18-Dec-2020

Darden Restaurants, Inc. (DRI)

Q2 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by, and welcome to the Fiscal 2021 Second Quarter Earnings Conference Call. All lines have been placed on mute to prevent any background noise. And after the speaker's remarks, there will be a question-and-answer session. [Operator Instructions]

I'd now like to turn the call over to your speaker today, Kevin Kalicak. Thank you. Please go ahead, sir.

Kevin Kalicak

Vice President, Investor Relations & Corporate Analysis, Darden Restaurants, Inc.

Thank you, James. Good morning, everyone, and thank you for participating on today's call. Joining me on the call today are Gene Lee, Darden's CEO; and Rick Cardenas, CFO.

As a reminder, comments made during this call will include forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. These statements are subject to risks and uncertainties that could cause actual results to differ materially from our expectations and projections. Those risks are described in the company's press release, which was distributed this morning and in its filings with the Securities and Exchange Commission. We are simultaneously broadcasting a presentation during this call, which is posted in the Investor Relations section of our website at darden.com.

Today's discussion and presentation include certain non-GAAP measurements, and reconciliations of those measurements are included in the presentation. We plan to release fiscal 2021 third quarter earnings on March 25 before the market opens followed by a conference call.

This morning, Gene will share some brief remarks about our quarterly performance and business highlights. Rick will then provide more detail on our financial results and share our outlook for the third quarter. And then Gene will share some closing comments.

Now, I'll turn the call over to Gene.

Eugene I. Lee

President, Chief Executive Officer & Director, Darden Restaurants, Inc.

Thank you, Kevin, and good morning, everyone. We continue to operate in a very fluid environment, and I was pleased with our ability to, once again, deliver strong profitability in an unpredictable sales environment. Total sales from continuing operations were $1.7 billion, a decrease of 19.4%. Same-restaurant sales decreased 20.6% and diluted net earnings per share from continuing operations were $0.74.

The last two weeks of the quarter negatively impacted our same-restaurant sales by approximately 200 basis points as we quickly went from 97% of our dining rooms being opened in the middle of the quarter to only 80% being open at the end of the quarter. As a reminder, Thanksgiving shifted back into our second quarter this year, and we believe guests modified their behavior in advance of the holiday.

During the quarter, we remained focused on four key priorities: the health and safety of our team members and guests, in-restaurant execution in a complex operating environment, deploying technology to improve the guest experience, and transforming our business model. The health and safety of our team members and guests has always been our top priority.

We continue to follow latest guidance from the CDC as well as our own enhanced safety protocols to create a safe environment for everyone. This includes daily team member health monitoring, requiring masks for every team member, enhanced cleaning procedures and social distancing protocols. I'm proud of the commitment our teams make every day to keep our guests and each other safe.

Second, our restaurant teams remain focused on our back-to-basics operating philosophy to drive restaurant-level execution that results in great guest experiences, whether our guests are dining with us or ordering curbside-to-go. Our teams have been operating in this environment for 10 months and they've become very adept at adjusting to the ever-changing COVID restrictions, while it's still not easy.

That's why we remain committed to our simplified operations, including streamlined menus, processes and procedures, which continue to strengthen our execution. And our guest satisfaction metrics confirm that our restaurant teams are doing a great job delivering exceptional guest experience in this challenging environment.

Third, we continue to deploy technology to improve the guest experience. Our brands benefit from the technology platform Darden provides, allowing each of them to compete more effectively by harnessing the power of our digital tools, including the 25 million e-mail addresses in our marketing database.

During the quarter, Olive Garden and LongHorn Steakhouse launched refreshed websites, and all our brands continue to use their digital storefronts effectively. More than 55% of our off-premise sales during the quarter were fully digital transactions where guests ordered and paid online. And at Olive Garden, 20% of our total sales for the quarter were digital.

During the quarter, we also rolled out Curbside I'm Here, which allows our guests to easily notify the restaurant that they've arrived to pick up their curbside-to-go order by simply tapping on a link embedded in a text message. As a result, our operators are spending less time on the phone and more time focused on ensuring orders are accurate and on time, which is leading to improved guest satisfaction scores.

We also introduced waitlist visibility, allowing guests to see their place on the waiting list using their phone regardless of whether they've checked in online or in-person. And we're working on several other initiatives, including streamlining our online checkout process and adding additional mobile payment options to provide even more convenience for our guests. We continue to accelerate our digital journey, and I'm encouraged by the progress we are making.

Finally, we continue to view this environment as a rare opportunity to transform our business model for long-term growth. We continue to make investments in our team members, product quality and portion sizes to ensure we emerge even stronger and better positioned to grow share.

Olive Garden same-restaurant sales declined 19.9%, as capacity restrictions continue to limit their top line sales. Olive Garden began November with 56 dining rooms closed and that number accelerated to 208 by the end of the month. However, they were able to deliver strong average weekly sales during the quarter of more than [ph] $73,000 (00:06:37) per restaurant, retaining 80% of last year's sales. Olive Garden also continued to realize operational efficiencies and strengthened margin as a result of the simplified menu and the elimination of promotional activity, including discounts.

In the current limited capacity environment, the reduced marketing spend was focused on showcasing the convenience of their off-premise experience, while featuring compelling core menu items rather than limited time promotions. This led to increased segment profit margin, while making additional investments in abundance and value.

Additionally, off-premise sales grew 83% in the quarter, representing 39% of total sales. Enabled by the technology investments I mentioned earlier, Olive Garden improved their to-go experience and achieved another all-time high in guest satisfaction for having orders ready to pick up at the time promised. Only Olive Garden successfully opened three new restaurants in the quarter.

LongHorn Steakhouse had another solid quarter. Same-restaurant sales declined 11.1%. Almost 20% of their restaurants grew same-restaurant sales in the quarter. They also successfully opened three new restaurants during the quarter. The LongHorn team remains laser-focused on their strategy of increasing the quality of their guest experience, simplifying operations to drive execution and leveraging their unique culture to increase team member engagement.

During the quarter, the team did a great job of managing controllable costs, while their simplified menu drove improved labor productivity. Finally, LongHorn grew off-premise sales by more than 175%, representing 22% of total sales.

And now I'll turn it over to Rick.

Ricardo Cardenas

Chief Financial Officer & Senior Vice President, Darden Restaurants, Inc.

Thank you, Gene, and good morning, everyone. For the second quarter, total sales were $1.7 billion, a decrease of 19.4%. Same-restaurant sales declined 20.6%. EBITDA was $206 million and diluted net earnings per share from continuing operations were $0.74.

Our second quarter start was encouraging, with weekly sales building on results from the first quarter. However, as COVID-19 cases began increasing in November and many state and local governments reimposed dining room restrictions, the last two weeks of the quarter trended down significantly. We estimate that this downward shift in sales over the last two weeks negatively impacted operating income by approximately $15 million.

Turning to the P&L. Food and beverage expense was 30 basis points higher than last year, primarily driven by investments in food quality and increased to-go packaging. Restaurant labor was 140 basis points lower than last year, with hourly labor improving by over 310 basis points driven by operational simplification. This was partially offset by deleverage in management labor due to sales declines and $3 million of emergency pay, net of retention credits, as we reinstated our Emergency Pay Program for our team members impacted by dining room closures.

Restaurant expense per operating week was 13% lower than last year, driven by lower repairs, maintenance and utilities expenses. However, sales deleverage resulted in restaurant expense as a percent of sales coming in 170 basis points higher than last year. We reduced marketing spend by almost $50 million this quarter, with total marketing 210 basis points favorable to last year. Restaurant level EBITDA margin was 17.9%, 140 basis points above last year despite the sales decline of 19%.

General and administrative expenses were negatively impacted by $8 million of mark-to-market expense on our deferred compensation. This is related to significant appreciation in both the Darden share price and equity markets this quarter. As a reminder, due to the way we hedge this expense, it is mostly offset in the tax line. Page

12 of this quarter's presentation illustrates the $8.1 million reduction of operating income and corresponding operating income margin reduction of 50 basis points from mark-to-market expense.

