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Q2: 2025-08-05 Earnings Summary

Insights



EPS of \$0.13 **beats by \$0.02** | Revenue of \$188.46M (3.63% Y/Y) **misses by \$7.37M**

Portillo's Inc. (NASDAQ:**PTLO**) Q2 2025 Earnings Conference Call August 5, 2025
10:00 AM ET

Company Participants

Chris Brandon - Corporate Participant

Michael Osanloo - President, CEO & Director

Michelle Greig Hook - CFO & Treasurer

Conference Call Participants

Andrew Marc Barish - Jefferies LLC, Research Division

Brian Hugh Mullan - Piper Sandler & Co., Research Division

Brian James Harbour - Morgan Stanley, Research Division

Christopher Thomas O'Cull - Stifel, Nicolaus & Company, Incorporated, Research Division

David E. Tarantino - Robert W. Baird & Co. Incorporated, Research Division

Dennis Geiger - UBS Investment Bank, Research Division

Gregory Ryan Francfort - Guggenheim Securities, LLC, Research Division

James Ronald Salera - Stephens Inc., Research Division

Sara Harkavy Senatore - BofA Securities, Research Division

Sharon Zackfia - William Blair & Company L.L.C., Research Division

Operator

Greetings, and welcome to Portillo's Second Quarter 2025 Earnings Conference Call. [Operator Instructions] As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Chris Brandon, Vice President of Investor Relations. Thank you, sir. You may begin.

Chris Brandon

Thanks, operator, and good morning, everyone, and welcome to our second quarter 2025 earnings call, my first since joining this outstanding team and exciting investor story.

With me on this call today is Michael Osanloo, President and Chief Executive Officer; and Michelle Hook, Chief Financial Officer. You can find our 10-Q, earnings press release and supplemental presentation on investors.portillos.com.

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 be happy to take questions from our covering sell-side analysts.

And with that, I will turn the call over to our President and Chief Executive Officer, Michael Osanloo.

Michael Osanloo

Thanks, Chris, and good morning, everyone.

Before we begin today's call, I want to take a moment to address what has been a very difficult few days for the Portillo's family. As you may have seen in the news, the front entrance of our restaurant in Oswego, Illinois was the site of a tragic car accident. We pride ourselves in being a special part of the local communities we serve. And right now, we are deeply hurting for the entire Oswego community and the families affected. We stand with them during this difficult time, and we'll continue to offer our support in any way we can.

With that, I'll now turn today's call to our second quarter results. I'd first like to thank our dedicated restaurant team members, managers and company leaders. Their hard work in a still challenging economic environment continues to allow us to bring the Portillo's experience to life for our guests every day. This is the foundation for our future growth.

We continue to manage the flow-through elements of our business effectively in the second quarter, delivering restaurant-level adjusted EBITDA of \$44.5 million with a margin of 23.6%. While there are bright spots, we know we have areas to improve within our overall performance. Specifically, our noncomp restaurants in Texas have gotten off to a slower start and continue to pressure overall top line revenue performance. We remain focused on building awareness and driving transactions while staying true to what makes Portillo's special, our craveable, high-quality food and one-of-a-kind guest experience.

At the same time, we're playing offense. We're testing new ideas, growing our loyalty and tech platforms and reducing build costs, all in pursuit of industry-leading unit economics. I'm proud of the progress we're making and confident these actions will drive sustained growth and long-term shareholder value.

We had an active start to the second quarter with 2 strong initiatives. First, we celebrated Italian beef month in May with a buy one, get one offer for our Portillo's Perks loyalty members. Then in a moment of perfect timing, the Vatican named the Chicago native as the new Pope. Our team acted quickly, launching The Leo, a nod to the new Pope Leo XIV with a version of our signature Italian beef sandwich. It was a great example of our company's agility and nimbleness to jump on a cultural moment creatively and with speed. We're proud of that ability, and that's a competitive advantage for Portillo's versus the rest.

Both initiatives drove meaningful engagement and positive transactions in May, giving us valuable insights on how we use Perks as a promotional and customer acquisition tool. As anticipated, we saw performance level off some in June. While transactions were negative 1.4% for the quarter, we did deliver 170-basis-point sequential improvement in transactions over Q1. It's a step forward, and we're encouraged by the early traction from actions designed to strengthen traffic as well as our favorable management of margins in Q2.

We remain committed to overcoming near-term industry traffic pressures and are focused on our 4 key initiatives. First, multichannel marketing. Our ongoing campaigns in key markets like Phoenix and Dallas led to sales lifts in both markets. Second, continuous operational improvement, especially within speed and hospitality. For example, our AI-powered drive-thru technology is getting strong feedback from operators for real-time execution and training benefits. We're actively expanding that test now. Third, kiosk adoption. In-restaurant usage now exceeds 33% with clear benefits to average check and mix. And fourth, evolving Portillo's Perks. Now with over 1.9 million members and counting, our May performance highlighted its growing power as a nimble, scalable platform for guest engagement, acquisition and retention. These 4 initiatives are building a stronger foundation for transaction growth now and in the future.

Shifting to restaurant development. We remain on track to open 12 restaurants in the back half of 2025, and our build cost reduction plan is delivering results, tracking in the range of our projected net cost average of \$5.2 million to \$5.5 million per restaurant. This represents well over \$1 million in per restaurant build cost savings versus our class of 2024 openings. We just opened our third restaurant of the Future 1.0 with 2 more to follow next week and are encouraged by what we're seeing. The combination of build cost reduction and operational efficiencies gives us even more confidence in our 2.0 restaurant design. This next iteration, which will debut in the back half of 2026, will reduce build costs further, streamline labor and unlock incremental site opportunities due to a more consolidated design.

