

07-Dec-2022

Portillo's, Inc. (PTLO)

Morgan Stanley 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.

OTHER PARTICIPANTS

John Glass

Analyst, Morgan Stanley & Co. LLC

MANAGEMENT DISCUSSION SECTION

John Glass

Analyst, Morgan Stanley & Co. LLC

All right. Good afternoon, everyone. John Glass from Morgan Stanley here. Before introducing our next restaurant fireside chat, let me do the obligatory for important disclosures, please see the Morgan Stanley Research Disclosure website at [morganstanley.com/research disclosures](https://morganstanley.com/research-disclosures).

It's my pleasure to introduce and have with us on stage Portillo's, Michael Osanloo who is the Chief Executive Officer; and Michelle Hook, the Chief Financial Officer of Portillo's.

QUESTION AND ANSWER SECTION

John Glass

Analyst, Morgan Stanley & Co. LLC

Q

I thought, Michael, it would be good since we are in New York and this is a Chicago brand and you are a relatively recent public company, is to talk about what is from an investors lens, what is a Portillo's, what is different about Portillo's? And then we can talk about the growth and all those things that we care about.

Michael Osanloo

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

A

Excellent. First, let me dicker with your characterization of a Chicago brand. We're a national brand that happens to be based in Chicago, but it's a great question. We like to think of ourselves as the finest of Chicago street food. So we are Italian beef sandwiches, which if you never had and sounds like an exotic dish, it's basically a roast beef sandwich with arch. It's amazing. We have Chicago style hot dogs, fries, onion rings. We sell \$600,000 worth of salad per unit, all freshly made, hand tossed salad. So we are iconic Chicago food. Our average unit volumes are \$8.4 million, right with mid-20 level restaurant level EBITDA margins. Our average person spends \$9.75 at a Portillo's. We have double lane drive-thrus. We were multichannel before it became a concept. So we have a robust dine-in business. We have phenomenal drive-thrus and then we do all of the off-premise stuff, right? So we have our own delivery. We have third-party delivery. We have a robust catering business. And we have the sneaky little shipping business. People gift Portillo's all the time. So we ship to all 50 states in the country. So that's sort of my synopsis of what Portillo's is.

John Glass

Analyst, Morgan Stanley & Co. LLC

Q

Got you. Thank you. I think it's important. And even as you describe it, it might be still hard for one to imagine. I mean, these boxes are – how, you know, the average square footage of Portillo's is it's probably 8,000 square feet.

Michael Osanloo

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

A

8,000 square feet.

John Glass

Analyst, Morgan Stanley & Co. LLC

Q

Yeah.

Michael Osanloo

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

A

Right? So, doing, you know, close to in some cases \$10 million a box in Chicagoland. You're right. It's a national brand, but it is a Chicago roots and therefore best known there. So I think you have to sort of see one to really understand the size, volume, the energy, the artistic elements of the box. Well, you know, just think about it, John, right, like, our average unit volume in Chicagoland is \$10 million. So at \$10 million and \$9.75, that's a lot of transactions. That's a lot of people going through our restaurant, right? We're not a high-end steakhouse where the average ticket is \$150 bucks, \$9.75.

John Glass

Analyst, Morgan Stanley & Co. LLC

Q

And so just describe that further. Just – sorry. You got me going on this now, but your kitchen, your kitchen staff, how many people alone in the kitchen are there?

Michael Osanloo

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

A

So, look, a typical Portillo's might have anywhere from 80 to 120 full time staff hired. And at any one time; you could have 20 to 30 people working in our restaurants, right? The vast majority are in the kitchen. We have a couple of people out in the dining room cleaning, maintaining, et cetera. But in a busy restaurant at lunchtime or dinnertime, there's probably 20 to 25 people working in the kitchen.

John Glass

Analyst, Morgan Stanley & Co. LLC

Q

Yeah. So I want to ask before talking about development which I think is sort of the underpinnings of the story as we think about this and growth, I want to just pause though and think about technology for a moment.

Michael Osanloo

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

A

Yeah.

John Glass

Analyst, Morgan Stanley & Co. LLC

Q

We hear a lot of brands talking about technology having an increasing level of relevance in their business.

Michael Osanloo

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

A

Yeah.

John Glass

Analyst, Morgan Stanley & Co. LLC

Q

How is it relevant to Portillo's? How important is it to your business and if you compare it to maybe some of the other companies you've worked with in the past you think it's technology-led, technology-enabled. How do you think about the role of technology?

Michael Osanloo

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

A

I think you need to be very thoughtful and somewhat cautious about the role technology plays in your business. I think in the restaurant concept, if technology is enhancing the guest experience, it's generally a good thing. If the technology is in general, easing the effort of your team members, it can be a good thing. But look, I don't want to become a glorified vending machine, right? So there's a point where you put kiosks in, you've automated everything, you're a glorified vending machine and you can't justify your price points. So we believe in technology that eases the guest interaction, which means what? It means I want to make payment as simple as possible, right?