Our hedge reduced income tax expense by $6.4 million, resulting in a net mark-to-market reduction to earnings after tax this quarter of $1.7 million. The effective tax rate of 8.3% this quarter was lower by 5.1 percentage points due the tax benefits from the deferred compensation hedge I just mentioned. After adjusting for this, the normalized effective tax rate for the second quarter would have been 13.4%.

Looking at our segment performance this quarter. Olive Garden, LongHorn Steakhouse and our Other segment all saw segment profit margin increase despite sales declines. This was driven by our continued focus on simplified operations which significantly reduced direct labor and lower marketing expenses. Our Fine Dining segment profit margin of 18.8% was impressive, although below last year, driven by a 30% sales decline.

We ended the second quarter with $770 million in cash and another $750 million available in our untapped credit facility, giving us over $1.5 billion of available liquidity. We generated over $150 million of free cash flow in the quarter and improved our adjusted debt to adjusted capital to 58% at the end of the quarter, well within our debt covenant of 75%.

The board declared a quarterly cash dividend of $0.37 per share, 50% of our Q2 diluted EPS, within our long-term framework for value creation. We will continue to have regular discussions with the board on our future dividends. As I mentioned earlier, the quarter started with sales building upon first quarter results. As dining room closures increased, these improving sales trends reversed. As of today, we have approximately 77% of our restaurants operating with at least partial dining room capacity versus a peak of 97% in the middle of the second quarter.

Moving forward, we may experience further dining room closures and increasing capacity restrictions in the third quarter. As you may recall, in our last earnings call, we mentioned that the third quarter is historically our peak seasonal sales quarter, driven by the Christmas, New Year's and Valentine's Day holidays as well as travel time during this time of year. At that time, we also stated that it will be more difficult to increase on-premise average unit volumes if capacity restrictions do not ease. Current dining room closures, capacity restrictions and reductions in travel will exacerbate our same-restaurant sales comparison to last year due to the higher sales – seasonal sales from last year. Additionally, there are still uncertainties surrounding further capacity limitations and dining room closures and the duration of these impacts.

Given all these factors, we are providing a broad range of expectations for the third quarter. We expect total sales to be between 65% and 70% of prior year levels, resulting in total sales of between $1.53 billion and $1.65 billion, EBITDA between $170 million and $210 million and diluted net earnings per share from continuing operations between $0.50 and $0.75 on a diluted share base of 132 million shares. With dining rooms closures increasing, we are focusing on our playbook of expense management and off-premise sales. While there is encouraging news on the broad distribution of COVID-19 vaccine in the spring, we currently don't anticipate meaningful sales trend improvements until sometime in the fourth quarter of fiscal 2021.

Despite the short-term headwinds we face with sales trends, operational complexity and impacts to our team members, I am confident we are making the right decisions for the long-term to create a better guest experience and strengthen our business. And consistent with our messaging last quarter, we continue to believe we can achieve 100% of our pre-COVID EBITDA dollars at approximately 90% of pre-COVID EBITDA – pre-COVID sales while continuing to make appropriate investments in our business.

Now, with that, I'll turn it back to Gene.

Eugene I. Lee

President, Chief Executive Officer & Director, Darden Restaurants, Inc.

Thanks, Rick. This morning, we also announced that Rick will become our President and Chief Operating Officer. Rick's career represents what our industry is all about. He joined Darden as a buster at Red Lobster in 1984, and has worked extremely hard mastering many functions. On January 4, he will become the President of the world's largest full-service restaurant company. He's been a great partner to me over last five years, and I look forward to working side-by-side with him in his new role.

Additionally, we announced that Raj Vennam will become our Chief Financial Officer. Raj began his career at Darden in 2003 and has done an exceptional job in every role he has held. His promotion recognizes the significant contributions he has made to our individual brands as well as the greater organization. With a brilliant mind and a keen understanding of our industry, Raj is the perfect person to take over for Rick. I'm excited to see him expand his role in the company as CFO. Rick and Raj are here with me in the room today, and I want to take this opportunity to congratulate both of them.

I want to close by recognizing our team members in the restaurants and at the support center. I can't say enough about the dedication they've demonstrated throughout the year. Their focus, commitment and determination is exceptional. With multiple jurisdictions implementing dining room closures, we know many team members will not get the hours they needed during this holiday season. That is why we have reintroduced our Emergency Pay Program that will provide three weeks of emergency pay to team members who are furloughed from their restaurant when dining rooms are closed. Our people are our greatest competitive advantage and we're committed to taking care of them.

On behalf of the management team and the board of directors, I want to thank all our team members for your tireless effort to serve our community by providing the comfort of a warm meal. Thank you for going to the extraordinary lengths to take care of our guests and each other. I wish you all a safe and a happy holiday season.

And with that, we'll take your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from the line of David Tarantino with Baird. Go ahead, please. Your line is open.

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

Q

Hi. Good morning. First, Gene, congratulations on being elected to Chair of the Board. And Rick and Raj, also congratulations on your promotions, very well deserved. Gene, my question is about those changes. I want to maybe to hear your thoughts on how your day-to-day involvement will change as a result of Rick taking on the President and COO role? And just your thoughts on whether investors should sort of interpret this as a signal that you'll be less involved in the business going forward?

Eugene I. Lee
President, Chief Executive Officer & Director, Darden Restaurants, Inc.

A

No, absolutely not. I plan on being as involved operationally as I ever had. That's my strength. I mean, I see this as an opportunity to create growth for both Rick and Raj. I think it's going to give Rick an opportunity to understand operations more deeply. Obviously, he has a great relationship with our presidents today, but I think it's important for him and his development to get a little deeper into the operations and get to know and oversee a lot of the other people that make things happen, just not the president.

I also think it's important for him to partner with me on making sure that we are leveraging all the non-consumer facing parts of our business and to see if there's an opportunity to continue to find additional synergies to enable us to further invest in our business. And so, I see this as an opportunity to work with people that deserve the opportunity to grow. And more importantly, have an extra set of hands to be able to do some things and look at things maybe a little bit differently.

Giving Rick the freedom and the time to look across the organization and see where we can pick up some additional synergy, I think, is a good thing. I think that I try to do that even in the position that I was in, but there's a limit to the amount of time you have. I think giving Rick that time will be very beneficial to the organization as we move forward.

So, I'm excited about these changes. I don't think anybody should read anything into it. I'm going to still be heavily involved in the food servicing atmosphere just the way I am today, and I look at it as a great opportunity. I also look forward to working with Raj and giving him a chance to develop into a world-class chief financial officer, and I think that's going to be really exciting. So, don't read anything into it other than we're creating growth for our people, creating new opportunities, and we have a few things that we want to get done with this change.

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

Q

Sounds great. Congrats again to all of you.

Operator: Our next question comes from the line of Chris O'Cull with Stifel. Go ahead, please. Your line is open.

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

Q

Thanks. Good morning, guys. Gene, how is the company thinking about returning to a normalized marketing spend? Meaning, does the company plan to wait until government restrictions on dining usage are lifted? Or does the company plan to see what kind of pent-up demand there's going to be as consumer mobility increases to determine how much advertising you'll utilize? I'm just trying to get a sense for how you guys are thinking about that?

Eugene I. Lee
President, Chief Executive Officer & Director, Darden Restaurants, Inc.

A

Yes. We have no definitive plans to put back marketing at this point in time. Obviously, we have developed multiple options of how to come back and use those resources that we have. But I think in part of your question, I think the answer is there, is that we're going to look and see what the competitive environment is like. We want to see what the pent-up demand is like.

And we're going to put back the marketing – put marketing resources back in the business judiciously. And I would love to get to a point where we can grow our business and rely a little less on advertising spend. We really like the P&Ls with the marketing line at the level it's at right now. And so, there's no predetermined outcome on this. We just – we need to get into the competitive environment and then make our decisions then. We have developed multiple options, if needed.

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

Q

Great. Congratulations on everyone's promotions.

Operator: Our next question comes from the line of Andrew Charles with Cowen and Company. Go ahead, please. Your line is open.