I'm really excited about our class of 2026 pipeline. It's the most diverse lineup of formats in Portillo's history, including multiple 2.0s and a great mix of new prototypes. Progress on new formats is equally encouraging. Later this week, we'll open our first in-line restaurant in the villages in Florida, followed by our debut airport restaurant at Dallas-Fort Worth Airport in 2026. We believe these in-line and nontraditional format restaurants could play a meaningful part of our development future.

As we grow, we're continuing to refine our new market playbook. We saw early traction in Dallas, and Houston has been a little bit slower to ramp up. In hindsight, we probably overcorrected at times in Texas to manage volumes and maintain service. We've since learned the importance of sustained marketing investment and have beefed up our efforts to accelerate awareness and drive revenue in Texas, which includes multichannel campaigns and new local field marketers on the ground to lead grassroots efforts. Every market is different, but we're learning quickly and adapting to build a more scalable, consistent approach for new market entries. Atlanta is our next big opportunity this fall, and we look forward to sharing those updates next quarter.

At Portillo's, there are some nonnegotiables, craveable made-to-order food and fast, friendly service. If we do these 2 things well, we will drive exceptional value for our guests while building restaurants that deliver industry-leading unit economics. In the restaurant business, growth follows strong 4-wall returns. Our AUV strength, coupled with our expedited efforts to reduce build costs positions us to deliver top-tier cash-on-cash returns across diverse formats, geography and stages of market maturity.

To level set, we know we're a bit of a show-me story within the investment community. It's an opportunity that we actually embrace. We're putting the right energy, investments and resources into what matters most, improving transactions, driving consistent new market performance, strengthening unit economics that support growth and continuously evolving our strategy without losing what makes Portillo's one of a kind. I believe in the work we're doing, the strength of our team and in our ability to create long-term value for both our guests and our shareholders.

With that, I'll hand it over to Michelle.

Michelle Greig Hook

Great. Thank you, Michael, and good morning, everyone.

Before we dive into the financial results, I wanted to recap an equity transaction by Berkshire Partners. In the quarter, Berkshire redeemed 7.3 million LLC units for newly issued shares of Class A common stock. As of the end of the quarter, Class A shares represent 95.4% and Class B shares represent the remaining 4.6% of the 75.3 million in total outstanding shares. Berkshire's beneficial ownership after this transaction is approximately 5.2% of the company, down from over 60% at the time of the IPO.

Now moving on to the second quarter. Revenues were \$188.5 million, reflecting an increase of \$6.6 million or 3.6% compared to last year. Our revenue growth in the quarter was driven by both noncomp restaurants and same-restaurant sales. Restaurants not in our comp restaurant base contributed \$6.1 million in revenue during the quarter. Same-restaurant sales increased 0.7%, which drove revenues up approximately \$1.1 million in the quarter. The same-restaurant sales growth was attributable to an increase in average check of 2.1%, partially offset by a 1.4% decrease in transactions.

The higher average check was driven by an approximate 3.4% increase in menu prices and a 1.3% decrease in product mix. Same- restaurant sales on a 2-year stack basis were flat. We are currently forecasting our comp sales for the full year at the low end of our 1% to 3% range. To address inflationary cost pressures, we increased menu prices by approximately 1.5% in January, 1% in April and 0.7% in late June. Our effective price increase for the third quarter is estimated to be approximately 3.3%. We will continue to assess pricing in relation to our costs, the competitive environment and our value proposition to our guests as the year progresses.

Moving on to our costs. Food, beverage and packaging costs as a percentage of revenues decreased to 33.8% in the second quarter of 2025 from 33.9% in the prior year. This decrease was the result of an increase in our average check, partially offset by a 1.9% increase in our commodity prices. In the quarter, we experienced increases in chicken, hamburger and dairy products. We continue to forecast commodity inflation of 3% to 5% in 2025 with the most significant pressures coming from beef.

Labor as a percentage of revenues increased to 25.7% in the second quarter of 2025 from 25.5% in the prior year. The increase was primarily due to lower transactions, increased benefit costs and incremental wage increases, partially offset by labor efficiencies and an increase in our average check. Hourly labor rates were up 2.9% in the second quarter of 2025. We continue to estimate labor inflation of 3% to 4% for the full year.

Other operating expenses increased \$2 million or 9.8% in the second quarter of 2025 compared to the prior year, which was primarily driven by the opening of new restaurants and an increase in repair and maintenance and utilities expense. As a percentage of revenues, other operating expenses increased to 11.6% from 11% in the prior year.

Occupancy expenses increased \$0.8 million or 8.2% in the second quarter of 2025 compared to the prior year, primarily driven by the opening of new restaurants. As a percentage of revenues, occupancy expenses increased 0.2% compared to the prior year.

Restaurant-level adjusted EBITDA margins decreased 90 basis points to 23.6% in the second quarter of 2025 versus 24.5% in the prior year. We continue to estimate our restaurant-level adjusted EBITDA margins to be in the range of 22.5% to 23% in 2025.

Our general and administrative expenses increased by \$0.9 million to \$18.8 million or 10% of revenue in the second quarter of 2025 from \$17.9 million or 9.9% of revenue in the prior year. The increase was primarily due to higher professional fees and higher advertising expenses driven by ad campaigns in the Phoenix market.

Preopening expenses decreased by \$0.4 million to \$1.7 million in the second quarter of 2025 compared to \$2.1 million in the prior year, primarily due to the number and timing of activities related to our planned restaurant openings. All this led to adjusted EBITDA of \$30.1 million in the second quarter of 2025 versus \$29.9 million in the prior year, an increase of 0.7%.

Below the EBITDA line, interest expense was \$5.7 million in the second quarter of 2025, a decrease of \$0.9 million from the prior year. This decrease was driven by a lower effective interest rate of 6.9% versus 8.3% for 2024.

