisfaction and a current Net Promoter Score of nearly 70, outperforming most of our peers. We know the play. We serve abundant, delicious food at a fantastic price in an engaging environment. This is the number one way we create value for our guests and keep them coming back.

In Q4, we flexed our multichannel muscle extremely well. We excelled in dine-in, our drive-thrus were humming, pick-up and delivery orders were flying off the shelves, and we did a great job growing our catering business. For example, in 2023, we invested in dedicated catering resources, such as a new concierge service to provide our guests with a high touch ordering experience. We also strengthened our ability to handle large scale catering events. For example, we served holiday meals to the frontline workers of a major airline in both Chicago and Arizona. The overarching theme there is that these investments are driving strong catering sales and will help us to continue to grow this channel. Today, catering represents only about 5% of our overall revenue. We know, it can be more. We're excited about the opportunities to grow this channel by marketing additional catering occasions and expanding this channel across our new markets.

So speaking of marketing, in the lead up to the holiday season, we ran an advertising campaign in Chicago that brought the sights, smells and sounds of Portillo's to the forefront. Instead of using discounting to drive traffic, we simply reminded fans in our largest market why they love Portillo's. If you haven't seen our ad, we have one linked on our Investor Relations website and you can see for yourself how a simple message like this can work as a traffic driver. And as we move forward in the New Year, we're going to continue to leverage traffic driving tools and initiatives. One that I'm excited to share is that we'll be adding two new salads to our permanent menu soon.

As you know, we take menu innovation very seriously at Portillo's. We don't just add items to add. They have to fill a gap in the menu, make sense operationally, and most importantly, be utterly craveable. Portillo's already generates more than $650,000 in salad sales per restaurant per year with our beloved Chopped Salad as the best seller. Based on consumer and competitive data, we know we've got space to add more variety to this already craveable menu category. So we created a spicy chicken version of our signature Chopped Salad. We've also tested a chicken pecan salad with a new honey peppercorn dressing. Like all of our salads, these are also made fresh-to-order and you can customize all the ingredients however you want. Both test salads are selling really well and we look forward to rolling them out system-wide soon.

Now, let's pivot to development. In 2023, we opened 12 restaurants, including 6 in the fourth quarter. That 12 includes 8 planned 2023 restaurants, as well as the 4 carryovers from the prior year. This is the most we've opened in a single year and I'm excited for what this means and what we can do in the future. We've already got a lot of momentum heading into 2024 and you can expect it to be another strong year of growth for us. We've committed to at least nine new restaurants in 2024 pipeline, five of which are already under construction. And by the way, we self-fund all of this growth. Our new restaurants generate cash flow immediately and we put all that cash right back into the business to fund further expansion.

Now, as for unit economics, I've been told that everyone is sick of me bragging about The Colony restaurant in Texas. So let's talk about some of the other stars of the class of 2023. I'm extremely happy with the results coming out of our growth markets in particular. Fort Worth, Texas and Clermont, Florida, have both opened strong out of the gate and especially impressive with our new efficient kitchen layout. We also opened our second pickup location in Rosemont, Illinois. We continue to learn a lot from this model and we're excited about its potential for Portillo's as we continue to grow.

Remember that this model has everything except a dine-in capability, so it's essentially a drive-thru. We delivered a strong finish for the class of 2023 and we're looking forward to entering the Houston market in 2024. All told, we're really happy with the quarter and how the year ended. We executed on the fundamentals of our business and invested incrementally to drive brand awareness. In 2024, we will continue to flex traffic driving tools, driving success first and foremost by being operationally sound and protecting our value proposition. We're just building on the factors that have made Portillo's great for 60 years. We continue to execute against our playbook, providing a great experience and great food at a great price point is our not-so-secret sauce. It's how we drive the kind of financial results you saw from us in 2023.

With that, let me hand it over to Michelle.

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

Great. Thank you, Michael, and good morning, everyone. In Q4, we saw strong top line revenue growth. During the fourth quarter, revenues were up $187.9 million reflecting an increase of $37 million or 24.5% compared to last year, driven by 4.4% increase in same-restaurant sales combined with the opening of new restaurants. The same-restaurant sales increase of 4.4% was primarily driven by an increase in average check of 3.1% and a 1.3% increase in transactions. The higher average check was driven by an approximate 6% increase in certain menu prices partially offset by product mix.