Andrew Charles
Analyst, Cowen and Company

Q

Great. Thanks so much. Gene, Rick and Raj, Happy Holidays and congrats on the well-deserved promotions. Gene, did the most recent few weeks of sales trends change your view from last quarter that 5% to 15% of the category is likely to see store closures? And what I'm trying to get at is are you starting to see more favorable terms from landlords and developers that will benefit the development pipeline as you look out to the 2022 and 2023 class of openings.

Eugene I. Lee
President, Chief Executive Officer & Director, Darden Restaurants, Inc.

A

I don't think – I mean, I think that my position on closure is still in that 5% to 15% range. And it's unfortunate that a lot of these small businesses are being impacted this way. Because I do think it has – it will have a negative impact on the creativity of our industry, so on and so forth. So, as far as real estate goes, I think that my position on that is still pretty much the same is that there's more availability out there right now. However, we're not seeing any weakness in the rent deals. I think what we're – I think there's some speculation going on out there right now with some of the REITs.

So, I think as we move forward, we'll continue to try to grow our businesses responsibly. We want to eventually get back into our long-term framework. We'll give you some more guidance in March, exactly how we're thinking about FY 2022 for development. But we reconfirmed our guidance for this year and hoping that we can get the number of restaurants that we talked about in the press release open. And we have a bunch of restaurants today sitting there ready to go and that are ready to open. We just need to – our guideline here is once we get to approximately 50% occupancy in a jurisdiction, we will go ahead and open that restaurant and we've been very successful doing that.

Andrew Charles
Analyst, Cowen and Company

Q

Thank you so much.

Operator: Our next question comes from the line of Brian Bittner with Oppenheimer & Company. Go ahead, please. Your line is open.

Brian Bittner
Analyst, Oppenheimer & Co., Inc.

Q

Thanks. Good morning and I echo the congratulations to all three of you on the upcoming move into our new roles.

Gene, in the press release and on this call, you talked a lot about the fact that you're taking this opportunity to transform the business for long-term growth. And on the call, when you spoke about that in your prepared remarks, you specifically said employee investments and some menu and portion changes, but can you just talk a little bit more beyond that? What else are you doing to truly transform this company for long-term growth? And how do you strategically think about growth both for the AUV recapture opportunity and the unit and portfolio growth of the company in the long-term?

Eugene I. Lee
President, Chief Executive Officer & Director, Darden Restaurants, Inc.

A

Well, good question, Brian. I think we think about it in three ways, right? What are we doing to ensure that we can grow the base from a same-restaurant sales perspective, and I think a lot of simplification and the efficiencies that we're creating, but more importantly and I think I talked about this in the last call is as we brought our menus down, we've learned a lot about guest behavior and what the guests wanted to buy without our nudge and I think that's really been eye-opening for us. And I think that that's going to strengthen the operation and day-to-day operation on that side. So I really think that we're well-positioned there. We've done a lot of good work to ensure that our brand is set up for success.

Secondly, we talked about transformation. And when we go to the second bucket of growth, which is new restaurants, the key here is that we believe that the business model from a cost side is much stronger than it was pre-pandemic which should enable us to be able to grow and especially in Olive Garden, deeper than we may have thought we would be able to grow pre-pandemic. So that's one of the things that I'm really excited about is we think that we can actually, over time, tick up Olive Garden growth and handle – because of the improvements we've made, we think we can handle the cannibalization a little bit better and still get a good return on our investment.

The third bucket that you highlighted was really around how do we continue to add brands to the platform? And as I've said forever, we continue to look at what our options are the filter that we use really comes down to does it benefit us to put that brand on the platform, does the platform benefit that brand, do we think it can grow faster than Olive Garden to improve our growth rate? And we've historically done something every three or four years. This has obviously been a different period of time but we believe that to be an avenue of our growth and to support our long-term framework. And so I think we're really well-positioned in those three buckets to drive the business.

The last thing that I would say is I think that in this transformation, it's moved a lot of the technology forward faster than what we originally are planning to do. And the big change for us is moving how we handle the off-premise business, which has been a big part of our growth historically over the last five years as we capture the convenience trend. But really getting clarity that this is going to be a curbside business that's going to be technologically enabled versus someone coming to the restaurant and getting out of the car and coming to pick it up.

And I think that we've really worked hard and our team has done a great job. And I think that experience today, when you come into an Olive Garden, especially Olive Garden and LongHorn, in all our brands but really this is an Olive Garden play because the food travels so well. I think that that's going to really be a competitive advantage going forward.

Brian Bittner
Analyst, Oppenheimer & Co., Inc.

Q

Thanks for that, Gene. And nobody seems to be taking their follow-up but I'm going to ask one, if you don't mind. The step-back that's happening in the business in the third quarter, it's pretty telegraphed by what's been happening in the world. But when you look back at the quarter that you just reported, when you got to that 97% of units offering in-store dining in the middle of the quarter, can you give us a peek into how the business was performing with that type of percentage of stores operating in that manner?

Eugene I. Lee
President, Chief Executive Officer & Director, Darden Restaurants, Inc.

A

Well, I think there are still geographic problems and I would say that we know we were really adhering to the social distancing. But the business, in some ways I gave you [ph] that because (00:29:14) I say we – in the last two weeks, cost us 200 basis points for the quarter. And so I think there are parts of the country that were performing really well. And I think you can look at the mobility index out there and see what parts of the country were performing well. And so you look at Georgia and Texas; Florida hasn't been performing as well just because the tourism is down and we have a lot of restaurants based in tourism.

But in our non-tourist markets in Florida, we're performing well. So we had some good momentum but we knew as a management team that we weren't – this wasn't done; that we're going to face this second wave and we're prepared for it. And we had good processes and we've been able to wind down the businesses effectively to off-premise only, and then we'll quickly be able to wind them back up and take advantage of the opportunity.

Brian Bittner
Analyst, Oppenheimer & Co., Inc.

Q

Thank you and congratulations, guys.

Operator: Our next question comes from the line of Eric Gonzalez with KeyBanc Capital Markets. Go ahead, please. Your line is open.

Eric Gonzalez
Analyst, KeyBanc Capital Markets, Inc.

Q

Hey, thanks. And I'd also like to add my congrats on the promotions. My question is as we look ahead to the vaccine rollout can you talk about what you think you need to do differently in order to maximize the opportunity to capitalize on that pent-up demand that likely exists?

And as a follow-up to that, what do you think the flow-through rate is on incremental sales today and what do you think it will be post-vaccine, assuming you don't need to discount or advertise? Thanks.

Eugene I. Lee
President, Chief Executive Officer & Director, Darden Restaurants, Inc.

A

I'll let our new President answer that.

Ricardo Cardenas
Chief Financial Officer & Senior Vice President, Darden Restaurants, Inc.

A

Well, first of all, thanks, everybody, for all the kind words. And I want to congratulate Raj as well on his promotion. He's been a real partner to me over the 4.5, 5 years that I've been the CFO and so I appreciate that.

What are we going to do to capitalize? Gene's been talking a lot about what we're doing to make sure that we invest in our team members, invest in our food and as the restaurants start to ramp up, we really believe that we're seeing and we've seen growth when those restaurants start to open.

We're not going to talk strategically about what we're going to do to capitalize on that, but just know that our business model is so much better that even if we – as we get our sales to grow, our margins will continue to improve, which gets you to the second part of that question that you asked and the question is flow-through on incremental sales.

As we look at what we're doing today, right, today our variable margins are closer to 50% and before they were closer to 40%. And so we've taken a lot of costs out, but some of those costs will come back in. And as we mentioned – and that would imply about 150 basis points of margin improvement over the long run.

But right now, incremental profitability is pretty strong. When we started to see some closures, we started to see that drop. And so as we move forward, we still believe that we're going to get to 100% of our pre-COVID EBITDA, 90% of pre-COVID sales. We just don't know when we're going to get to the 90% of pre-COVID sales.

Eric Gonzalez
Analyst, KeyBanc Capital Markets, Inc.