So we're being smart. We're catching up. We're making it so that you can basically use any payment technology that you want to pay. I want to make the ordering process as streamlined and easy as possible. I still believe that we are beneficiaries of having human beings take the order because we can curate that order. So you've experienced us. If you go to a Portillo's and you want an Italian beef sandwich, a human being will say what kind of peppers would you like on that, because from a culinary experience, the peppers make it a better sandwich. It's better eating. It's also good for my investors because the peppers are an add-on, an additional ring. If you order and you don't order dessert, our order takers will say, would you like a slice of chocolate cake? And if you look confused, they'll tell you, you know, we make fresh chocolate cake every day.

John Glass*Analyst, Morgan Stanley & Co. LLC*

Q

Right.

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

A

So, that's really important to us. But if the technology is eliminating needless work, so we like automating a lot of prep, right; like chopping onions in the morning, chopping tomatoes in the morning. We get Polish sausages. We cut them up. We're getting out of that. We're using automation and our suppliers to buy onions that are pre-sliced and vacuum-sealed. They're beautiful. They're fresh. They taste good. You only open a bag when you need it. You eliminate waste. You don't have people putting on cut gloves, sharpening knives, doing low-value added labor, but the human interaction is still really important. And so I'd say we're being appropriately thoughtful on that. Michelle like what is that your story you say about the kiosks?

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

A

I always tell; I pointed, as I said, this is a kiosk.

John Glass*Analyst, Morgan Stanley & Co. LLC*

Q

Right.

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

A

We all have a kiosk in our hand. Right? So if you want to do – you want to think about line busting, so to speak, you can do things like that. You all see it in restaurants where you use QR codes, exciter right to do things like that. I think there's opportunities, John, as we move forward to look at things like that and how technology plays into the world that we live in. I think that does play a role as we move forward but we have all the bells and whistles on digital ordering. We smart partner right. We're not going to be a shop that's going to all of a sudden create that experience for you. We're going to smart partner with those that do it best. And so we have all the digital capabilities to online order. You want to order from your phone, you want to pick it up at Portillo's, have at it, right. Third-party delivery companies we're partnering with from that standpoint.

So, the technology, even for our team members, to Michael's point that we use in the restaurants, it has to make it seamless for our team members to fulfill the order as well because as Michael said, we got a lot of volume pumping through our restaurants. So we have to make sure that we're built for speed and using that technology even for our team members, I think, is equally as important as to Michael's point, the guest experience is super important as well.

John Glass

Analyst, Morgan Stanley & Co. LLC

Q

Yeah. And you raised just one other on technology. What do you think about third-party delivery? How important is that to your business? How operationally complex is it to your business? Is it additive?

Michael Osanloo

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

A

Yeah. You're putting me in a bad place, John.

John Glass

Analyst, Morgan Stanley & Co. LLC

Q

I know, but you know...

Michael Osanloo

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

A

Yeah. It's a thing, right? People, and especially during COVID, I think people really got comfortable and acclimated to having food delivered. And that's clearly a valuable service that some people really value. The dark side is that in some cases you might be paying almost double what it would have cost you to go get it yourself. So it's a mixed blessing. So the third-party delivery companies we work with, there's a markup on the food. We remain margin neutral. So we price it so that my investors are not taking a hit because of the third-party guys. So we're margin neutral. The food can take 45 minutes to an hour. You guys know like food dies very quickly. French fries in the restaurant are amazing. You order French fries through the drive-thru. I guarantee you you're going to eat them on the way home. You're not going to wait. French fries delivered different story.

So I think, we participate. It's still on a growth trajectory. But I would encourage guests, you want to get the best experience possible and you want to get the greatest value possible, go through our drive-thrus. Our drive-thrus – our double lane drive-thrus are built for volume and for speed. And so when a guest goes through the drive-thru, you're getting your food within 6 to 8 minutes. It's the lowest possible price. It's the highest food integrity and you get the best experience. But we partner with the third-party delivery guys. We do our own delivery. For orders over \$100, we deliver ourselves. Because I can get a team member to go do that. The economics work at that price point for us, because the team member gets a great tip. They love it. The guest gets a great experience because you get a little bit more of a white glove experience when Portillo's is coming and we're bringing in like all the napkins, and the forks and the knives, and the sides, and the condiments, and we kind of help a little bit. And I worry about what happens with the third-party delivery in a recessionary environment.

John Glass

Analyst, Morgan Stanley & Co. LLC

Q

Yeah. I would as well. I'm going to turn to development...

Michael Osanloo

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

A

Yeah.

John Glass

Analyst, Morgan Stanley & Co. LLC

Q

...which is the big story for Portillo's. I first want to just paint us this picture of where you are on the map right now. And when you arrived, kind of what the development plan is and how you've changed it philosophically, how you today think about development versus a few years ago?