We had 14 weeks this fiscal quarter versus 13 weeks last year. Excluding the 14th week, revenue in the fourth quarter increased approximately 15.3%. The 14th week in fiscal 2023 included Christmas Day, resulting in six operating days. You have all seen choppy performance during the first quarter due to winter weather and consumer headwinds in our industry, we are not immune to that, but we don't expect that to derail the rest of our year. Our long-term growth algorithm reflects low-single digit comps. Now, there will be years when unexpected things happen in any given quarter and years when we outperform, but on average, we have confidence we can hit that target on an annual basis and we feel no different as we sit here today.

On the development front, we expect to open at least nine new restaurants in the class of 2024. We currently expect one new opening later in the first quarter of this year with two to three openings in each of the subsequent quarters. We remain committed to delivering on our long-term mid-teens revenue growth target, primarily through new restaurant growth while continuing to deliver positive comp growth. We updated our long-term outlook in September at our Development Day, increasing our restaurant growth and revenue targets. These are also outlined in our earnings release issued this morning.

Moving on to our costs. Food, beverage and packaging costs as a percentage of revenues decreased 34.8% in the fourth quarter of 2023 from 35% in the fourth quarter of 2022. This decrease was primarily due to an increase in our revenue and lower third-party delivery commissions, partially offset by 4.4% increase in commodity prices. We estimate overall commodity inflation to stay consistent with recent trends and are currently estimating commodity inflation in the mid-single digits in 2024.

Labor, as a percentage of revenues decreased to 25.4% in the fourth quarter of 2023 from 26.5% in the fourth quarter of 2022. The decrease was primarily driven by an increase in our revenue, partially offset by higher labor utilization and incremental investments in our team members, including hourly rate increases and variable-based compensation. Hourly labor rates were up 2.4% in the fourth quarter of 2023 and up 4.3% year-to-date versus the prior periods. We are currently estimating labor inflation in the mid-single digits in 2024.

Other operating expenses increased $2.4 million or 13.5% in the fourth quarter of 2023 compared to the fourth quarter of 2022, which was primarily driven by the opening of new restaurants, as well as higher credit card fees, utilities and repair and maintenance expenses. Occupancy expenses increased $0.6 million or 7.4% in the fourth quarter of 2023 compared to the fourth quarter of 2022, primarily driven by the opening of new restaurants. As a percentage of revenues, occupancy expenses decreased 0.7% compared to prior year driven by an increase in our revenue.

Restaurant-level adjusted EBITDA increased 42.7% to $45.7 million in the fourth quarter of 2023. Restaurant-level adjusted EBITDA includes an impact of approximately $3.5 million due to the 14th week. Restaurant-level adjusted EBITDA margins were 24.3% in the fourth quarter of 2023 versus 21.2% in the fourth quarter of 2022, a strong improvement of 310 basis points quarter-over-quarter. For the full year 2023, our restaurant-level adjusted EBITDA margins were also 24.3%, which was an improvement of 170 basis points versus fiscal year 2022.

As we said at the beginning of the year, increasing our margins was a focus in 2023 and we delivered. Our improvement and restaurant-level adjusted EBITDA margins is on top of opening a record level of new restaurants in 2023, which all have a lower margin profile to start. This improvement was the result of our ongoing efforts to deploy strategic pricing actions, elevate guest experiences and implement operational efficiencies. We will continue to focus on driving long-term shareholder value by focusing on our operational execution and a disciplined development strategy.

On pricing, as a reminder, in 2023, we took two pricing actions in January and May. We recently announced an additional pricing action in January of 2024 of approximately 1.5%. We will continue to monitor our cost pressures, the competitive landscape, as well as consumer sentiment to inform our pricing decisions in the coming quarters. This recent action puts us at an effective price increase of nearly 5% in the first quarter of 2024.

Our general and administrative expenses increased by $3.8 million to 11.5% of revenue in the fourth quarter of 2023 from 11.7% in the fourth quarter of 2022. The increase was primarily driven by higher variable-based compensation, higher advertising expenses due to our Chicagoland ad campaign, increased wages and benefits attributable to annual rate increases and the filling of open positions to execute our growth plans, partially offset by a decrease in equity-based compensation expense and insurance.

In 2024, we currently expect general and administrative expenses to be between $85 million to $87 million. Pre-opening expenses increased $1 million to 2.1% in the fourth quarter of 2023 from 2% in the fourth quarter of 2022. The increase was due to the number and timing of executed and planned new restaurant openings. We expect pre-opening expenses to be between $8 million to $9 million in 2024. Please keep in mind that our reported pre-opening expenses, as well as our estimates for 2024 includes deferred or non-cash rent expense as well as actual costs incurred prior to the restaurants opening.