At the end of the quarter, we had \$70 million drawn on our revolving credit facility. Our total net debt at the end of the quarter was \$317 million compared to \$312 million at the end of last year. We have approximately \$75 million of available capacity on the revolver, and we'll continue to use our cash generated from operations and the capacity on the revolver to fund our new restaurant growth this year.

Income tax expense was \$3.7 million in the second quarter of 2025, an increase of \$0.2 million from the prior year. Our effective tax rate for the second quarter was 26.8%. We expect the full year tax rate to be approximately 25% to 27%.

Cash from operations decreased by 31.1% year-over-year to \$28.7 million year-to-date. We ended the quarter with \$16.6 million in cash.

Lastly, let's turn to our financial outlook for 2025. We have updated certain metrics to reflect our year-to-date results and expectations for the remainder of the year. We expect our total revenue growth to now be in the range of 5% to 7%. Two key factors from our noncomp restaurants are driving this revenue change. First, the class of 2024 restaurants have seen a slower ramp up, specifically in Texas. Second, our Stafford, Texas opening originally scheduled for Q1 has been delayed for several months due to local permitting challenges, driving lower sales weeks versus our forecast.

During the third quarter, we plan to open 4 to 6 new restaurants out of our 12 targeted this year, with the remainder opening later in the fourth quarter. On the cost side, we are now estimating G&A expenses in the range of \$78 million to \$80 million. Given the change in our revenue and G&A outlook, we now estimate adjusted EBITDA growth to be flat to low-single digits. We remain confident in the long-term financial targets we have previously provided.

Thank you for your time. And with that, I'll turn it back to Michael.

Michael Osanloo

Thanks, Michelle.

In closing, Portillo's is a place people want to be a part of. In a recent report by William Blair, Portillo's was named in the top 10 of nearly 90 restaurant companies in employee satisfaction. And in April, Newsweek ranked us 25th out of 700 companies in its America's most trusted companies list. I believe it's because of the amazing experience we strive to create for anyone who enters our restaurants. Whether it be in our restaurants or amongst field operators, restaurant support team members and the management team, the Portillo's culture is something we're very proud of and thrilled to share with our guests each and every day.

Look no further than the talent that has joined our company, particularly in Q2 as we put the finishing touches on what is undoubtedly the strongest Board of Directors in the restaurant industry. I'm proud of the work we're doing to evolve the Portillo's investor story, some of which is tangible and some of which has yet to hit the scoreboard. But we're getting there and the foundation in place is exciting. Thank you all for your time today, and we're happy to take some questions.

Question-and-Answer Session

Operator

[Operator Instructions] Our first question comes from the line of Sharon Zackfia with William Blair.

Sharon Zackfia

I guess 2 questions. First, on the mix in the quarter. I was a little surprised to see it go negative just given the kiosk usage increasing. So maybe if we could get some clarity on what's going on with mix. And then separately, I think the bigger question that investors have is just kind of the path to get to that mid-teens revenue growth that is the longer-term goal here. Is that something that you think can be achievable in '26? And what are the key kind of strategies to get there?

Michael Osanloo

Sharon, let me tackle your second question, and then I'll let Michelle take the first one. I think we're -- we remain confident on mid- teens revenue growth. We have built some great restaurants in Texas, and they've just started off slow. And we're not -- we haven't given up on them. We think that there's a lot of potential there. We're seeing some momentum. We've done, I think, a lot of the foundational work to make sure that Texas continues to grow and evolve. We've got field marketers in both places. We have active marketing campaigns. We're building a loyalty database, and we'll keep using the loyalty database. So mid-teens growth is very reasonable to target for us for '26.

And I think that -- I'll let Michelle talk about the mix.

Michelle Greig Hook

Yes, Sharon, in terms of mix, so you're absolutely right. The benefit we see on kiosks is definitely benefiting that. So there's 2 components to the mix. The first is the items per transaction and then the next is true mix in terms of what people are buying. So where you're seeing the kiosk benefit is the lift on the items per transaction. But where we're really seeing pressures is on the other part of mix where essentially people are still buying the item, but they're trading down.

So think of it as instead of buying a big beef, they're buying just a regular beef instead of buying a large fry, they're buying a small fry, et cetera. And so that's really where we're seeing the pressures on the mix is that true mix being offset not fully by the benefits that we're seeing on kiosk. And obviously, we believe that's an indicator of what's going on in the broader macro in terms of the trade downs that we're seeing there. But we clearly, as Michael said in his prepared remarks, want to drive the business through transaction growth and other mechanisms. But we're definitely seeing pressures in mix on the trade downs.

Operator

Our next question comes from the line of Chris O'Cull with Stifel.

Christopher Thomas O'Cull

I did have a follow-up on new stores. And I mean the annualized sales contribution from the 10 locations that you guys opened last year was lower this quarter than in the prior quarter, which I believe you guys expected it to improve. So just can you give us a little more detail of what you did this quarter to try to improve the performance of those stores? And what's planned for the rest of the year?

Michelle Greig Hook

Yes, absolutely, Chris. So when you think about the class of 2024, some of those restaurants are getting into being in their second year. So you're starting to see some of a honeymoon effect to certain of those restaurants. Some of the later restaurants that were open in the class of 2024 later in the year, such as the Houston restaurants that we've mentioned. And so the things that we're doing are what Michael mentioned, which is continuing to pump the markets with marketing and advertising. And so as we've talked about previously, we ran a campaign in Dallas in the first quarter.

In the second quarter, we were on with a campaign in the Phoenix market, but then also hired a field marketer within the Houston market and continue to do some advertising within that market as well. So we're going to continue to invest in those newer markets to make sure that we continue to grow the top line. And as we go into the back half of the year, we'll continue to look at advertising efforts. We'll run another campaign in Dallas in the fourth quarter as well to continue to pump that market with additional awareness and trial.