Michael Osanloo

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

Yeah.

A

John Glass

Analyst, Morgan Stanley & Co. LLC

What's the Portillo's map look like today?

Q

Michael Osanloo

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

Well, I think the original Portillo's map was what I would call as a – we like to be food punny, but it was like a cheese sauce spill, right? We start in Chicago. If you pour a big tub of cheese sauce, it just kind of emanates. So it was very much just a Midwest. And there's merit to that, right? The brand has resonance. People know it. There's not as much of a psychological barrier to understanding the food. People from Michigan, Wisconsin, Minnesota, Iowa, they visit Chicago and they've experienced us. So that's a great dynamic and there's still merit to continuing to expand from a core.

A

The vector that we have added and I think very thoughtfully is a strategy to grow along the Sun Belt. You will see that of our seven restaurants this year, five are between Florida, Texas and Arizona. We're committed to the bulk of our growth going forward coming across the Sun Belt; and it's a really simple reason why. Florida, Arizona and Texas are the three fastest-growing states in terms of just total population, right? We're building a restaurant in Gilbert, Arizona, that is forecasted for population growth of 10% to 12% a year for the next five years. Being inherently lazy, I like rolling out of bed and knowing I've got a 10% comp in Gilbert without having to do anything. So, we're focusing on that. Those states tend – they have growth. They tend to be a little less expensive to develop and build. They tend to be a little bit easier. The labor markets in those states tend to be a little bit more robust and so we're building.

I'm cheating. I also know that our brand has resonance there. We have done studies on aided and unaided brand awareness and we're building outside Dallas, Texas, and in the metroplex. We know that Texas is the number one place we ship our food to. There's a Facebook page for DFW with thousands and thousands of people saying, please bring a Portillo's to North Texas – North Dallas. So yeah, we're going to be very thoughtful about that and go where the demand is and where there's macroeconomic factors in our favor.

John Glass

Analyst, Morgan Stanley & Co. LLC

And just remind us again, either Michael or Michelle, the difference between volumes, Chicagoland versus non-Chicago, what has your experience been versus that pro forma, right, so we all understand kind of what you've done?

Q

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

Yeah. When you cut the number of stores, Chicagoland restaurants are generally \$10 million AUVs and 30% margins. Outside of Chicagoland, you're doing about \$6 million AUVs and about 20-ish percent margins. When

A

you even cut that data further, John, and this is one of the cuts we gave at our Investor Day about a month or so ago was a lot of folks say, well, okay, like Michael said, that cheese sauce spill, right? You have brand awareness in the Midwest markets. And so when you cut the Chicago side, right? When you cut the non-Chicagoland markets even further and you look at our restaurants in California, Arizona and Florida, they outperform those restaurants in the Midwest. So those restaurants are trending at \$6.4 million AUVs in a higher margin than those that are within the Midwest outside of Chicago. So to Michael's point, we know this brand travels and it resonates with folks outside the Midwest because a lot of times people say, well, of course you have Chicago expats in those markets, right? Well, we have examples where we have very high performing restaurants that are not in areas that have Chicago transplants. Tempe, Arizona, is a college town that we talk about. That restaurant performs extremely well and that's not full of Chicago expats.

John Glass

Analyst, Morgan Stanley & Co. LLC

Right.

Q

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

So I think there's good data points out there that tells us and should tell everyone here that this brand travels and resonates outside of just Chicagoland.

A

John Glass

Analyst, Morgan Stanley & Co. LLC

And is there anything you've learned along the way the way there or maybe examples of markets that you've gotten into prior to your rival? I'm thinking about California, I'm thinking about maybe some of the...

Q

Michael Osanloo

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

Yeah.

A

John Glass

Analyst, Morgan Stanley & Co. LLC

...west where it didn't maybe work out – you never closed restaurant, but maybe not as well as you thought, what you learned from that?

Q

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

Yeah. Yeah.

A

John Glass

Analyst, Morgan Stanley & Co. LLC

What's your observation?

Q

Michael Osanloo

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

I think that – I try to be a student of history because I don't like repeating mistakes. I make mistakes all the time. I just like to learn from them, make new ones.

A

John Glass

Analyst, Morgan Stanley & Co. LLC

Right.

Q

Michael Osanloo

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

So I went to school on my predecessors. And I would tell you in the development pipeline, the biggest mistakes that the company made was there was a certain level of arrogance in building outside Chicagoland. Here's the truth. We go build it anywhere in Chicago and go build in a parking lot behind a defunct mall; and it's going to do \$8 million to \$10 million.

A

John Glass

Analyst, Morgan Stanley & Co. LLC

Right.