All this led to adjusted EBITDA of $26.1 million in the fourth quarter of 2023 versus $18.1 million in the fourth quarter of 2022, an increase of 44.5%. Adjusted EBITDA includes an impact of approximately $2.4 million due to the 14th week. For the full year 2023, our adjusted EBITDA margins were 15% compared to 14.5% for 2022. Below the EBITDA line, interest expense was $6.9 million in the fourth quarter of 2023, a decrease of $1.4 million from the fourth quarter of 2022. This decrease was primarily driven by improved lending terms associated with our 2023 term loan and revolver facility.

As of today, our outstanding borrowings under the revolver are $13 million. Our effective interest rate was 8.4% for 2023 versus 10.4% for 2022. Income tax benefit was $0.4 million in the fourth quarter of 2023 and we had an income tax expense of $3.2 million for the year. Our effective tax rate for the fourth quarter of 2023 was negative 3.8%, driven by a change in our valuation allowance. Our effective tax rate for the year was 11.5% versus 9.6% in 2022. The increase in our effective income tax rate was primarily driven by an increase in the company's ownership interest in Portillo's OpCo, partially offset by a decrease in the valuation allowance and the recording of net operating loss carry forwards.

Our future effective tax rate will fluctuate as Class A equity ownership increases and as equity-based awards are exercised and vest. As a reminder, we invest our strong operating cash flows into our future by self-funding our new restaurant growth. Cash from operations increased by 24.4% year-over-year to $70.8 million for the year. This was primarily driven by solid revenue growth across the existing base of restaurants, the record number of new restaurant openings in 2023 and margin expansion. Note that in the fourth quarter of 2023, we pulled forward some capital expenditures to support activity for the 2024 pipeline. We're motivated to capture as many operating weeks as possible from our new restaurant openings in any year.

You may see quarterly CapEx spend flex based on timing of new restaurant openings. Having said that, we are committed to staying within the $6.2 million to $6.5 million average build cost range for the class of 2024. We previous previously shared that we have accelerated our timeline to bring restaurant of the future into Q4 of this year. And remember, these are expected to carry an even lower build cost.

In 2024, we estimate the CapEx range to be $90 million to $93 million, which will fund our 2024 openings and the first wave of our 2025 pipeline in addition to other operational CapEx needs. We are currently estimating that 85% of our 2024 projected CapEx will be spent on new restaurant builds, including early 2025 builds, 10% on investments in existing restaurants and 5% on other discretionary capital, including investments in our commissaries.

We are confident in the strength of our brand, our operational execution, and look forward to continuing to deliver on our long-term outlook that was provided in our earnings release this morning. Thank you for your time.

And with that, I'll turn it back to Michael.

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

Thanks, Michelle. Before we open for questions, I want to reiterate how pleased we are with the progress our team's made in 2023. We grew revenue and adjusted EBITDA by double digits. We generated record operating cash flow. We opened 12 new restaurants. We ended the year with positive traffic and multi-year highs in guest satisfaction. None of this is possible without our great team members. I'm extremely proud of them and thankful to our frontline folks who delight our guests every single day. I feel great about these results and I've never been more confident about our future. Thank you.

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now be conducting a question-and-answer session. [Operator Instructions] Our first question comes from Sharon Zackfia with William Blair. Please proceed with your question.

Sharon Zackfia
Analyst, William Blair & Co. LLC

Q

Hi. Good morning. Two questions.

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

A

Good morning, Sharon.

Sharon Zackfia
Analyst, William Blair & Co. LLC

Q

First, Michelle – good morning, Michelle, it sounds like you're probably not going to price away all of the labor and commodity inflation you're expecting this year. So if you could give some thoughts on kind of how do you think restaurant-level margin ebbs or flows this year, I think that would be helpful. And then, Michael, given the success of the marketing in Chicago, can you talk about what plans might be for marketing in Chicago this year and whether there are any other markets where you have density where that might make sense?

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

A

Yeah, Sharon, so I'll address the first question. On pricing, we haven't made any decisions yet. It's still early in the year on how we're going to approach pricing as we go into this year. As you know, we always take an approach that generally we want to set – offset our inflationary pressures with price. Having said that though, you all know that the consumer right now is a little bit shaky, and so we need to be careful in how we approach pricing. And so we're going to continue to assess how that consumer is, what the competitive landscape looks like before we make any decisions further on pricing.

In terms of your restaurant-level margin question, when we look at the portfolio on bringing in 12 new restaurants into the base this year, plus the 9 plus that we're going to open this year, we do expect to see some margin degradation from those restaurants. As you know, they don't come out of the gate doing 20-plus percent margins generally in year one. They're going to be in that high teens. And so, we do expect to see those restaurants impact restaurant-level margins as we approach this year.