Michael Osanloo

Yes, Chris, I would just add to what Michelle said that it's a little bit of pick and shovel work. We're building awareness every week. It takes a little bit of time. And you're right, I think that the essentially flattish performance in Q2 versus Q1 for some of those Texas restaurants was disappointing to us. But we're active and very aggressive in building awareness. We've got field marketers out there, making sure that people know who we are. We do really well once people try our food. So we're being very aggressive at getting our food in people's mouth, sampling, doing things with local communities and embedding ourselves in local communities. So it does take a little bit of time. I'm not daunted by the fact that it hasn't picked up aggressively, but I do expect it to improve over the next few quarters.

Christopher Thomas O'Cull

Okay. And then, Michael, just given the weak year-to-date comp and new store performance, why does it make sense to continue opening units beyond the current signed leases, especially when it will likely require the company to increase borrowings to kind of fund those openings?

Michael Osanloo

Yes. That's a great question. I would tell you that we are taking a hard look at the performance of new restaurants and how actively we're building. So we're not building for the sake of just building. We're building, I think, in a very thoughtful way. There is this balancing act. We see that when we reach a certain level of awareness and scale, our business performs very well. And we have those proof points.

Arizona performs really well for us. It's a great testament to what Portillo's can do once it has a certain level of awareness and once we have a certain level of scale. Indiana actually performs well for us. Wisconsin is starting to pick up some speed. So there is this balancing act between getting a sufficient density so that you start to build awareness and then those restaurants fill in. So we probably are a little bit ahead of demand with the supply that we have of restaurants in Dallas. And that's -- and we've got a couple more in flight, but we're not pushing the gas there. We're making sure that we're filling in, in other places where there's a lot of growth ahead for us.

And the other thing that I would just reiterate, we're really being focused on generating the right cash-on-cash returns. So that number that Michelle and I have talked about, class of '25 thus far is coming in at that \$5.2 million to \$5.5 million. I'm not -- that's a material decline in cost versus the class of '24, which is I'm sure you recall, came in at \$6.8 million. And we have other examples of really great investments. We just built an in-line that we're opening in the next few weeks in the villages in Florida. And that thing is going to come in at sub-\$4 million in investment costs. If it can do anywhere near what we think, it's a home run for investors. So we're not trying to like step on the gas and grow crazy. We're being very prudent. I think we're being thoughtful, and I think we're targeting growth where we think we can get best-in-class cash-on-cash returns.

Michelle Greig Hook

And just to add on to borrowing in the short term, Chris, we've talked about the fact that we're getting ahead of the pipeline for '26. And so we're going to have a lot of spend this year that's going to be for the class of '26. And so that's going to come into play in some of the capital needs this year. But our goal is what we continue to say, which is as we go into '26, we don't want to have any net new borrowings on the revolver. But yes, we're going to continue to borrow this year because we have to fund some of that growth as we move into '26.

Operator

Our next question comes from the line of Gregory Francfort with Guggenheim Partners.

Gregory Ryan Francfort

I had 2 questions. The first is maybe just looking at Texas versus the rest of the Sunbelt, how much of the Texas performance do you think is just how many stores in the industry are opening up in the state right now? And can you maybe talk about how Arizona and Florida have been performing? I think you touched on it a little bit, Michael, but if you could just expand.

Michael Osanloo

Well, I think that's a great insight. Texas is not unique to us in development. I think Texas continues to be -- especially with all of the growth, all of the development, the population growth, it's no secret to the restaurant industry. So there -- wherever we're building, there's -- all of our competitors are building right near us. So I'm sure that has a little bit to do with the slower start. And I'm sure that there are other restaurant companies that need to get up sort of that curve in Texas as Texas digests all of these restaurants.

I don't know what the time line is for Texas to become as great as Arizona and Florida and other markets are for us. I just have -- I take solace in seeing the performance in Arizona. We've talked about this in the past. When we went from 2 to 4 restaurants, we saw a material improvement in both awareness, in revenues, but most importantly, in our margin profile in Arizona. And I'm really confident that we're going to see the same dynamic as Texas matures and that as the demand for us catches up with the supply of restaurants. And I think that there's just this balancing act always between having restaurant -- when somebody has a craving for Portillo's, we'd like to be able to satisfy it. All of the research that we do, when we ask people, why did you not -- if you don't regularly visit us, why don't you visit us? The top 2 things are awareness, I didn't know you're here and then inconvenience.

There's a reason why we are so dominant in Chicago. If you're in the Chicagoland area in any of the suburbs, pretty much within 5 miles of you, there's a Portillo's. So if you have a craving for Portillo's, you can go. We're not there yet really in any other market. And so I think there's this balancing act.

Gregory Ryan Francfort

That's helpful. And then maybe my second question is for you, Michelle. The -- just as I look at labor inflation and food inflation, it feels like you have beef moving maybe a little bit against you, but it also seems like the labor market might be a little bit easier. Can you just talk about the outlook for both of those going forward?

Michelle Greig Hook

Yes, absolutely, Greg. So as we came into this year, we knew we were going to be pressured on beef. We knew it was going to be back half loaded. So I'll start with commodities. So you saw we were up 3.4% in Q1, 1.9% this quarter. I expect Q3 to be the most pressured quarter for commodities. And then Q4 will be higher as well than what we saw in the first half of the year. So that's how we get to our 3% to 5%.

But we -- yes, we absolutely expect the back half to be a little bit more pressured, and that is primarily related to beef. But I feel really good about our ability to derisk this and get in front of it. We're almost 90% hedged on our beef flaps for this year. For our overall commodity basket, we're over 70% locked in. And so I feel really good about us coming into this year having derisked that line item for us. So we feel very comfortable with the commodity outlook.