Q

Michael Osanloo

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

Okay. Don't kid yourself and think that makes you really smart about where real estate locations. And so we had to approach real estate decisions outside our core with a level of humility that we were not doing before. And so we got a whole new team on development. We use analytic toolkits to identify locations. We have brought in a world-class Chief Development Officer dealmakers, and we're super selective. Like, I say no more than I say yes on sites outside Chicagoland, and there should be, at this stage in our development, no compromise. We want A+ locations only. So what does that mean for Portillo's? It means we need to have 2-plus acres because we need that big, double-lane drive-through. We need 100-plus parking spots. We need some co-tenancy. We're a destination in most places. I don't want to rely on being a destination as we're expanding outside our core. I would love to be near a Costco, Whole Foods, be near Meyer in Michigan, be near – pick your great retailer, but co-tenancy is important. We don't want to rely on being a destination to be successful.

A

You need great visibility. You need great ingress and egress. And so we have gotten really disciplined about site location, site characteristics and about saying no. And I think we're seeing that, like we built a restaurant about 18 months ago in Orlando, Florida, that is approaching Chicago-level performance. It's just a killer location, right? It's not like there's a ton of Chicago expats outside Orlando. Of course we're getting the tourist benefit.

John Glass

Analyst, Morgan Stanley & Co. LLC

Yeah.

Q

Michael Osanloo

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

But we planned on that, right? We're on the right side of the road as you're heading into Disney. We aggressively market the fact that we have this beautiful outdoor terrace with a beer garden. So if you've been to Disney, you're tired of paying \$10 for a bottle of water, you're exhausted; you go get a great, value-driven meal with abundance and as an adult, you can have a beer and relax. And so we're being very thoughtful about that.

A

John Glass

Analyst, Morgan Stanley & Co. LLC

Q

It sounds good to me, having been through Disney when my kids were younger and you weren't there. Can you talk about – before leaving development, let's talk a couple of things. One is you do have a new Chief Development Officer, right?

Michael Osanloo

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

Yeah.

A

John Glass

Analyst, Morgan Stanley & Co. LLC

And he is coming up with an inflationary environment.

Q

Michael Osanloo

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

Yeah.

A

John Glass

Analyst, Morgan Stanley & Co. LLC

And so two questions really is one is how you're mitigating the cost inflation of your box...

Q

Michael Osanloo

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

Yeah.

A

John Glass

Analyst, Morgan Stanley & Co. LLC

...of your building. And, two, how has these new executives reshaped how you think about design, location. What new insights have you have you gained in the process of development from this?

Q

Michael Osanloo

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

Yeah. Both great questions. So his name is Mike Ellis. He's got a storied background. He's been Chief Development Officer multiple times at multiple restaurant concepts. So we're thrilled to have Mike on board and he presented at our Analyst Day. The first part of your question, like, think about the restaurant and I actually have Michelle and my Chief Marketing Officer leading an initiative we call Restaurant of the Future, right because restaurants are evolving. There's these secular shifts in how people want to use a restaurant. The off-premise business is growing. And so you just want to make your restaurant as frictionless as possible for how our guests wants to use it. So we're putting parking spots right outside an entrance for the third-party delivery guys and anybody who wants to do pickup. We're making the pickup shelves right there with the back to the kitchen so you can stuff the food. We're adding third lanes and drive-thru to see if that helps with stacking and mobility.

A

We're being thoughtful and shrinking the kitchen footprint not – I don't want to give up the capacity. I still want to be able to do ridiculously high volumes, but like we have equipment that's duplicative, et cetera. So they're leading a team of what the restaurant of the future looks like, which is streamlined, and we'll start deploying elements of that in the 2023 build.

We think that takes costs out of the restaurant. I want to be careful about terms like value engineering. I don't want to take anything away from the guest experience. I want our restaurants to still be engaging and inviting. We compete with casual dining because we build beautiful restaurants, right? It's balance sheet marketing. We don't discount, don't spend. We spent like less than 0.5% on marketing because we don't need to. So, that's a part of it.

And then, what Mike is bringing, which I love, is he's bringing a discipline on how to use general contractors versus self-contracting. Here's how to think about when to stage the buy. He's being a lot more pragmatic on the timing of our builds. And there are some things that are just like the permitting process, the approval process with municipalities. It's kind of out of our control. And I think we were being a little optimistic in how we budgeted time. And he's like, I can't commit to this, Michael. We need to just be pragmatic. Here's what's going to happen.

He's also gotten us really focused on and disciplined on growing our development pipeline further out. So like this time last year, I was hopeful we'd get our seven in, but I wasn't certain. I'm rock solid about the 2023 pipeline, and that team is now aggressively developing the 2024 pipeline and beyond. We were not as farsighted before.

John Glass

Analyst, Morgan Stanley & Co. LLC

Q

What happened? I'm sorry, let me just be clear...

Michael Osanloo

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

A

Yeah.

John Glass

Analyst, Morgan Stanley & Co. LLC

Q

...and that be. So, first of all, let's rewind. We're in 2022, you had a big fourth quarter or, I mean, a big fourth quarter.

Michael Osanloo

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

A

Yes.