Q

Very helpful. Thanks.

Operator: Our next question comes from the line of Chris Carril with RBC Capital Markets. Go ahead, please. Your line is open.

Christopher Carril
Analyst, RBC Capital Markets LLC

Q

Hi. Good morning, Gene, Rick and Raj, congratulations on your new roles and the promotions announced this morning.

Rick or Raj, could you please provide your thoughts on how to think about G&A now moving forward, both in the near term and longer term? At this point, how much of the savings that you've seen thus far do you think could be held on to in a more normalized environment? And how does the increased focus on technology impact us?

Ricardo Cardenas
Chief Financial Officer & Senior Vice President, Darden Restaurants, Inc.

A

Yeah, Chris. Thanks. The G&A, I'll talk about this quarter that we just ended. As you saw, we reported about $90 million in G&A, but that would have been closer to $82 million without that mark-to-market expense. And as you recall, at the end of the first quarter call, we talked about the early retirement program that we had saving us about $25 million to $30 million a year. We're still seeing that, and we still believe that we'll keep that as we move forward.

But we've also had some savings in G&A because of reduced travel and other things, no General Manager Conference and those kind of things. Those things will come back. How fast they come back is the question, but we're running about 5% G&A – 5.5% G&A right now which is remarkable considering our sales where they are. As we get back to our pre-COVID sales, we will start seeing G&A come up a little bit, but nowhere near where it was before because of that $25 million to $30 million – I'm sorry, $25 million to $30 million of savings that we got on early retirement.

Christopher Carril
Analyst, RBC Capital Markets LLC

Q

Got it. Thank you. And just, again, the increased focus on technology, is there any potential impact there?

Ricardo Cardenas
Chief Financial Officer & Senior Vice President, Darden Restaurants, Inc.

A

Yeah. No, we've been investing in technology for years. As we continue to work on our technology investments, that will impact the depreciation line, amortization line going forward, but we also have some projects that we worked on, five and six [audio gap] (00:34:34) would fall off. We're going to continue to invest in technology.

Will that help make us more efficient here in the support center? Yes. But a lot of our G&A is out in the field and our Directors of Operations and our Senior Vice Presidents of Operations and technology will help them be more effective and more efficient, but it won't get us a whole lot of G&A save. But absolutely, the technology investments we're making are more about in restaurants. So that's not a G&A, that's kind of restaurant margin.

Christopher Carril
Analyst, RBC Capital Markets LLC

Q

Got it. Thank you.

Operator: Our next question comes from the line of Jeffrey Bernstein with Barclays. Go ahead, please. Your line is open.

Jeffrey A. Bernstein
Analyst, Barclays Capital, Inc.

Thank you. Good morning, and congratulations, Gene, Rick and Raj. One question and then a follow-up. The question just in terms of the labor outlook, obviously, lots of moving pieces, and I think we'd agree Darden is an employer of choice. And with unemployment up, inflation, in theory, should ease and you experienced significant leverage in the second quarter.

I'm just wondering how you think about that in the context of potential for national minimum wage increase, just wondering your bigger picture industry thoughts maybe using Florida as a guide or how you think about how you can offset that, whether with cost savings or menu pricing or just broad outlook on the labor line going forward. And then I had one follow-up.

Ricardo Cardenas
Chief Financial Officer & Senior Vice President, Darden Restaurants, Inc.

A

Yeah. Good morning, Jeff. Labor definitely is a little bit of a question mark, right, for us and for the industry. But as we think about labor, we've dealt with the structural increases over time very effectively. We are better positioned than anybody else in the industry to be able to deal with that because of where our margins are today.

Do I – [ph] at bottom (00:36:21), if you're asking me, do I think there'll be a federal minimum wage increase that's similar to Florida, I think, over time that we will see federal minimum wage increase, but not at the same rate as Florida. I think the key for us and the way we're thinking about it is how do we get to the right tip wage and to keep that relationship between the constituents – two constituents; the guest and the server, that don't want that relationship to change, albeit people in public office and some advocacy groups believe that that relationship should change where our team members and servers really don't want that to change.

So how do we protect that, get that to the right level? If we're all – if the industry is all faced with it, then we're going to have to figure out how, from a pricing standpoint, we are able to pass that through. I think long term, when I look at the P&L and think about it, I think California is an example of it today. You're going to end up with a little bit lower cost of goods sold and a little bit of higher labor cost, but you're going to end up at the same place.

And so as long as you're thinking about it that way, I'm confident in our ability to manage that over the long term. Could it have some short-term impacts in volatility of the cost structure? Yes. But long term, I like where we're positioned and our ability to be able to deal with it.

Jeffrey A. Bernstein
Analyst, Barclays Capital, Inc.

Q

Understood. And then just the follow-up, you mentioned earlier, Gene, that maybe there's an opportunity to increase penetration of your brands, obviously, Olive Garden is the furthest along, so maybe that's the best example. I'm just wondering whether there's any quantification on that or how you would think, as an alternative, about maybe using ghost kitchens. I mean with your portfolio being as large as it is, I would think you can create your own ghost kitchen just of your own portfolio since the brands are already pretty well-known and not necessarily need to open up as many new boxes. So just trying to get a sense for that. Thank you.

Eugene I. Lee
President, Chief Executive Officer & Director, Darden Restaurants, Inc.

A

No. We believe we're an on-premise restaurant company and we strongly believe that demand for in-restaurant dining is going to come back really strong. There'll be some fall-off on the off-premise occasion. I think people have a lot of fatigue with that right now. Long term convenience is going to – and when you think about long term, convenience is still going to be important, but I think that right – and off-premise will come back and be strong, it's going to be stronger at some point than it was pre-COVID.

But I believe that these brands need to be developed to be on-premise locations that's your primary business, that drives an auxiliary business which is your off-premise location, for off-premise business, but you developed a brand in a box and we create a great in-restaurant experience. And the logistics of moving that the last mile are just so, so expensive and something that we know really cuts into the profitability and something that we don't want to be involved in.

Jeffrey A. Bernstein
Analyst, Barclays Capital, Inc.
Q

Thank you.

Operator: Our next question comes from the line of Peter Saleh with BTIG. Go ahead, please. Your line is open.

Peter Saleh
Analyst, BTIG LLC
Q

Great. Thank you and congratulations to the team on the promotions. Gene, I wanted to ask if you can give us an update on the Cheddar's brand, and what, if any, changes you guys have made throughout the pandemic and how should we think about the unit growth of that concept when we come out of this pandemic?

Eugene I. Lee
President, Chief Executive Officer & Director, Darden Restaurants, Inc.
A

Yeah. I think we talked about it on the last call, the biggest transformation we've made in the cost structure has been at Cheddar's. As we simplified the menu, we really were able to get in there and look at all the processes and procedures from the back door to the dining room table, and the team has made great progress there which has resulted in a significant reduction in labor costs.

And we've had a significant reduction in the waste in that business around cost of goods sold which has really changed the business model. Prior to the pandemic, we had just rolled out croissants to every single guest, which is being received very well and we were able to absorb the pricing that we implemented. When we did that, our value ratings have actually increased.

I think the other thing that, going through this crisis, has accelerated their off-premise capabilities. Prior to the pandemic, we did not have a ton of capabilities there. We only had a couple of phone lines. It was just a mess. So we've increased the number of phone lines. We've got online ordering in place.

We've now got the Curbside I'm Here in there. And the take-up business is growing fairly rapidly through the pandemic and we're very pleased with that. We've got to get better at it, because it's not a core competency in Cheddar's, but I think the team has been working really hard on it and I know they've got a big initiative, and I'm really proud of what they're doing.

As far as unit growth goes, we've really – I always talk about human resources when we talk about unit growth. We've stabilized the human resources in Cheddar's. The human resource metrics are getting closer to Darden metrics. I think actually management turnover is actually in the middle now after being such an outlier for so long. So I'm excited about that but we still need to build management strength to handle growth.