Michael Osanloo

Yes. Greg, let me just build on that. I'm very proud of our team and under Michelle's leadership that we saw this coming towards the end of last year. And early, you'll recall, we did -- we had higher beef inflation numbers than most everybody else. And we took that -- we believe that beef was going to be inflationary this year, and we've taken a number of actions to mitigate that forward buying, making sure that we're pushing every lever that we can to minimize conversion costs and making sure that we are on top of this. And so I'm very proud of the team because we've done all those things so that our guests will not experience that inflation like they see elsewhere.

We still are really focused on making sure that despite the inflationary pressure on beef that we're providing amazing value to our guests. We're not playing any games with shrink inflation. We're not gouging people. We're still -- our burgers are still 1/3 of a pound. Our beef sandwiches are huge and indulgent. So, we're making sure that the guest gets all the value that we want, and we have managed that behind the scenes like a prudent company should.

Michelle Greig Hook

Yes. And Greg, just on the labor front, you saw in both quarters, we were up 2.7% and 2.9% in Q2. I don't expect that to be materially different in the back half of the year. We've continued over the course of the last several years to make meaningful labor investments within our system. And so I feel good about that guide at 3% to 4% for the full year. We don't see that changing.

Operator

Our next question comes from the line of Sara Senatore with Bank of America.

Sara Harkavy Senatore

Just a question about maybe unit economics and then a follow-up on maybe the line items. So, you mentioned build costs are \$1 million lower maybe with this new prototype. But as I think about the shift to some of these maybe smaller boxes, I think you mentioned in line. Presumably, those are more of the build-to-suit approach. And I guess, as I think about that model, presumably, it would lower your build costs even more.

I mean, optically, you'll be paying more rent. So, your margins might look lower, but presumably, the ROI would be much higher. So, I guess the question is, can you give me a sense of what that might look like for restaurant-level margins and also for the invested capital associated with it? And I guess, confirm that, that is kind of the complexion, maybe lower margins, but a higher ROI?

Michael Osanloo

Let me start with that and give Michelle a chance to build on that. We have -- I think I mentioned just briefly that the Class of '26 is going to be the most -- we're excited by it. So, we have some of these 1.0s. They're smaller restaurants. Those are the ones that have come in this year between 5.2 and 5.5. We have some 2.0 restaurants, and they'll start opening up in the back half of next year. Those are another order of magnitude smaller. They should be lower costs. We haven't talked about the costs yet. And then we have some atypical restaurants. We have obviously a restaurant opening up at the Dallas Fort Worth Airport. And we have a couple of other in-line restaurants that I can't talk about the locations yet, but should be fantastic economics for us. So, you're 100% right, Sara, that as a class, we're going to see reduced build costs across the board.

We're actively determining what the margin impact is if, in fact, we do more build-to-suits. Keep in mind that some of these smaller restaurants, especially the 2.0s because it's a different configuration in the kitchen. I don't want to get super technical, but our kitchens are historically very linear. That kitchen is either U-shaped or a little E, which creates a lot more work sharing, reduces overall energy load capacity needs and reduces HVAC needs. So, we expect to see some operating improvement in terms of labor costs and OpEx. I'm not sure how much margin you give up with those smaller kitchens if, in fact, you do, do a build-to-suit and pay more rent. So we're still -- it's still evolving. But for certainty, I can tell you that we are targeting lower capital -- not lower capital and you can imagine a world where you get to a certain capital point with our typical revenues that we target by year 3, the cash-on-cash returns get really, really attractive.

Sara Harkavy Senatore

That's very helpful. And then just on the line items, when I look at your P&L, your cost of goods is probably higher than almost any other fast-casual restaurant. That reads as very good value on the plate. But I'm not sure if consumers really recognize that. I mean, I would think in this current environment, that would translate into a lot of traffic share gains. So, I guess on that front, do you get credit for that? And also whether or not you do, is there any opportunity, whether it's from a supply chain or distribution or something else to maybe lower that cost of goods line?

Michael Osanloo

Yes. It's a great question. I mean, let me start with the second part. Everything is on the table for us. We are actively looking at distribution costs. It is expensive for us to get our -- some of our products across the nation. And so we need to evolve that. We need to get better at distribution and the entire supply chain motion. I mean, your question really is a, call it, the 34-ish percent in

commodity cost, how much of that is really value to the guest and is there some waste in there? The reality is there's probably a little bit of efficiency that we can do, and we'll always keep looking at improving efficiency. But I want to anchor back to your first point, we're very proud of the fact that we give that kind of value to our guests, right?

It's important to -- our burgers are 1/3 of a pound. Our beef sandwiches are really big. They're beefy. We're not playing games with fries. Our small fry, our regular fry is bigger than most people's large fries, and it's cooked in tallow. So, we're very proud of the quality and the value that we give guests. I believe that guests notice this. I don't think it's one of those things where they move in a herd week-to-week. I think it takes a little bit of time. And I think right now, we like being in a position where we're providing great value. Our value scores are really good internally. We're very happy with it. And I think it's just a question of time when the consumer behavior catches up to the consumer sentiment for us.

Operator

Our next question comes from the line of Brian Mullan with Piper Sandler.

Brian Hugh Mullan

I just want to ask about the breakfast testing in Chicago. Can you talk about how that's going? What you are seeing on incrementality, which I think was a really important factor that you were watching?

Michael Osanloo

Yes. Look, breakfast is -- we're trying to be very cautious with breakfast, Brian. I appreciate you asking about it. It's, frankly, going as well as I could have hoped. It appears that it is incremental. It appears that our guests really love it. And it's not negatively affecting in any way our lunch or dinner business at those restaurants, either in terms of guest satisfaction or sales. So, there's a lot to like about breakfast. And if you haven't tried it, it's absolutely delicious. I think we have the best -- I've gotten feedback from one investor that they're too big. Our egg sandwiches are just too big in decadence, but it's delicious. And we're continuing to evaluate it. We want to make sure that it's sustainable for our teams and our management.