John Glass

Analyst, Morgan Stanley & Co. LLC

Q

Five openings?

Michael Osanloo

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

A

Five openings.

John Glass

Analyst, Morgan Stanley & Co. LLC

Q

Five openings?

Michael Osanloo

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

A

Yeah.

John Glass

Analyst, Morgan Stanley & Co. LLC

Q

How are you – look, I know the world has gotten difficult.

Michael Osanloo

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

A

Yeah.

John Glass

Analyst, Morgan Stanley & Co. LLC

Q

How do you feel about those five?

Michael Osanloo

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

A

Yeah.

John Glass

Analyst, Morgan Stanley & Co. LLC

Q

And then when you talk about 2023, feeling really good about 2023...

Michael Osanloo

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

A

Yeah.

John Glass

Analyst, Morgan Stanley & Co. LLC

Q

...what really changes the pacing? Hopefully, you're going to get them all open. But is it the pacing of which you're going to get them open you feel better about?

Michael Osanloo

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

A

No, I'm still – I'm not thrilled with the pacing of upgrade on 2022. Everyone – we have like – we have two restaurants that are built. We're training in them. We have two restaurants that are just waiting for final inspections. And the fifth restaurant might leak a couple of weeks into January. But it's fine. So I feel good about that, but it was a bit of a stressful fourth quarter to get there.

John Glass

Analyst, Morgan Stanley & Co. LLC

Q

I'm sure, right.

Michael Osanloo

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

A

And I really – your fourth quarter in this business, you really want to focus in on operations. You don't want to be – because we make a lot of money in the fourth quarter. And so I'd rather be focused on that. The 2023, what Mike basically said is, look, these permitting, permitting dynamic in municipalities has just fallen off a cliff. And so we are budgeting significantly more time to get approvals, permitting, et cetera. So unfortunately, 2023 is so back half loaded, not as far back half as 2022, but still back half. And I would like when we put capital into the dirt like it is early in the year as possible...

John Glass

Analyst, Morgan Stanley & Co. LLC

Q

Yeah.

Michael Osanloo

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

A

...so that we can get some return in period, right? And so 2024, my pipeline already looks better because it's more front half loaded. So, that's work.

John Glass

Analyst, Morgan Stanley & Co. LLC

Q

And then just on development, the shelf costs. Remind us what costs were or the capital was to build and where it sort of stands today? And do you think you can go backwards in those cost or is it a lot of what you're doing avoiding sort of future cost increases? So, look, we've all stepped up in the world...

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

A

Yeah.

John Glass

Analyst, Morgan Stanley & Co. LLC

Q

...of cost base, but maybe you can mitigate further inflation.

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

A

Yeah. We were at this point last year looking at \$4.5 million to \$5 million of build cost for our restaurants. For the 2022 build, John, we're looking at \$5.5 million to \$6 million. I think as we look at the 2023 builds, I do expect costs to mitigate somewhat. But they're not going to come back to the \$4.5 million, \$5 million levels...

John Glass

Analyst, Morgan Stanley & Co. LLC

Q

Yeah.

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

A

...that I saw a year plus ago. So we know that that's going to be the case, right? To your point, it'll come down some, but it's not going to come all the way down to levels that like I saw over a year ago. So to Michael's point, we're doing some things, restaurant of the future is more 2024 and beyond, but we're doing some things that

we're calling it within our Kitchen 23 project, that is going to reduce some equipment costs within the restaurant build in addition to help out with labor, et cetera.

So we're trying to control some of the things we can control, knowing that you're still going to have slightly elevated costs within 2023. And then who knows beyond that? But at least that's what I'm seeing today. And we're going to do our best to mitigate against those. But at the end of the day, right, we – it's not going to prevent us from building those restaurants. The return profile for Portillo's still remains the same. We're still committed to by year three, that 25% cash on cash return. At this point last year, I didn't think I was going to have to take pricing the way that we had to do this year more, not as much as others, but for us an 8% price range. So, the equation changes a little bit between build costs and the top line in the flow-through. But we're still committed to the return profile.

John Glass

Analyst, Morgan Stanley & Co. LLC

Q

Thank you. I want to talk about operations, right, which is vital to this business probably more than others, just given I think we talked about this 25 to 50 people per shift. Managing that sizable crew is difficult. Can you just talk about, one, is labor productivity, how you measure it? I think you have your own metrics and how you look at labor productivity?

Secondly, during 2022, I think you've made some pretty important changes that will improve labor productivity. So, first, just talk about how you measure it an importance and then maybe we can talk about how you're improving that labor productivity.

Michael Osanloo

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

A

Yeah, I think the cleanest measure of labor productivity is items per labor hour, right? It's just how much stuff are you producing per labor hour? There's always a little bit of noise because this restaurant sells more this or this. But once you establish a baseline, it's really easy to look at. I don't like sales per labor hour because you inflate that away and you think you're doing good, but you're really not. And it's – it gets your operators focused on the wrong stuff.