Now, we've been opening restaurants all the way through the transition, through the pandemic and really through the integration. And I would expect unit growth to be somewhere in that 5% to 8% range, which I think we can handle from a human resource standpoint. So it's additive to our growth rate. We're excited about the business and we're excited to see what the P&L will really look like in a post-pandemic environment. We've always loved the business and we love the business today. We're excited about it. We got – the team's done a great job. I'm really proud of them.

Peter Saleh
Analyst, BTIG LLC
Q

Do you anticipate having to spend more as a percentage of sales for Cheddar's, on the marketing side, to accelerate that growth in the coming quarters or year?

Eugene I. Lee
President, Chief Executive Officer & Director, Darden Restaurants, Inc.
A

No. We just don't have – we don't have a density in that business to be cost-effective from a marketing standpoint. I think we'll continue to use a digital – our digital capabilities there. But really it was always a high-volume concept that didn't have the cost structure set up right. Now, we have the cost structure set up – we think set up right and doing 5,000 guests a week, I think that the growth from that business really comes from new units, not really comp growth because there's not many restaurant companies out there are doing 5,000 guests a week.

Peter Saleh
Analyst, BTIG LLC
(

Thank you. Very helpful.

Operator: Our next question comes from the line of John Glass with Morgan Stanley. Go ahead, please. Your line is open.

John Glass
Analyst, Morgan Stanley & Co. LLC
Q

Thanks very much. Happy holidays to everyone and congratulations from me as well. Rick and Raj, just maybe two – maybe more boring finance questions: One is just on the third – on your current quarter guidance, even at the high-end it would assume revenues might be a little lower than they are in total revenues this quarter. But the operating margins might be actually higher, I should say, EBITDA margins. Is that just a function of like the G&A which was a little bit off this quarter because of mark-to-market? Is there something else going on that would actually allow you to even have higher profitability versus second quarter on lower sales?

Ricardo Cardenas
Chief Financial Officer & Senior Vice President, Darden Restaurants, Inc.
A

John, no, I think you've got it a little bit on the G&A front. But as we continue to reopen restaurants, we're getting more efficient at that, right? So if restaurants come back and reopen, we're just getting better at doing that. And as restaurants close, we're getting them more – we're more efficient doing that as well. So we just believe that we've got a business model that's wired pretty well right now and that should show up in our margins in Q3.

John Glass
Analyst, Morgan Stanley & Co. LLC

Q

And the next – this is probably the last quarter we'll be talking about negative same-store sales and then you start to lap the May period, et cetera, where – how should investors sort of think about how to model the business or think about the recovery? Should we just focus on average unit volumes and then just sort of back into this implied same-store sales because that's what really drives things to be really – year-over-year doesn't matter, it's really just the volume capacities are limited to a point until those capacity restrictions end. Is that the best way to think about your business over the next couple of quarters after you start lapping the pandemic?

Ricardo Cardenas
Chief Financial Officer & Senior Vice President, Darden Restaurants, Inc.

A

Yeah. John, I think what investors have to do is make assumptions for when the pandemic starts to ease and when dining room restrictions kind of re – when dining was reopened and then look at our average unit volumes, what we're doing today and kind of put some kind of a factor on that. And you can kind see some of the things that we've shown in our releases and pretty transparent on our weekly sales and restaurants that have dining rooms open versus the total company, and just kind of make your best guesses on when you think the pandemic is going to wane and when dining rooms are going to reopen. We can't tell you when that is, but we feel really confident that when it does happen, we're going to be there to capitalize on it.

John Glass
Analyst, Morgan Stanley & Co. LLC

Q

Great. Thank you.

Operator: Our next question comes from the line of Dennis Geiger with UBS. Go ahead, please. Your line is open.

Dennis Geiger
Analyst, UBS Securities LLC

Q

Thank you and congrats to all on well-deserved promotions. Gene, wondering if you could talk a bit more about technology and the digital platforms? You talked a bunch about the initiatives that recently rolled out and those that are coming, but can you size up the opportunity a bit more on the role that tech plays and digital plays and can play for the brand, perhaps a bit more maybe on some of the top line benefits and thinking about guest satisfaction, speed ultimately and sales?

And then, Rick, I think you talked some about the benefits from a cost and margin perspective a little bit, but if there's anything more to kind of frame up that net opportunity as well? Thank you.

Eugene I. Lee
President, Chief Executive Officer & Director, Darden Restaurants, Inc.

A

Well, I think, first of all, I think technology really helps you on the off-premise side. As we talk to our guests, they continue to tell us they don't want a technologically advanced or enabled in-restaurant experience. They don't want to look at digital menus. I mean as we put the QR codes out there and have people try to look at their menus on their phone, they really pushed back. They don't like that.

And so that trend, I don't think, is going to take place in-restaurant. We're playing with some handheld devices to see if we can get orders quicker. I think that Ziosk has played a major role in a lot of our brands. It's enabled our servers to, in a non-pandemic time, be able to use that device to get orders in. It really does a great job on payment. The adoption rate on payment is extremely high with that device as the consumer becomes used to using it.

So in restaurant, I don't see a ton of technological advances there over time. I think the things that we're working on; I think the wait list is important. Again, I mean the big one that we're working on right now is how do you accelerate the checkout process on an online order and how can that be as friendly as the big retailers? And so those types of things on the margin, I think technology is there.

We are fairly technologically advanced with our dining room system, our KDS system. I'm not sure how much more is there that we see right now. We are working on a technology roadmap over the next five years to figure out where do we want to invest and how do we get the highest return on that? And so there's still work to be done. I think the majority of it still is on off-premise to accelerate that.

And on the other side, we don't talk much about but when you think about the size of our e-mail database today and how we interact with our guests digitally, we'll continue to evolve that and get better at that and more efficient with that, trying to figure out how to communicate more effectively with our consumers and let them know about the things that might drive a visit.

So I'm excited about that. There's a lot of engagement digitally with our brand, both on – from an e-mail database, from social. Just think about what happened last week when Taylor Swift dropped the song with Olive Garden in it and how we were able to capture that socially and create buzz around that. And all of a sudden, when Taylor Swift drops our name in a song, our brand becomes very, very relevant.

It's a 40-plus year old brand that's all of a sudden relevant with her audience. And our team is working around-the-clock to capitalize on that activity. And to those that are listening that were on that team, they did a fantastic job to be able to make that relevant. So thank you to them and thank you to Taylor Swift for dropping Olive Garden in her song.

Dennis Geiger
Analyst, UBS Securities LLC

Q

Thank you.

Operator: Our next question comes from the line of Jeff Farmer with Gordon Haskett. Go ahead, please. Your line is open.

Jeffery Daniel Farmer
Analyst, Gordon Haskett Research Advisors

Q

Great. Thank you and congratulations to all three of you, well-deserved across the board. Another labor question for you, so if memory serves, you saw 350 basis points of hourly labor favorability in the fiscal first quarter. It sounds like you guys just talked about 310 basis points in the second quarter. How should we be thinking about favorability moving forward, especially with the emergency pay coming back?

Ricardo Cardenas
Chief Financial Officer & Senior Vice President, Darden Restaurants, Inc.

A

Hey, Jeff, this is Rick. On the labor front, the hourly labor of 310 basis points favorability this quarter, it was really driven by the fact – compared to 350 basis point in Q1, it was really driven by the fact that in Q1, we had a much,

much more simplified menu in some of these restaurants because some of them were still to-go only. Some of those restaurants were running with very few hourly employees.

And so as we started ramping up dining rooms, yes, we added some labor, but 40 basis point difference isn't very big when you consider the sales that we added from Q1 to Q2. And the emergency pay isn't – we don't necessarily put that into our direct labor cost. It's more in the kind of fixed labor. We talked about it. So when we talk about the 310 basis points to the 350 basis points, it does not include emergency pay.

Jeffery Daniel Farmer
Analyst, Gordon Haskett Research Advisors
Q

Okay. And just as a follow-up, again, on labor, this is a popular investor question but – you touched on it. But with indoor dining suspensions affecting roughly 25% of the system, as you – most recently, can you provide some color on the impacts that has on variable restaurant-level costs specifically on the labor and restaurant expense lines?