We don't want to burn people out. We don't want to take our eye off the ball. So, we're going to run this test through the end of the year. And then we'll have options. We'll -- if we decide that the test is a distraction, we'll kill it. I don't know if that's going to happen, but none of us are obtuse in seeing that there's a lot of other great restaurant companies that have tried breakfast multiple times and failed. I don't know. I don't think that -- I hope that's not going to happen to us, but that happens.

Second option is we decide that breakfast is really just a Chicago thing and that in Chicagoland, we have the credibility and the right with consumers to give them an amazing breakfast meal that they will buy in. And then the third test -- the third option is that we think breakfast has potential for us as a national thing, at which point we would have to test outside Chicago to see if we can also be relevant in breakfast. But it's going really well. We're happy about it, and we just want to make sure that it's sustainable.

Brian Hugh Mullan

Okay. And then I wanted to ask about the limited menu you went with in Houston. It doesn't seem like it would be right to equate the slow start just to that. So, would you agree with that? And then if so, what are some of the merits to the limited menu? And are you still exploring the idea of trying that in other geographies potentially?

Michael Osanloo

Yes. It's a great question. There's definitely a tail on that limited menu that we're really confident in eliminating across the board as we open new restaurants. So that's for sure. But I do think that there are other things that we think create some uniqueness and experiential vibe at Portillo's that maybe we should not have taken off, and we've already been adding back. So like any good test, there's learnings. There's learnings on what you did right, and there's learnings on what you didn't do. So, simplification is healthy for us, right? It -- when you can -- you go from 8 to 3 salads, that's a great dynamic because everything is fresher. It's being made faster. It requires less training on your team. You're less likely to screw things up. So, that's a great example.

I think we went with a reduced fleet, a reduced variety of salads. And I think that's a great -- that was a great takeaway. There's a couple of things like quirky things that we sold in Chicago that we didn't put into Houston, no one's missed. We didn't -- we decided to test not selling beer in Houston. I think that was a mistake. I think there's a dynamic where people love coming to a Portillo's and

having a frosty stein of beer with a burger or a beef sandwich, we missed that occasion. That was a mistake, and we've added that back now and we learned. So, I think it's a balancing act.

Operator

Our next question comes from the line of Jim Salera with Stephens Inc.

James Ronald Salera

Michael, I wanted to ask a little bit about the Portillo's Perks and that you guys said you're almost at 2 million members now. Are you able to give us any insight? Presumably, those are all predominantly in the Chicago land area, but just kind of the geographic breakdown of the rewards program? And is that possibly a lever that could be willing to do a little bit more in some of the expansion markets to maybe drive repeat and frequency?

Michael Osanloo

Yes. So great question about Perks. Let me sort of -- I wish I could tell you it was 2 million. It's a little over 1.9 million, but it's growing. Here's what I'd say. Let's keep in mind, Perks, we literally rolled this out in March. So, it's super early days for us. Our aspiration, I think back when we talked about it was we would be at 1.5 million to 1.7 million members by mid-summer. We're at 1.9 million. So, I feel really good about that. And in almost every way, it's exceeding my expectations. It's really easy to forget that we only have 95 restaurants.

If you look at loyalty members per restaurant, I think that the 1.9 million puts us in pretty rarefied air in terms of people who are engaged with our brand and want to be part of our brand. So, I'd encourage you to pop that into your ChatGPT and ask it, loyalty members per restaurant across all leading restaurant companies. That's a really good place to be. We're still learning what it can do for us. And it's like a brand-new toy that we're playing with. We're learning that food promotion works really well. People love our food. When we offer something for free or a BOGO or bring in a friend and sign up, when we do that kind of stuff, it really works well. People love our -- it's -- but we're also -- we get a lot of engagement with badges. We get engagement with people who want to be loyalty members. We have people who are posting all kinds of fun stuff in social media. So, they're becoming an army of evangelist for us. I don't think we have plumbed the depths of what Perks can do for us. I don't think we fully appreciate it yet. It's going to be a great gift that we give to a new CMO who will be able to use Perks to generate activation, guest acquisition and improve frequency. So, I think that it's very early days, and I'm super excited by what we're going to do with this over the course of the next 18 months or so.

James Ronald Salera

Great. And then I apologize if you guys touched on this already, but if we think about DFW AUVs and the expansion market AUVs, is there a scenario if the consumer kind of stabilizes that we could see an acceleration there in '26? Or are we still kind of trying to find stabilization point for some of those market AUVs?

Michelle Greig Hook

Yes, I think, Jim. I'll take that one. So, we've talked about how we've gotten out of the gate a little slower in Texas. But I think as we get into '26, we're still going to be heavily focused on growth in the Sunbelt. That's going to include, continuing to grow the markets that we're in, in Texas and Dallas and Houston. We'll likely go into -- we've talked about going into San Antonio, Austin. So, we need to continue to drive that awareness, which is going to continue to drive the top line in those AUVs. And so we're learning. Like we're still learning how these curves are behaving in these markets. And so I think that's one of the things for us as we move forward. And there still is a honeymoon curve to what we see in some of our restaurants -- actually in most of our restaurants. And so you have to play that into consideration, right?

Remember, we're still going to have 12 restaurants that are going to open into '25. Our expectations continue to remain high. But in terms of what we're targeting, we are still targeting by year 3 as a class to be in that 5.9% to 6.3% range. That is still our target goal. Now the composition of the classes will determine how the behavior of those AUVs are because as Michael and I sit here today, I don't think that we expect Houston to have a significant curve. We expect that market to continue to grow. And we'll have 3 more opening in Houston this year as well.

And so we're going to continue to put that new market playbook into play, and we're going to continue to get tighter on that. And as Michael mentioned, new CMO coming on board, they're going to have great tools to work with. But I can't reiterate the excitement that myself and Michael and the rest of the team have about the Class of '26. I think it's going to be fantastic. We're still on the Class of '25, but we're really excited about that class as well.