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

A

Yeah. And then on – I think your question, it's marketing, but it's really traffic driving. So undeniably, we have a muscle that we use but we like to use selectively when it comes to TV and ad campaigns to drive traffic. It works really well in Chicago. I think we're approaching a scale where it could work for us in markets like Arizona and Indiana. And so, we certainly have that arrow in our quiver and we won't hesitate to use it if we need to. I honestly think though, Sharon, that the best way to drive traffic is operational excellence. We're already investing in that. We're already paying people to do that. So the difference between good and great is a guest comes back frequently or guest comes back less frequently. And so we think that being operationally excellent is probably the most important lever to use to drive traffic, but of course, we have advertising, we have new menu innovation, we have our PR machine. So we have other tools that we'll use to make sure that we're appropriately driving and balancing traffic versus expense.

Sharon Zackfia
Analyst, William Blair & Co. LLC

Q

Right. Thank you.

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

Sara H. Senatore
Analyst, BofA Securities

Q

Great. Thank you. Just I guess a little bit more of a deeper dive into that comp. So I guess you talked about catering. And so, I was curious if that was an outsized driver for the fourth quarter. I know that's a bigger share of the mix in the fourth quarter but just trying to understand to what extent is that a driver in the fourth quarter versus over time.

And then, as we think about the advertising in the Chicagoland, I guess the sort of perception has always been that your new markets tend to comp better than the core market. One, is that fair? And two, should we think about the fourth quarter being just maybe less of a drag from the Chicagoland comp or did you actually see traffic improve sequentially across all your markets?

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

A

Yeah. I'll take the catering question, Sara. So I would only say that as we were comparing catering this year versus last year, remember we had a little bit of weather impacts as we approach that heavy catering season for us in Q4 last year. And so, when we look at quarter-over-quarter, yeah, we did see a growth in catering from that perspective. But having said that, it wasn't out-weighted, I wouldn't call it anything out-weighted in Q4. But as Michael mentioned, over time, I think it is a real opportunity for us to push catering, particularly in our outer markets. And so that's we're going to – what we're going to continue to work towards is making sure that our guests understand that we have this channel outside of Chicagoland.

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

A

Yeah. Let me – and two little builds. One is I think the catering theme is part of a broader theme for us, which is we're incredibly proud of our multichannel capabilities and it's important to us that we are masters at flexing each one of those channels. There's a lot of folks right now who are trying to learn how to do drive-thru, people who are trying to get better at catering. We're really good at all of these channels. And so our goal is that catering, we think there's more opportunity, more tailwind and we look at the catering performance in the core versus in our growth markets, and we know that we can get better. And so that's one of the reasons I think we're excited about catering. We want that to be a stronger channel for us as drive-thru is, dine-in, delivery. So that's sort of the big picture.

Your second theme question, Sara, about trends. The trends were pretty consistent for us across all of our markets. I would say that we probably saw a little bit of an acceleration with the advertising campaign in the Midwest. So that certainly helped, but we had very, very positive trends across all of our markets for the fourth quarter.

Sara H. Senatore
Analyst, BofA Securities Q

Got it. Thank you very much.

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

Chris O'Cull
Analyst, Stifel, Nicolaus & Co., Inc. Q

Thanks for taking my question, and congratulations on a strong quarter. I had a follow-up question just on advertising. And Michael, I appreciate the need to drive frequency by delivering on the experience inside the store but just curious, why not have a more consistent advertising strategy in Chicago that keeps the brand top of mind really during important seasons for the brand?

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

First, thanks for the compliment. And I actually – I think we do, we're just not comfortable telling everyone exactly what we're going to do and when, to be totally honest with you. We have done – we have pulsed in and out of the Chicago market as appropriate and I think we will continue to do that. Like – and it doesn't – I'm not telling you anything that's state secrets, but like trying to advertise during an election cycle is a really tough spend. And so we're probably not advertising the back half of this year anywhere in the country. We would get shouted out by local politicians. So you can imagine that if we're going to advertise, we're going to do it selectively. We're going to advertise as necessary and when we think we're going to get great returns on those dollars. I don't want – Chris, I don't want to be formulaic and say, oh, I got to spend this much money on advertising in this quarter. We like to be more opportunistic when it comes to spending those ad dollars.

Chris O'Cull
Analyst, Stifel, Nicolaus & Co., Inc. Q

Okay. That's fair. And then when you look at the early sales curves of the 2022-2023 class of units, new units, do they continue to outperform your previous classes at a similar point in time, particularly those new units outside of Chicagoland?