And I know you've shared some color on hourly versus management labor as a percent of total labor but anything there to sort of help analysts and investors understand the movement between fixed and variable costs for restaurants that are essentially close to indoor dining?

Ricardo Cardenas
Chief Financial Officer & Senior Vice President, Darden Restaurants, Inc.
A

Yeah. When you think about when you have no indoor dining, a big part of our restaurant is the servers. And so that's a little bit less – actually, a little less efficient in number of hours than an off-premise business.

On dollars, it's not so bad. But on an hour's basis, you have a lot more servers per guest than you do on a to-go experience. So actually, it does help us a little bit when we go to off-premise only just for a little bit of time. We actually don't like to be off-premise only. We would much rather have the total sales and the total margin of being open on-premise.

In relation to the fixed versus variable, that – as the definition says, the variable cost definitely go way down as our sales go down. Most of our costs on the fixed side will be there. We have a few things that we can turn off when we go to off-premise only; the TVs, the music and those kind of things but that's not significant.

The other thing that is significant is we have a little less repair and maintenance. When your restaurant isn't getting beat up in the dining room, you don't have to do as much repairs there. But I would say we would much rather have a full restaurant, full dining rooms and deal with the cost of that than have empty dining rooms and just do off-premise.

Jeffery Daniel Farmer
Analyst, Gordon Haskett Research Advisors
Q

All right. Thank you.

Operator: Our next question comes from the line of Lauren Silberman with Credit Suisse. Go ahead, please. Your line is open.

Lauren Silberman
Analyst, Credit Suisse Securities (USA) LLC
Q

Thanks for the questions and congrats to all. Hopefully, this time next year all restaurants will be open at full capacity. When you reopen restaurants, how long does it take for restaurants to ramp up sales to their full allowable capacity? So is it immediate, takes several weeks to build? What I'm trying to get at is how quickly do you expect to reach full pre-COVID sales levels, assuming capacity restrictions are lifted 100%?

Eugene I. Lee
President, Chief Executive Officer & Director, Darden Restaurants, Inc.

A

Well, I think that – I mean that's hard for us to really define for you. I think that from our standpoint, we can – other than maybe having to ramp up some staffing, we can get to a point where we can move back to 100% fairly quickly of where we were from a volume standpoint. I think even staffing, it would be more of a fatigue thing because we'd probably have to work our people more hours than what they are used to in the near-term, but I think we can get there right away.

The question is going to be more on the consumer demand is that – is this going to come back in all at once or is it going to come back over a period of time as more and more people get comfortable. You think about the different demographics out there today and is it going – are people going to, as soon as they are vaccinated, say, okay, I can get out and move or are they still going to be cautious? And that to us is the unknown.

But what I would tell everybody on the call and our investors is that we're going to be prepared to be able to handle this situation as it unfolds. And we're going to be in a situation where I think that our brands are trusted and beloved by our guests and that people, once they feel good about being able to have a little bit more mobility, they're going to come back to us quickly and we're going to be ready to serve them a great meal and deliver on our expectation.

Lauren Silberman
Analyst, Credit Suisse Securities (USA) LLC

Q

Great. And then Gene you touched on ghost kitchens but extending that to virtual brands operating out of business, [ph] seeing (00:56:02) restaurants, more restaurants that are developing these virtual concepts to complement their businesses and add near-term sales, I think uncertainty regarding the staying power over the long-term. Last quarter, you said this wasn't the right approach for Darden. Is that still your view and can you just expand on your view on the concepts of virtual brands and whether that's appropriate for any of those concepts in the Darden portfolio?

Eugene I. Lee
President, Chief Executive Officer & Director, Darden Restaurants, Inc.

A

It's still our position. We believe that we need to stay focused on running the brands that we've spent many, many years investing in; in marketing, in building and I believe that that's the right place to be. I believe, as I said last quarter, others have got to do what they think they need to do to run their business. I think the question that I would ask is who owns the virtual brand? Is it the kitchen or just DoorDash on the virtual brand?

Lauren Silberman
Analyst, Credit Suisse Securities (USA) LLC

Q

Great. Thanks.

Operator: Our next question comes from the line of Jon Tower with Wells Fargo. Go ahead, please. Your line is open.

Jon Tower
Analyst, Wells Fargo Securities LLC

Q

Awesome. Thank you. Appreciate you taking the questions. Congrats to the team. Happy Friday and happy holidays to everybody. Just two follow-ups really: First one, when thinking about the targeted 100 to 150 basis point margin improvement over time, does that take into account potentially a higher or a lower level of marketing spend over time or essentially returning back to, say, the 3% spend?

And then digging a bit deeper into the unit potential we were discussing a little bit earlier, when thinking about it are you contemplating the idea of potentially putting more units in an existing trade area or do you think that there is greater opportunity for your brands to move into smaller markets over time and is this more about the portfolio or Olive Garden-specific?

And then just one more on top of it, yeah, how much has cannibalization weighed on same-store sales and margins historically?

Ricardo Cardenas
Chief Financial Officer & Senior Vice President, Darden Restaurants, Inc.

A

Hey, Jon, this is Rick. I'll go through those questions. So lower marketing is part of the $100 million to $150 million – 100, 150 basis points, I'm sorry. But most of that is going to be from our labor efficiencies that we've come to play.

As sales go back up, depending on what the competitive environment looks like, we will market and Olive Garden is a national brand. And one of the benefits of Olive Garden is their scale and their national footprint, so Olive Garden will be on TV nationally because we think that's a big competitive advantage for us.

And so marketing will come back, not to the level it was before but most of our 100 to 150 basis points is going to be on the labor front. As it relates to unit potential, while we're not going to give a number on units, Gene did mention Olive Garden, seeing that we could potentially go into smaller markets because of the business model enhancements that we've made but other brands are going to fill in markets.

I mean one of the things that Gene mentioned earlier about Cheddar's is they don't have scale. They really don't have a whole lot of scale in most of the markets they're in either so we really believe in relative market share. And we think Cheddar's has the opportunity; LongHorn has the opportunity; all of our brands have the opportunity to build scale in some of the markets they're in while still growing into new markets.

And in regards to cannibalization, we haven't given that number in a long time and most of the cannibalization would be at Olive Garden and Olive Garden isn't growing that many restaurants. So the cannibalization isn't that impactful for us. And as it relates to the other brands, as we do go into some markets that we already have restaurants in, because we're so – especially for Cheddar's because we're so dispersed on where our restaurants are, when we add a new restaurant, yes, we will have some cannibalization but the business model is so much better now that we believe that it's the right thing to do plus it actually leverages some of the G&A and other things in that market, even our supply chain. So while our restaurant level margins may tick down if we cannibalize, the costs outside the restaurant will get better.

Jon Tower
Analyst, Wells Fargo Securities LLC

Q

Great. Thank you.

Operator: Our next question comes from the line of Nicole Miller with Piper Sandler. Go ahead, please. Your line is open.

Nicole Miller Regan
Analyst, Piper Sandler & Co.

Q

Thank you, good morning, congrats to everybody. Two quick questions for me: The first is on numbers with the guidance. Can you talk just a little bit more about what is underlying that? I would wonder about two things. I think you said like 75% of the dining rooms are open. So I can't imagine you're contemplating all of those reopening yet, you're not contemplating everything closing so what is kind of the spectrum there?

And then on the comp, is it holding steady for dining rooms open and the momentum they have achieved? And – or are they also seeing some softness? Thank you.

Ricardo Cardenas
Chief Financial Officer & Senior Vice President, Darden Restaurants, Inc.

A

Hey, Nicole, this is Rick. As it relates to our guidance and then I'll get into the comp, we aren't assuming or contemplating any significant changes in net capacity restrictions. So where we are today is where we're going to expect to be through the quarter. Other than those that are already contemplated by officials, if there are some new ones coming then – that we already know about but we don't know about any new ones coming. Now, hopefully those things will ease as the quarter goes on. And so we do have some – a little bit of that.