It's how much stuff are you producing per labor hour. So, we look at that. We look at that very carefully. Our labor productivity and no secret, everybody knows this, but happy people are more productive. And so we actually work really hard on taking care of our team members, right? I believe in what I like to call enlightened capitalism. Frontline people at Portillo's, our most important asset, and so we take care of them.

We've raised wages significantly over the course of the last two years. We have a benefits package. They're super competitive. We are a values-driven organization and we believe in our values. Culture is really important to me, and we train and develop the heck out of our people. If you see a manager in a Portillo's walking in the morning, they're greeting everyone. Hi, John. How are you? At the end of a shift, they're thanking people for their performance.

And I'm saying all this because this actually drives productivity, right? Our productivity is we had very, very good productivity during COVID, but our productivity now is higher than any time in 2019 and before. People just work a little harder because they're happier, they're trained, they're well-developed. We also spend a lot of our time on training and cross-training folks. So if you know if you work at the beef station and you're great at making beef, it's awesome. We have training programs so that you can learn to slide over what we call table, which is where you

make hot dogs. And by the way, I'll pay you more once you get cross-trained and you are certified that you can work at hot dogs.

You want to get paid more, then learn how to go work fries and drinks. Even more, go learn how to front cash, take orders inside and outside. But there's an element of pay for performance that we think makes our team members more productive. They get paid more and it allows us to be much more nimble in staffing and how we do that. And so that's been a huge, huge unlock for us.

John Glass

Analyst, Morgan Stanley & Co. LLC

Q

There was some talk about sort of this goes back maybe a little bit to development, too, but just reorganizing the kitchen to where historically there were some built in inefficiencies that we made salads or the way different item. Can you just describe kind of what it was and what this goal to improve kitchen efficiency is?

Michael Osanloo

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

A

Yeah, I'm going to humble brag about our COO here, right? He's a deeply experienced guy, came from Starbucks. I just ask for crazy things. So I'd say, how did you get me labor productivity?

It's like, I can't just squeeze ours out, Michael. I got to do something to change the operating model so that it requires less hours, Mike. Fine, do whatever you want, just get me my productivity. And so, what he did, which is brilliant, is we have places where typical Portillo's is a real quirky dynamic in the old school restaurants, which is you come here and place your order. And if you are ordering an Italian beef sandwich and a salad, you walk down here to pick up your Italian beef and somebody's got to walk over here to this side to pick up the salad. And there is what we call the salad bowl, and you can see them making your salad and tossing it.

Well, that's unpleasant from a guest experience because if you're going with somebody else, you kind of lose each other. If you're with kids, it's a disaster. It's also a ton of like conveyance and capital and so on. So our COO said, look, I'm going to move the salad area. I'm going to put it in line with the main kitchen. There's some space in the back that we don't really fully utilize, and so we can make salads along the same kitchen line.

We're testing it. It's part of the Kitchen 23 that she talked about and, oh, my gosh, first, it dramatically reduces conveyance. It allows us to take the equivalent of two FTEs out of our kitchen at peak times. And it's faster. The food is made just as fresh, just as quickly, but it's a homerun. It's a capital savings, it's a space savings, and it's labor arbitrage. And it's things like that. Kitchen 23, here's a – it's going to sound goofy, but this is an unlock.

Our kitchen line is very vertical and at the end of it is the fry – everything that we fry, onion rings and French fries, and it's a vertical thing. So there is five to seven steps a person's got to take from the French fry place to take the French fries to outside expo, to send the food to the drive-thru. So we're pivoting the fry station. It's going to be perpendicular to the line so that the person standing here can go this way for outside expo, this way for inside expo.

Again, it sounds silly to say this, but those five to seven steps that they don't have to take is huge at our volumes. We put freezers underneath the fry station so that you don't have to walk down to the freezer to get the next bag of fries or the next bag of onion rings. They're literally right here. And so you just pull them out, dump them in, and keep going. So little things like that, that's technically a change to our operating model, but it's a massive unlock.

And just to be clear, I think these are new restaurants that are going to deploy...

John Glass

Analyst, Morgan Stanley & Co. LLC

Right.

Q

Michael Osanloo

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

...not the fleet itself.

A

John Glass

Analyst, Morgan Stanley & Co. LLC

Right.

Q

Michael Osanloo

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

We can't – we are retrofitting the salad bowl thing I talked about.

A

John Glass

Analyst, Morgan Stanley & Co. LLC

Yeah.

Q

Michael Osanloo

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

We retrofitted one of our restaurants in Chicago to see if that works, and it's been really successful, and we're negotiating with Michelle to get capital to do it for more.

A

John Glass

Analyst, Morgan Stanley & Co. LLC

Okay.

Q

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

I see a payback, Michael.

A

John Glass

Analyst, Morgan Stanley & Co. LLC

Yeah. You heard it here.