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

Yeah, Chris, as you know, we put out at our Development Day how the class of 2022 was trending in that first year at that $8 million AUV level. Class of 2023 frankly, Chris, is really very new and young. So we opened six of the eight just in Q4 alone. So it's really too early to tell but I'll point to what Michael said, which is we're very happy about the performance, particularly when you look at those outer markets, he called out Fort Worth and Clermont, but really it's too early for me to make any commentary on the class of 2023 because it's just so new right now.

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

A

Yeah.

Chris O'Cull
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Yeah. Fair enough. Thanks, guys.

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

A

Thanks, Chris.

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

Brian H. Mullan
Analyst, Piper Sandler & Co.

Q

Hey. Thank you. Just a question on Texas. You're off to a great start in that market. Can you speak to how the Arlington and Fort Worth openings went? And out of curiosity, do you see any cannibalization effect at The Colony or at Allen that you could observe? And then related but separate, just talk about the entrance into Houston this year, and kind of what's the roadmap.

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

A

Yeah. So look, we're super excited about Texas. I've been consistent about how well – how great our response has been from people in DFW. We've gone from zero restaurants a little over a year ago to four open, the fifth is going to open soon. That's – I mean, we're really happy with that. The Colony had a ridiculously good first year and I think that's not surprising. We have a very strong brand, we have an install base, there was a lot of demand for us. And so I think that that first year you see a lot of visitation that's outside of a normal catchment. You have people driving 30, 40 miles. I mean, heck, we had people driving from Houston and Austin to visit us at The Colony. So that's of course not sustainable.

So we fully expected The Colony to slow down a bit this year and we're seeing that still performing exceptionally well. But Arlington, Fort Worth have gotten off to great starts. Those are great stars. Allen has been a little bit slower. You'll recall that it was, I don't know, maybe eight, nine months ago that mall that we're at had a shooting, and so I think that whole mall has been a bit depressed. It's still performing well. It's just not performing at the same pace as Arlington, Fort Worth or The Colony. So we're super excited about DFW. We're continuing to build in DFW and we're continuing to develop scale there.

We will open our first few restaurants in Houston this year, similar to Dallas-Fort Worth. I think that we're going to come out of the gate strong. All of the modeling that we have done, for what it's worth, says it's going to be every bit as good as Dallas is for us. And so we have great – we have some great locations. We took our time to make sure we have A-plus locations that have great visibility, great ingress, great egress, great demographics, tailwind population growth, sort of all the things that matter to us and I'm excited. I'm excited to see how Houston grows for us. I'm excited to get to scale very quickly in Houston.

Brian H. Mullan
Analyst, Piper Sandler & Co.

Q

Okay. Thank you for all that color. And then just a follow-up question on the Rosemont, Illinois location. I think you touched on it a little in the prepared remarks, but just elaborate a little how that second location is doing and maybe anything you're learning there relative to the first one. And then, when might you start to expect to deploy these formats a little more broadly across the system? I mean, could that be next year or should we be thinking a little bit longer term for that type of format?

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

A

Yeah. I – Joliet was fantastic. It exceeded all of our expectations when we built Joliet. That was the very first Portillo's pickup. Rosemont is doing well. We learned from Joliet. I think in the Joliet, we realized we overbuilt the kitchen. It was a little bit bigger. We probably under-built the amount of space necessary for teams. And I think, frankly, we underestimated how many people would walk up and order food and we were not quite as well prepared for walk-in business. So we tried to tweak all of that in Rosemont. Rosemont, I really want to – I want to stew on a bit to make sure that we've learned everything that we need to learn. Do we have the right kitchen line, do we have enough space for our team members, are we appropriately friendly to walk-ups and people who just want to come in and get their food and eat at the counter maybe. And so we're learning all of that and my expectation is that we'll probably have one more iteration to perfect the model, and then, we can hit go and grow aggressively.

Brian H. Mullan
Analyst, Piper Sandler & Co.

Q

Thanks a lot.

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

Andy Barish
Analyst, Jefferies LLC

Q

Hey, guys. Good morning. Yes, it was kind of more on sort of explicit guidance versus implied guidance. Michelle, you noted a couple of things on same-store sales, margins maybe down a little bit. New units are a little bit below the 12 to 15, but really, kind of distilling it down to adjusted EBITDA growth in the low-double digits. Is that a reasonable starting point kind of adjusting out the extra week for 2023? Just trying to kind of get a little bit closer to what really matters there.