Michael Osanloo

And I would just -- one other follow-up on what Michelle said. This is not -- it's not totally unusual for us when fill-in restaurants start off a little slow. We've experienced this in the past. We had restaurants in Wisconsin that started off slow that are performing admirably. We've had restaurants in Arizona, fill-in restaurants that started off slow that are performing admirably. So, our newest restaurants in Florida right now are probably performing better than some of our first few restaurants. So it's not an uncommon thing that happens. This is not something that we're ill-equipped to deal with. We're not daunted by the notion of driving some sales in Dallas.

Operator

Our next question comes from the line of Andy Barish with Jefferies.

Andrew Marc Barish

I didn't hear much on kind of operations and drive-thru speed. And can you kind of give us an update on that channel vis-a-vis the rest of the business, just kind of given the persistent promos and discounts in the broader QSR world?

Michael Osanloo

Yes, that's a great question. We continue to grind and slowly but inexorably improve on speed in the drive-thru, Andy. So, thank you for bringing that up. And that's hugely important because speed very quickly converts into frequency and transactions, et cetera. At the same time, to be totally transparent, the drive-thru is where you typically see the most economically pressured guests, and it probably has the place that has some of the most challenging dynamics for us. So we have to get faster, and that's a way of mitigating some of the pressure for the guest. We can't -- we're not going to go to value menus or dollar menus or any of that stuff. And that guest will choose those other options if they have to. So, speed continues to improve.

Accuracy continues to improve. I'm really happy overall with how we're performing in the drive-thru. And the test we mentioned it, the AI tests that we're using, we've got, I think, the right -- it's really fun to watch. We have these cameras. The cameras translate into highly intuitive monitors inside the restaurant so that the team knows exactly what's going on. The individual anecdotes that I'm hearing about we had times that were ridiculously long late in the evening because we just weren't aware of people waiting. Now we are. It immediately has changed.

We've shaved minutes off at different day periods. So, I love it. It's helping us train our teams better. We're putting tools in the hands of the team so that they can be more successful. And we're seeing that real time. It's a test. My expectation is that we will wrap up this test sometime in the third quarter. And all things going well, we will deploy it in the fourth quarter and in the first half of '26, we'll see material improvement on drive-thru times.

Andrew Marc Barish

Got it. Appreciate it. And then, Michelle, just on the revenue guidance change of kind of the mid-single-digit reduction, I guess, just thinking about that, is it sort of evenly balanced between a point or so of lower comp as well as new restaurant openings and then fewer operating weeks? Kind of how do you parse that out?

Michelle Greig Hook

Yes. I'd say it's primarily driven by more of the non-comp pressures, Andy, that I mentioned. You'll get a little bit on the comp. Like you said, we're trending to the lower end of the 1% to 3% range that we previously guided to. And so I think about it as more heavily weighted on the non-comp side, specifically as we talked about the Class of '24 continuing to see a little bit of headwinds there as well as timing. I think that the timing issue is real for what we came into the year thinking in terms of timing for the Class of '25 versus what we're seeing.

I mentioned our Stafford, Texas restaurant, which is in Houston, the delay of that, which was months of delays. And then for our Q4 openings, it's more back-end weighted in the quarter as well. So it's the timing component, the Class of '24 component that's primarily the driver, but you do get a little bit of comp in there.

Operator

Our next question comes from the line of Dennis Geiger with UBS.

Dennis Geiger

I wanted to ask another one just on the new stores and specifically the new stores outside of Texas. I guess just kind of clarifying the stores outside of Texas, newer stores outside of Texas, generally all or mostly performing well or consistent with expectations? Or Michelle, I couldn't tell if you were alluding to maybe some other markets a little softer albeit. Anything on the non-Texas newer stores to call out?

Michelle Greig Hook

Yes. I would say, Dennis, that it is primarily Texas. And when we say Texas, we have the Dallas restaurants in there as well. So when we think about the Class of '24, there's 3 restaurants that are in Dallas. There's 3 restaurants that are in Houston of the 10 that we opened. And so the other restaurants that you have in that class, Michael mentioned Florida. There's a Florida restaurant in there. There's an Arizona restaurant. There's a restaurant in Michigan. Those are largely performing near expectations.

I wouldn't say that there's any one of those restaurants that's I would call a home run restaurant. But the pressures that we're seeing are primarily the infill restaurants within the Dallas market, not all the Dallas infill restaurants, a certain -- a handful of those as well as Houston. So, that's why we called that out specifically. We're not -- the Arizona market continues to be, as Michael mentioned, a very strong market for us as we continue to infill that market, and we've been in that market for over 10 years. And so we're beginning to continue to build awareness. And then our second restaurant in Michigan is one that, again, is challenged by awareness. So, we got to continue to work through some of those challenges. But there's nothing outside of that, that I would call out that we're concerned about.

Dennis Geiger

Great. Helpful. And then just one more either for Michael or Michelle. As you think about sort of those 4 key priorities or initiatives to drive sales, how do you think about maybe the most impactful to support either transaction or comp gains in the back half of this year into next? And I'm sure it's all 4 and then some working in tandem, but are there any kind of particular call-outs? I know you've given some color on the initiatives individually, but just what you think could be more impactful for that -- for the base, driving that comp over the coming quarters?

Michael Osanloo

That's a great open-ended question, Dennis. Here's what I'd say. I think that the priority of those tactics is slightly different in the core versus outside the core. So when you think about in the -- like the continuous improvement on operations, getting great at drive-thru, that really benefits us in Chicagoland. So, every second that we can improve speed dramatically helps us in Chicago. We need awareness outside Chicago, particularly in Dallas and Houston as we open in Atlanta. We need people to know who we are. And that's where all that multichannel marketing.