Q

Michael Osanloo

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

Yeah.

A

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

Yeah.

A

John Glass

Analyst, Morgan Stanley & Co. LLC

Pricing and inflation rate, right?

Q

Michael Osanloo

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

Yeah.

A

John Glass

Analyst, Morgan Stanley & Co. LLC

It's that – it's those questions that just don't go away.

Q

Michael Osanloo

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

Right.

A

John Glass

Analyst, Morgan Stanley & Co. LLC

I want to first ask you about pricing just...

Q

Michael Osanloo

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

Yeah.

A

John Glass

Analyst, Morgan Stanley & Co. LLC

...philosophically, right? So there are brands that are taking more pricing as inflation has crept up.

Q

Michael Osanloo

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

Yeah.

A

John Glass

Analyst, Morgan Stanley & Co. LLC

And they're fully covering their inflation. Here's the benefit, theoretically, right? They got their margins back to where they wanted them to...

Q

Michael Osanloo

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

Yeah.

A

John Glass

Analyst, Morgan Stanley & Co. LLC

...and they don't have to really price as much going forward.

Q

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

A

John Glass
Analyst, Morgan Stanley & Co. LLC
Other brands and this is probably the majority have delayed...

Q

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

A

John Glass
Analyst, Morgan Stanley & Co. LLC
...thinking there will be a follow-on. I think you fall into that camp.

Q

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

A

John Glass
Analyst, Morgan Stanley & Co. LLC
But then [indiscernible] (00:31:11) at some point you have to price above inflation if your goal is to get margins back to pre-inflationary levels...

Q

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

A

John Glass
Analyst, Morgan Stanley & Co. LLC
...and if there's no other tools. How do you react to that? Is there – like is there a better place to be? You obviously have a view because you did it.

Q

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

A

John Glass
Analyst, Morgan Stanley & Co. LLC
But I can see the other point, too, right?

Q

Michael Osanloo
President, Chief Executive Officer & Director, Portillo's, Inc.
Yeah. I mean, I think there's certainly – no, I don't actually think there's multiple sites. I think we're right.

A

John Glass

Analyst, Morgan Stanley & Co. LLC

Okay.

Q

Michael Osanloo

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

So I believe that a price laggard strategy is actually the right way to behave right now. And here's what I mean by price laggard. We take our pricing. We protect our margins. But what we do is we let everybody else create air cover and price as much as they want, and then we follow on. It doesn't – I think some people conflate that with you don't take your price. We get our pricing. It's just I believe in elasticity and the cost of elasticity impact. And so when you've got competitor A taking 15% pricing and competitor B taking 12% pricing, I'm like all applause, go for it. I'm taking 8%.

A

And here's what it means. Our value scores – our value perception scores are the highest they've been in three years. Our guest satisfaction scores are the highest they've been in three years. We look assiduously at guests counts. And don't be confused by what people say by traffic. Traffic is checked and there's a noise in that, right? People coming into the restaurant is one person per check. In the drive-thru, it's more than one person per check. And in delivery, it's way more than one person. So there's a lot of noise in check count.

Our guest counts are entrée sandwiches sold and entrée salads sold. Our guest counts are up this year. And we've had, in the last two quarters, sequentially better performance. So our value proposition is at its peak. Our satisfaction is at its peak. We're growing guest count. We're still sporting, what, 23% restaurant level EBITDA margins and have a very attractive comp. I feel good about where we are. And if the country behaves even remotely in a recessionary way in 2023, then we're in great position, right, because value is important to consumers. And I think that the elasticity impact of some of the more aggressive pricing has not been fully felt yet.

John Glass

Analyst, Morgan Stanley & Co. LLC

Interesting. Interesting. Well, thank you for that answer, yeah. Michelle, I will end with you, maybe just thinking a little bit about framework.

Q

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

Yeah.

A

John Glass

Analyst, Morgan Stanley & Co. LLC

One is, well, you – long-term [ph] algo (00:33:38), what kind of how you think about the growth of the business?

Q

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

Yeah.

A

John Glass

Analyst, Morgan Stanley & Co. LLC

Q

And then I want to bring it down to 2023 just for final slides. But first of all, long-term [ph] algo (00:33:44) in terms of top line EBITDA, how should investors think about?

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

A

Yeah, so we think about growing our comp in the low-single digits. We're committed to growing new units at 10%. So that adds to low single – high-single, low-double digit revenue growth, John, and then low-teens adjusted EBITDA growth. So that's what we are committed to doing over the long term. Obviously, this year, in particular, we've seen what inflationary costs have done, but Michael and I are committed to that. And so, as we think about we've talked a lot about development, I think there's a reason why we're focusing on building that local scale, right?