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

A

Yeah. I think, Andy, as you know, we don't give short-term guidance. But we – as I mentioned in terms of the long-term growth algorithm, right, we're always going to be aiming to hit that as we look at any given year. I will say on the margins though, that yes, we have a lot of new units coming in and obviously we still have a lot of year to play out here but our operational teams are phenomenal in terms of just continuing to look for ways that we can become more efficient as we have these new kitchens coming online. As Michael mentioned in his prepared remarks, Kitchen 23 as we build restaurant of the future, even as we retrofit another 20-plus restaurants within 2024, I think we continue to look for operational efficiencies so that we can come back some of that margin pressures that we see from the new units, as well as getting to scale as quickly as possible. And I know we've talked to you all about that and continuing to do that so we can, again, buffer against any margin degradation, but that's just the fact, right. With the 12 from last year and the 9-plus this year. But look, I think if you look at how you expect the units to perform when you layer in the 9 units, et cetera, obviously again, I'm not going to give short-term guidance but it's something that we're always going to aim for. So that's what I'll comment on, Andy, without giving explicit guidance in 2024.

Andy Barish
Analyst, Jefferies LLC

Q

Right. That's very helpful. And it sort of dovetails into my follow-up I was going to ask. Last couple of years, you've kind of had a handful of really effective operational changes and productivity measures that Derek and the team have put in place. Anything, you're willing to share with us kind of in your back pocket for 2024 or is it really kind of around the labor deployment with the new [ph] kitchens (00:37:37) and the remodels and things like that?

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

A

I think it's the latter, Andy. I think you nailed it. Like -Michelle just I think probably gave more guidance than she wanted. Like we have 20 – we did 17 restaurants last year that we retroed in Chicagoland to do the grab and gos, to streamline the kitchen, to get some efficiency for our team members. We have another 20 we're doing this year. I mean that is very, very – that's real, it's helpful and it helps protect our margins.

Our new kitchens, the more we deploy these, the more we learn and the more excited we are. The shorter kitchen lines have improvements. They were seeing every little element of our staffing, our productivity getting better and better. And so, I think it's more of the same in what we did in 2023 on a go-forward basis. We're passionate about efficiency. We're sort of closet Lean Six Sigma people, and so, we want to get really great at that in our restaurants.

Andy Barish
Analyst, Jefferies LLC

Q

Thanks.

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

A

You bet.

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

A

Thanks, Andy.

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

Dennis Geiger
Analyst, UBS Securities LLC

Q

Great. Thanks, guys, and congrats on the results. Wondering if you could talk a little bit more about the traffic strength that you saw in the quarter and what that means for this year. Michael, I know you talked about a bunch of key traffic drivers. I assume all those are in play for 2024. Is there anything else to add on how you're thinking about traffic this year, given those drivers, given the momentum you had in the 4Q? Michelle, I know you kind of spoke to the long-term low-single digit comp, any other considerations, and how you are thinking at a high level about that traffic momentum broadly going into this year or for this year?

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

A

I think traffic is obviously really important and we take traffic trends very, very seriously. It's probably the most important health metric of an organization. And I would say, Dennis, like in my experience, the reason people choose to go to a restaurant is because of a past great experience. Think about where you all go when you want to go get something to eat for lunch or dinner, you're going to go somewhere that you said, man, I had a great experience there last time, and it was delicious and it's craveable. I think that's the healthiest way to be a consistent traffic driver.

Now, of course, you need to have an entire toolkit. And so part of our toolkit is – great experience is the preeminent one, but part of our toolkit is channel flexibility. If the weather is bad, you've got great drive-thru, we have great delivery, we have great catering. If the weather is great, we have beautiful restaurants that you can sit outside and enjoy. So having channel flexibility is really important to be a traffic buffer.

Having an ability to market aggressively and whether that's doing – we have some really entertaining quirky marketing campaigns coming up with our new salads. I think that's going to be awesome. I think it's going to drive visitation. I think it's going to drive incrementality to salad. And we've got two amazing new salads coming out that our guests love in the test panels, in the test kitchens and in our restaurants and our investors are going to love because they're – they mix a little bit higher price point and better margins.

So I think those are the kind of things that a company needs to do, and it's – there's no one lever that's the magical lever that you pull all the time. You have to be balanced in what levers you're pulling and our commitment is we will use whatever levers are necessary to make sure that we have a healthy level of transaction growth.

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

A

And I'll just add on to that, Dennis. One of the things that we know is very powerful is having digital menu boards...

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

A

Yeah.

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

A

...in our restaurants. And so to Michael's point earlier on, you don't have to have a massive ad campaign but we found that to be effective, whether it's in the core or outside of the core, how we market Portillo's [ph] or (00:41:53) market certain things on those menu boards I think matters. And we talked to you all about Portillo's classics and Portillo's pairings and how we pivoted into that advertising within the back half of last year, and I think there's some opportunities to utilize those assets within our restaurants...