We've got field marketers deployed right now who are sampling food, setting up fundraisers, going to local baseball games. In Texas, they're going to -- we're sending our Beef Bus to high school football games in the fall. That's a thing. They're stadiums with 10,000, 20,000 people. That's a great way of building awareness. So, you've got to do that. And then the sort of my favorite thing, which is not fully deployed yet is Perks. I think that as Perks matures, as we learn more, we will use it very surgically to drive guest acquisition outside Chicago and frequency in Chicago. That tool allows us to do basically one-to-one marketing, and it allows us to be very segmented in our approach. And that's, I think, what gives me the most confidence for '26 and beyond.

And of course, like I didn't mention the kiosks. I think we've done a great job with the kiosks. Our data and our partners' data would say we're awfully close to best-in-class already with the kiosks. But what I love about the kiosk is that it's just creating a frictionless environment for guests. There's a whole generation of people who just want to order digitally. They want to come into the restaurant.

They want to see pictures of food. They want to order it on the kiosk. We've made great strides on kiosks. They haven't even been deployed yet a year. And we're rolling out the next innovations over the next 6 months on kiosk. Already, if you come to one of our kiosks, you can see your order history. If you have something that's pretty specific, you can put it in once, you don't have to recreate it every time. So we're getting really good with kiosks, and I think that's another way of becoming frictionless for our guests.

Michelle Greig Hook

I would just add on to what Michael is saying in terms of the menu. And when you think about Perks, I think there's some cool fun things we can do with the menu when you talk about secret menu items, an exploration of what we're going to do with the menu as we move forward. I think there's some things that are potentially in the pipeline for us that we're exploring for menu innovation that could be fun and exciting, not so much in the short term in terms of the third quarter. But as we go into '26, I think menu innovation can play a role as well in helping to drive some transactions, whether it's in our core or outside.

Operator

Our next question comes from the line of Brian Harbour with Morgan Stanley.

Brian James Harbour

What are the in-line locations going to look like? I mean, how big are those? Like what's the experience going to be like there relative to kind of a typical Portillo's?

Michael Osanloo

Yes. So I would -- I don't know if we post them online yet. I'm sure we will in social media soon. But our Villages restaurant is gorgeous. It's a beautiful experiential restaurant. I mean, we call it an in-line. The truth is, I think, technically, it's an end cap. So it's a beautiful location. It's in -- I don't know how familiar you are with The Villages. It's one of the largest retirement communities in America. So it's a beautiful restaurant. We're not going to make them anything less than that. They still need to be experiential.

We want people to enjoy coming to Portillo's feel good about that dynamic. And then we want to win them over forever with amazing value, quality and speed. So, we're not -- when we say an in-line, don't think of a tiny little box that could be anything. It's still a Portillo's. It's still decorated to the 9s. It looks beautiful. You're still going to see people cooking in the kitchen. You're going to see action in the kitchen, and it's going to have that Portillo's look and feel.

Michelle Greig Hook

Yes. And I'll just add on to that, Brian. Not all are created equal. So as Michael said, The Villages may be different than a few in- lines that we're exploring for the pipeline, whether it's next year or in the future. I think what we're all excited about is the potential -- the return potential of these in-line units when you look at the investment cost and what we believe that the AUVs can do, what we believe that this can provide to the cash-on-cash return targets. I think as we sit here, the unit economic story for us is extremely important. And as we think about that class of restaurants, continue to drive that industry-leading unit economics is something that is paramount for us as we move forward. And I think the in-lines play a role in driving that for us when we think about the composition of classes as we move forward.

Operator

Our final question comes from the line of David Tarantino with Baird.

David E. Tarantino

One more on the performance of new units. And I guess, Michael, I know you've learned a lot as you've kind of opened some of these locations in Texas. And I wondered if you could just comment on whether you're thinking differently about how you enter new markets in the future. And I know you've talked in the past about marketing support, but also, I guess the nature of my question is you added a lot of locations in a fairly short window. And I'm wondering if you're rethinking whether that sort of pace of openings in the new markets should be adjusted going forward. So, any thoughts you have on that question would be great.

Michael Osanloo

You bet, David. Good to hear from you. I would tell you that there's -- you're always learning and trying to get better every single day, trying to get a little bit better than you were yesterday. And so our perspective is that we've learned a lot about how to open and how to open successfully. I think we're lulled into a false sense of security with the success of The Colony. It was just -- we put a lot in, in pre-marketing that restaurant. And it was just an enormous opening that almost broke the restaurant. So, we quickly then tamped down all marketing. And Houston was the result of that. We started off slow in Houston. And the fill-ins in Dallas were slow because we didn't really have a lot of active marketing going on.

So, I think the biggest lessons for us is we are -- we do want a big opening because we do want to get some excitement and momentum and get people engaged with the brand early on. And then we need to keep a steady drip of marketing going on during the course of the next, call it, 12 months. I think we'll see that in Atlanta. I think Atlanta is going to be an exciting good test for us. We're opening in Kennesaw, which is a very, very attractive market. It's a great location. We're doing all of the good grassroots things that we should do to build momentum. We're partnering with Coca-Cola who -- you don't get better at marketing than Coca-Cola. And we'll get some great activation in that restaurant.

I think the pace of growth is something that we continue to think about and learn from. I think implicit in your question is, did you build too many restaurants too quickly in Dallas? I think it's a very fair question. And I don't know if I have a clean answer for that. I think that clearly, without the marketing support, that was -- it was too many too quickly. The flip side is that we need to build awareness. And so maybe it's a combination of building and doing marketing to continue to build awareness and drive demand. So, I think that's more of a nuanced balancing act. And we'll continue to evaluate, look at what's happening in Dallas and figure out what the impact of that is in Houston, et cetera.

Operator

Thank you. We have reached the end of our question-and-answer session, and this concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation, and have a wonderful day.

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