I want to give you a couple of data points. So, as of Sunday, our quarter-to-date on a fiscal basis which is what you all look at, our comp sales are down about 26%. But if look at it on a comparable calendar basis, because remember we had a 53rd week last year and Thanksgiving shifted we're down 35%, as Gene mentioned, over the first two weeks.

And so our guidance takes all that into account. It takes into account that we think that our sales are going to maybe grow a little bit on a per-op week basis or an average unit volume basis. But because we're going up against that high seasonal sales last year, our comps will be a little bit more challenged.

And so that leads to the second part of your question, what are we seeing in comps for restaurants that still have dining rooms open. We're now getting into our seasonal period. So we're getting into that point that we talked about after Q1 and recently mentioned on today's prepared remarks is that our comps are going to be harder.

What I would focus everybody on is our average weekly sales. And if you look at our press release that we shared, we still have average weekly sales growing. Unfortunately, we're not growing as fast as average weekly sales grew last year which we knew would happen and we highlighted that. So we're focusing more on Q4 and next year. We believe we have the business to get us through that and we're really comfortable with the guidance that we gave for Q3, but we're really focusing on getting our business really ready to capitalize on when sales come back.

Nicole Miller Regan
Analyst, Piper Sandler & Co.

Q

That's super helpful. Thank you. And to your point on – yeah, looking through this quarter and looking to the next, absolutely, that just leads me to my second and last question is exactly that. There's not even just a thought process anymore about these bigger chains like yourselves being able to take share, but it's absolutely modeled, let's say, in the consensus estimates. That's where we're at. And I want to understand what you think about that.

What's the opportunity for sales transfer? The NRA is saying [ph] 110,000 (01:03:45) locations are closed. What's sort of the type and the location and health? What's the probability in the interim that you pick up those sales? I mean we all hope for an independent revival, but that's going to take time. Has consensus been too optimistic on that front or is that what is happening and is going to happen? Thank you.

Ricardo Cardenas
Chief Financial Officer & Senior Vice President, Darden Restaurants, Inc.

A

Yeah, Nicole, I don't want to comment on what consensus is for Q4 or beyond. But what I do want to get everybody understanding is before the pandemic, the full-service restaurant business was about a $100 billion category. We believe after the pandemic, it's going to be a $100 billion or more category. I mean we also know that unfortunately there have been a lot of restaurants that have closed and there might be more that are coming.

We really are unhappy with that. We really like to see these independents stay open, as Gene mentioned, because they do provide some novelty and flare that we can learn from as well. But as we think about our business in the long run, full-service restaurants was a big category. We had about an 8% share, a 9% share. We believe it's going to be at least as big, potentially bigger because of the pent-up demand and people really understanding and realizing what they missed out of casual dining in full-service restaurants.

And so if restaurants stays closed for a while, we're bound to pick up some of that share. How much that is? I can't comment on it, but we believe we're really well-prepared to capture that share. And with the business model that we have, we believe that we're going to benefit from that.

Nicole Miller Regan
Analyst, Piper Sandler & Co.

Q

Thanks again.

Operator: Our next question comes from the line of David Palmer with Evercore ISI. Go ahead, please. Your line is open.

David Palmer
Analyst, Evercore ISI

Q

Thanks. Good morning and congratulations to all of your promotions. A follow-up on your comments so far about how Darden is transforming the business model for the long term, you mentioned how simplification and productivity will result in a longer-term margin step-up and that can lead to greater unit growth opportunities down the road. That's great. And I think I get that.

The one thing I'm curious about is about this whole crisis in your internal actions, has the business been transformed in a way in your major brands that is going to bolster sales per restaurant long term, perhaps some year like fiscal 2023 might be higher than it would have been without the crisis and your internal actions? I'd be curious to hear about that.

Eugene I. Lee
President, Chief Executive Officer & Director, Darden Restaurants, Inc.

A

Yeah, David. I think this crisis has done a few things. I think it's done – not just for the restaurant business, but for all businesses when I listen to all these CEOs talk. I mean we've identified a lot of non-value-added activity inside our organizations that you were funding, but also was creating distractions at the operational level. And I think that's a big upside for us and it's something that we're really focused on to ensure that there's not this gravitational pull to bring us back to do that type of work.

What gives me the most confidence in our ability to get above pre-pandemic sales is the investments we've made. And from the minute after – the day after April 20 when we raised the $500 million in the equity offering and we knew liquidity wasn't going to be an issue, this management team focused 100% on what do we need to do to ensure our businesses are stronger than they were before we went into the crisis. What actions, what investments do you want to make? What things that you do in history that turned out to be wrong that you want to make right? And our businesses have worked hard to do that.

Now, each one of our brands is in a different place on that journey. I think our bigger brands are much further along at this point and they've made the moves. And what I'm really impressed with is the stuff that they're working on today, at the level of detail we're trying to improve guest satisfaction, to me is absolutely amazing.

Word's down to we're spending a lot of time working on how do we improve the off-premise experience and how do we ensure the food at 15 minutes, if it's not going to go back into a microwave, is in its optimal eating point. Or what does it look like at 30 minutes when it goes back into the microwave. So there's just a tremendous amount of work and investment being made at what I would call the second level that I think is going to pay big dividends. We've invested a lot back into quality and value in our brands. And I'm really excited about that and the guests are telling us that they're noticing these changes.

David Palmer
Analyst, Evercore ISI

Q

Is kitchen capacity an issue at Olive Garden? I mean, can these step changes happen without you running into bottlenecks and thresholds where the experience is compromised on either off-premise or on-premise?

Eugene I. Lee
President, Chief Executive Officer & Director, Darden Restaurants, Inc.

A

No, actually the opposite, David, because we've removed a lot of the extraneous products that we were trying to serve that we were getting 0.5% of sales out of and then we've really, through our menu and our menu engineering, we are moving the high value, high satisfaction, more of those items through to our guests. And the more we make them, the better we get.

So actually everything we're working on today, speed is taken into account. And that holds the simplification of that process. And you guys have heard me talk about this and you're probably tired of me talking about it. A great kitchen starts with how the product comes in the backdoor [ph] and you guys (01:09:46) streamline all those processes until it gets to the table. And during this crisis, we've been able to re-evaluate all that activity and all those processes and we're so far along in that journey today. And I think that's what gives me confidence about the future.

David Palmer
Analyst, Evercore ISI

Q

Thank you.

Operator: Our next question comes from the line of Nick Setyan with Wedbush Securities. Go ahead, please. Your line is open.

Nick Setyan
Analyst, Wedbush Securities, Inc.
Q

Thank you, and congratulations on all the promotions. As the recent months progressed, the strength of the consumer in the context of the dining room capacities was a positive surprise. Is there a way to tease out that – how strong the consumer now is as the reversals happen and the dining room closures accelerate, is there a way to tease out whether part of it is also the customer just spending less?

Eugene I. Lee
President, Chief Executive Officer & Director, Darden Restaurants, Inc.
A

Yeah. Nick, we haven't really seen a whole lot of difference in our check average, so that's one way to think about the consumer. I mean how strong they are. And as you look at our week-to-week sales in dining rooms that are open, they're still growing. Now it's really hard to tease out consumer strength versus people going out for holidays, or people actually curbing their spending because maybe they were self-quarantining before Thanksgiving, and those kind of things. So, it's really tough to see that, other than the fact that our check really hasn't had a big dip.

Nick Setyan
Analyst, Wedbush Securities, Inc.
Q

Thank you very much.

Operator: Our next question comes from the line of Andrew Strelzik with BMO. Go ahead, please. Your line is open.

Andrew Strelzik
Analyst, BMO Capital Markets Corp.
Q

Great, thank you. Good morning. Two things for me. The first, just in thinking through what off-premise sales could look like in a normal operating environment whenever that may be, can you share where sales were on the off-premise side in markets where the dine-in recovery maybe was farthest along or anything you've gleaned from your customer data that's informing your thinking around post-pandemic off-premise sales?