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

Yeah.

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

...to drive home whatever messaging we want, whether that's the new salads or other things. So I think that's a powerful tool as well.

Dennis Geiger
Analyst, UBS Securities LLC
Q

That's great. Thanks, guys. And then just one more. As it relates to I guess, Michael, you talked about the strength in the guest satisfaction scores to all-time highs, which is terrific about the strength I think across channels. Anything else as it relates to what you saw with your customer behavior changes that helped support some of that traffic, whether it's dayparts, days of the week. Anything else that you would flag there that you maybe saw that was a shift in the fourth quarter versus prior quarters? Thanks very much.

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

It's a great question, Dennis, but I think that I would say it was a broad-based improvement. It was not dinner versus lunch or weekends versus weekday or anything like that. It was – no unique segments of consumer. It was pretty broad-based and we feel really good about that.

Dennis Geiger
Analyst, UBS Securities LLC
Q

Terrific. Thanks, again.

Operator: Our next question comes from David Tarantino with Baird. Please proceed with your question.

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

Hi. Hi. Good morning. Two different questions actually. One, it sort of dovetails off some of the comments you're just making, Mike. I was just wondering, on traffic whether you think speed of service is a big opportunity for Portillo's and is that something you're focused on more so going forward than in the past or I'm just wondering what your thoughts are on that as a potential traffic driver?

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

Well, I mean, for sure, David. It is one of – I don't know, that might be my secret sauce that we didn't want to talk about, but yes, we have a very strong emphasis internally on speed of service even to the point where, look, we know exactly what our service times are in the drive-thru. A 30-second improvement in the service time in the drive-thru represents a 1% comp. When we're packed, that is incremental and the incrementality of that revenue flows through remarkably well. So we are – our operators right now are maniacally focused on speed of service. Number one in the drive-thru. It's less relevant frankly on dine-in. Still important but just it doesn't have the same impact as in the drive-thru. And so absolutely speed of service matters, how fast you get guests in and out matters, not just their perception of the time and how happy they are with it, but literally the math of getting them in and out and moving the next person and it's – drive-thru could be almost infinite capacity if you're fast enough.

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

Q

And I guess...

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

A

So, yes, a huge emphasis for us. We don't like to talk about it, we'd like to just do that.

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

Q

Okay. I thought that was going to be your answer. But I guess my follow-up to that is, I guess, where are you on speed of service now versus maybe where you were previously? And is this a bigger opportunity now that you have more new locations and new markets that maybe you have less experienced operators so to speak? I guess how do you think about kind of where you are now and maybe where you want to be at the end of this year or next year or the following year so to speak?

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

A

Yeah. I think you want to separate speed of – I think there's two ways to think about speed of service. One is, what do customers say in terms of their satisfaction on speed of service. That is their perception which matters and it makes them happy or not. Then there is something on speed of service just the absolute time it took you to get a guest through your drive-thrus. I think we have material room for improvement there. We're nowhere near when we were at our best and it's always a balancing act. When you focus purely on speed, there's a tendency to perform less well on accuracy, on all these other things that really matter. So for us, it's what's hugely important is, sort of the old adage of walking and chewing gum at the same time. So we need to be fast, but we also need to be accurate and friendly. And so those things are always a balance. I think we have perhaps pushed accuracy and friendliness to the detraction of speed a little bit and it's – and that's – we'll will rejigger that, we'll rebalance that and hopefully that's a traffic driver for us this year as well.

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

Q

Great. Thank you for that detail.

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

A

You bet.

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

Brian Harbour
Analyst, Morgan Stanley & Co. LLC

Q

Thank you. Good morning. I had just a couple of margin questions. Was the timing of the openings in the fourth quarter kind of consistent with what you planned or could you shed any light on what the timing looked like? And was there any sort of impact on 4Q versus like what you might expect in 1Q 2024 from a margin perspective?

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

A

Yeah, Brian, no it was as expected, our openings. You can look whether it's in the 10-K or the earnings release. We give the [ph] bumps (00:47:35) that we opened those restaurants. So you can see heavy into November and December when you look at the openings there. And so yeah, as you look at again those coming into the first quarter, right, always within that first, call it, six-month time period, Brian, right. You're still going to be heavy on the training, heavy on the labor side, heavier on the inefficiency side, whether it's labor or on the food side. And so that's where you'll see I think a little bit more of the impact would be in that first part of 2024 versus the back half. But then remember, we start to layer in then [ph] with the (00:48:12) new class of restaurants, one in Q1 towards the tail end of Q1 of this year and then two to three in Q2, et cetera. So yeah, I think you'd see a little bit more out-weighted impact from those six, particularly in the class of 2023 coming into Q1 and Q2.