You can – Portillo's is a brand that's going to travel. You can plant flags right anywhere. But I think really getting scale within markets, which we think is six to eight restaurants in a market, really gives you an opportunity then to see that expansion, John, on the bottom line, right? And so you do see, and I gave this example during Investor Day where we saw 370 basis points of margin expansion within Arizona when we went from two restaurants to four, which, by the way, we don't even consider to be upscale, right? We think scale six to eight.

So that's how I think about like the long term, the question could be, well, great, how do you expect to continue to grow that bottom line? As we get that scale, right, we definitely see the benefits of scale of that.

John Glass

Analyst, Morgan Stanley & Co. LLC

Q

Is that where scale really shows up in your business? It's just densification of markets, or is there scales in project? Or are there other obvious areas, is it really just inflowing markets? And whether markets are like Arizona, where you're going to get to four or five or whatever it is, five, six, seven, eight soon to get that scale?

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

A

Yeah. No, like we said, we were planning our first five in Texas as the Class of 22. So here in a couple of weeks, we've said three to five next year in the Dallas market alone. And, Arizona, 2 more in the Class of 22 are opening. So we'll be up six in Arizona. We're committed to another two to three in Arizona next year. Central Florida, Orlando is our first restaurant. We're going to open [indiscernible] (00:35:35) here in the Class of 22 and we're going to scale another two to three, I'd say, in Central Florida next year. So our goal is to scale quickly...

John Glass

Analyst, Morgan Stanley & Co. LLC

Q

Perfect.

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

A

...in markets than versus what you've seen in the past.

John Glass

Analyst, Morgan Stanley & Co. LLC

Yeah. Thank you. So, now, we're out of time. We're going to hear from your next at ICR and that's when you'll talk a little bit about 2023. Is that right?

Michael Osanloo

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

And for those of you who go to ICR, who've never had our food, our Beef Bus will be there, so you can try it firsthand.

John Glass

Analyst, Morgan Stanley & Co. LLC

Right. Or just drive over to the big one in Disney World, right?

Michelle Hook

Chief Financial Officer, Portillo's, Inc.

Yeah.

Michael Osanloo

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

That's right.

John Glass

Analyst, Morgan Stanley & Co. LLC

Michael and Michelle, thank you so much. Bon voyage on your trips and thank you, all, for listening.

Michael Osanloo

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

Thank you. Thank you. Thank you, John.

Disclaimer

The information herein is based on sources we believe to be reliable but is not guaranteed by us and does not purport to be a complete or error-free statement or summary of the available data. As such, we do not warrant, endorse or guarantee the completeness, accuracy, integrity, or timeliness of the information. You must evaluate, and bear all risks associated with, the use of any information provided hereunder, including any reliance on the accuracy, completeness, safety or usefulness of such information. This information is not intended to be used as the primary basis of investment decisions. It should not be construed as advice designed to meet the particular investment needs of any investor. This report is published solely for information purposes, and is not to be construed as financial or other advice or as an offer to sell or the solicitation of an offer to buy any security in any state where such an offer or solicitation would be illegal. Any information expressed herein on this date is subject to change without notice. Any opinions or assertions contained in this information do not represent the opinions or beliefs of FactSet CallStreet, LLC. FactSet CallStreet, LLC, or one or more of its employees, including the writer of this report, may have a position in any of the securities discussed herein.

THE INFORMATION PROVIDED TO YOU HEREUNDER IS PROVIDED "AS IS," AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, FactSet CallStreet, LLC AND ITS LICENSORS, BUSINESS ASSOCIATES AND SUPPLIERS DISCLAIM ALL WARRANTIES WITH RESPECT TO THE SAME, EXPRESS, IMPLIED AND STATUTORY, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, ACCURACY, COMPLETENESS, AND NON-INFRINGEMENT. TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, NEITHER FACTSET CALLSTREET, LLC NOR ITS OFFICERS, MEMBERS, DIRECTORS, PARTNERS, AFFILIATES, BUSINESS ASSOCIATES, LICENSORS OR SUPPLIERS WILL BE LIABLE FOR ANY INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL OR PUNITIVE DAMAGES, INCLUDING WITHOUT LIMITATION DAMAGES FOR LOST PROFITS OR REVENUES, GOODWILL, WORK STOPPAGE, SECURITY BREACHES, VIRUSES, COMPUTER FAILURE OR MALFUNCTION, USE, DATA OR OTHER INTANGIBLE LOSSES OR COMMERCIAL DAMAGES, EVEN IF ANY OF SUCH PARTIES IS ADVISED OF THE POSSIBILITY OF SUCH LOSSES, ARISING UNDER OR IN CONNECTION WITH THE INFORMATION PROVIDED HEREIN OR ANY OTHER SUBJECT MATTER HEREOF.

The contents and appearance of this report are Copyrighted FactSet CallStreet, LLC 2022 CallStreet and FactSet CallStreet, LLC are trademarks and service marks of FactSet CallStreet, LLC. All other trademarks mentioned are trademarks of their respective companies. All rights reserved.