Brian Harbour
Analyst, Morgan Stanley & Co. LLC

Q

Okay. Yeah. It makes sense. And then just on your food cost ratio, I think it was a little bit higher than I would have thought in the fourth quarter relative to kind of what you said inflation was. Were there any product mix drivers of that or anything we should keep in mind? And then into the coming year, would you expect pretty even inflation throughout the year? Anything we should keep in mind just with regards to food cost?

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

A

Yeah. I'd say, Brian, the 4.4% in Q4 was right about where we thought it would be. Maybe just a hair higher, but nothing that I would call out in terms of what we were thinking versus where Q4 came in at. When we look at 2024, I think, Q2 looks to be a little bit more heavier impacted for us, just based on again, these are projections based off of our basket of goods and where we think some of the pressures might come into play in Q2. And then Q3 and Q4 will be a little bit more moderated. But yeah, I'd call it more Q2 as maybe being a little bit heavier impacted. At least that's what we're seeing today.

Brian Harbour
Analyst, Morgan Stanley & Co. LLC

Q

Okay. Thank you.

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

A

Yeah.

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

Gregory Francfort
Analyst, Guggenheim Securities LLC

Q

Hey, thanks. I have two questions. The first, I know you guys don't like to talk short-term, but Michelle, maybe can you address what the 53rd week? Is there a comp impact to the first quarter just based on laps? And any thoughts on kind of rightsizing expectations for how much weather might be impacting you early in the quarter?

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

A

Yeah, Greg. So the comp, there's no impact. So our comp is actually a 53-week comp number, that'd be 4.4%, and we did that purposefully because that 53rd week has Christmas in it. And so when you look at it, if we were to do our 52-week comp, it would have skewed the comp a little bit higher in Q4. And so that's where we reported a 53-week comp in the fourth quarter because we felt that was more honest in terms of what's the true nature of the business doing actually in the quarter. So therefore, when we come into Q1, Greg, there is no impact because we're going to continue to be comparing like-for-like weeks that – Jan 1 week, starting Jan 1 week in 2024 to starting Jan 2 in 2023. So no impact in terms of whether you think about holidays, et cetera, on the comp.

To address your question on Q1 of this year, absolutely we are not immune to the impacts that the industry have seen on weather as well as how the consumer is feeling as we look at not just performance in January but performance in February, but I'll come back to we feel really good about the health of the business to Michael's point. And regardless of how choppy the comp may be in Q1, not just for us but the rest of the industry, we feel really good about the health of the business, the trends that we were seeing outside of a weather impact in January. And so that's what I would say about Q1.

Gregory Francfort
Analyst, Guggenheim Securities LLC

Q

Got it. Thanks. And then, Michael, maybe just – I think you now have, what is it, five stores in the Phoenix market. Can you talk – sorry, there's a horn honking behind me, just can you talk a little about the Phoenix market? I think you now have five stores there. What has changed as you hit maturity? What benefits are you getting as you scale up that market?

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

A

Yeah.

Gregory Francfort
Analyst, Guggenheim Securities LLC

Q

It seems like you're now maybe hitting a path where other markets are looking to go? Thanks.

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

A

Yeah. You bet, Greg. So we have we have seven restaurants in Arizona, six are in the valley area, and one in Tucson. And so, we are approaching scale and Michelle gave a little dissertation on the impact of scale in Arizona, when we went from two to four. And just the demonstrable margin improvement that we had but scale allows us to leverage the cost side of the P&L really quickly. It's a wonderful dynamic because you get supply chain, distribution and even some staffing synergies when you have scale.

The second thing that it does for us is, it creates some revenue synergy because now when you're craving a Portillo's beef sandwich dip with hot peppers on that delicious crusty bread, you have one relatively close. You don't have to drive 45 minutes to the one on the other side of the valley or the only one that you know of. There's something a little closer. And so there tends to be a revenue synergy once we achieve scale. We're at the early stages of scale in Phoenix, and we're still planning more restaurants in that market. We've got – I don't know, but we publicly announced we're going to – we're definitely building more restaurants in that market to leverage that scale that we're getting. So you'll see it across the P&L, in terms of revenue, but you will also see it in margin improvement, and that's – they're both super exciting things.

Operator: We have reached the end of our question-and-answer session. This concludes today's conference. Thank you for your participation. You may disconnect your lines at this time.