And then the second question as you mentioned, adding brands to the portfolio, has the COVID environment either created more or fewer attractive opportunities for acquisitions? Are multiples less or more of an inhibitor now than they were before, just any comments on the M&A environment would be great.

Eugene I. Lee
President, Chief Executive Officer & Director, Darden Restaurants, Inc.
A

Yeah. First, on the off-premise capacity, what I would say is it's hard to get your arms around it, because you still have capacity restrictions in your restaurant if you're living with the six feet. So, there's still a lot of people that pull up to our doors that realize that we've got an hour wait and then they transition to an off-premise experience. So, we really don't have a feel for where that's going to level out.

And I think I said last quarter, we actually see a scenario where that could actually fall down to below pre-pandemic levels once you open up the dining rooms because there'll be less demand for it. And then we believe it will come back at a higher level than it was pre-pandemic, but we don't have a feel for where that's going to settle in right now because I think everybody's behavior is just so modified in this environment. I'm really not going to comment on the M&A environment any further than what I've already said.

Andrew Strelzik
Analyst, BMO Capital Markets Corp.

Q

Okay. Great. Thank you very much.

Operator: Our next question comes from the line of Andy Barish with Jefferies. Go ahead, please. Your line is open.

Andy Barish
Analyst, Jefferies LLC

Q

Hey, guys. A lot of kind of medium and long-term questions. I just wanted to kind of think about the fourth quarter, given obviously, there's impossible number of variables to try to – and try to project at this time. But if the environment kind of stays the same as it is, I mean, historically, your 4Q has looked a lot like your 3Q, is that how we should kind of be thinking about things on a high level?

Ricardo Cardenas
Chief Financial Officer & Senior Vice President, Darden Restaurants, Inc.

A

Yeah, Andy. Our fourth quarter isn't that different than the third quarter. We've got Mother's Day in Q4 so that's a really big day for us. While it's not as seasonally high as Q3, it's not that different.

Andy Barish
Analyst, Jefferies LLC

Q

Okay. Thanks, Rick.

Operator: Our next question comes from the line of Brett Levy with MKM Partners. Go ahead, please. Your line is open.

Brett Levy
Analyst, MKM Partners LLC

Q

Great. Thanks for taking the time sharing all this information. Congratulations to all of the team members who were elevated and all the people who actually helped them get there. I guess just one data question, if you'd be willing to share. And then just a second question on that. The first is on market share, would you care to share what Olive Garden and LongHorn were ex, and if you had any thoughts on positive units just across those two systems?

And then just a second question, we've talked a lot about technology and the people. How are you thinking about the physical boxes, the existing ones and new ones, with all of these transformative issues that you're dealing with, whether it's tech or people or just how the consumers are looking and some of the structural issues you dealt with at Olive Garden, how are you thinking about what you need to do to your current and your future boxes? Thank you and good luck.

Eugene I. Lee
President, Chief Executive Officer & Director, Darden Restaurants, Inc.

A

Yes, Brett, we get the share information pretty lagging. So, we're usually a quarter behind to see what kind of share we've gained in Olive Garden and LongHorn. So, I really can't really comment on that. I would assume that we've gained share-based on the industry data. I mean, because we're looking at total industry, so a lot of restaurants are shut down.

As far as our boxes, and I think the biggest thing that we're looking at right now and I mentioned this earlier, is that we believe the off-premise experience will be driven by curbside, enabled by technology. We were on a pathway in our big brands to really develop space that's consumer-facing to deal with an off-premise experience where the consumer came into the building to get it.

So, now we're really looking at that, and we're trying to develop ways to adapt the current facilities to make that space non-consumer facing and closer to the kitchen. So, it should actually cost less longer term as we make these adjustments. We had just built a new prototype in Orlando for Olive Garden with a dedicated consumer-facing off-premise experience more like a, what I would call a fast casual type restaurant and now we've determined that's not necessary. So, that's good news on that end.

And so, our team is working real hard to figure out what these adjustments will look like. They'll target those investments in the high-volume off-premise locations, and they'll react and get that done over the next couple of years.

Operator: Our next question comes from the line of John Ivankoe with JPMorgan. Go ahead, please. Your line is open.

John Ivankoe
Analyst, JPMorgan Securities LLC

Q

Hi, thank you. I don't think this was touched on in any of the questions. But you did mention technology you're making and I think it was field level management more effective and more efficient. So, I wanted to explore whether that has been fully implemented in the field and the regional manager ranks? And exactly, I guess, how big that could be?

And then, secondly, as you do think about repopulating the restaurants, is there a possibility of changing the mix between manager and hourly employees? Do you think you actually may have an opportunity to run more efficient restaurants from a managerial perspective as we return back to normal?

Eugene I. Lee
President, Chief Executive Officer & Director, Darden Restaurants, Inc.

A

John, good questions. I think from a technology standpoint, there's nothing we're adding to help our supervision. We've got management information systems that we've been well-developed over the years. We continue to evolve those, streamline those, try to get them the most important information that they need to run their businesses.

I think the biggest challenge there is how to not give them too much information and paralyze them. And so, I think that will be one thing that I think Rick will look at in his new role, especially with his technology background, is how to fine-tune that platform to ensure that they're getting the information they need, but not too much information.

As far as the team member management mix, I don't see any gain there. We've always been efficient, maybe more efficient than I think a lot of our competitors are, at that level. We use key employees to supplement – as a supplement to management, but also as a development program as a gateway into our management program.

So, I think we're pretty lean there. And I don't see how technology is going to change that at all. I mean, I'm always going to want a management person in the business, in the facility, leading these large groups of people. I think the difference in casual dining and I think it's one of the reasons why it doesn't franchise all that well, that these are complex businesses with lots of team members and you're not doing this business over a counter.

And the one thing that off-premise has added is added more complexity, as you're dealing with 10 or 12 guests a time in your parking lot, as you're bringing the food out. So, the business is, in some ways, getting more complex as you're trying to deliver food through different channels. So, I don't see a whole lot of cost savings there.

John Ivankoe
Analyst, JPMorgan Securities LLC

Q

Thanks.

Operator: Our next question comes from the line of Gregory Francfort with Bank of America. Go ahead, please. Your line is open.

Gregory R. Francfort
Analyst, Bank of America Merrill Lynch Research

Q

Hey. Thanks, and I'll keep it brief. I just had a follow-up to Palmer's question about the menu. And can you maybe talk about from two quarters ago to today how your thoughts might have changed on re-expanding the menu. You shrunk it quite a bit and I think customers were okay with that. Are they still okay with it? And just have your thoughts on re-expanding it changed at all? Thanks.

Eugene I. Lee
President, Chief Executive Officer & Director, Darden Restaurants, Inc.

A

Yeah. Good question, Greg. I think that obviously, we shrunk it for many reasons, primarily supply chain and then just from a labor productivity standpoint. We've been very judicious as we brought the products back. We think we, through our [ph] TURF (01:20:34) studies, we think that we've satisfied everybody on – any consumer and offer them places that they would want to go eat and eat specific menu. What we've really focused on is eliminating duplicity in the menu where you have a menu item that does the same thing.

I took it to someone else that I think that runs – has a very broadly appealing menu, but yet limited number items, you have to go to a Hillstone or Houston's environment where they touch everything in each category that you might want as a consumer, but they do it with 15 menu items. And so, I think that's what we're trying to do is to ensure that we don't have duplicative.

And I think the example I would use is in LongHorn as an appetizer, you don't need both Wild West Shrimp and Calamari. It's the same consumer that's going to buy the product. And so, what we're working on is how do we – well, how do we end up with a unique product, a product that you can only get in our restaurant that's very craveable, and that differentiates you and having two products that do the same thing and one's not – and one's ubiquitous and one is differentiated makes no sense to me. And so, that's how we're thinking about it.

So, over time, yeah, will there be a product here and a product there? Yes, but what you have to have, you have to have discipline and the discipline is you have to take stuff off. And we haven't demonstrated that as an industry over the last 15 years and we need to demonstrate that moving forward.

Gregory R. Francfort
Analyst, Bank of America Merrill Lynch Research

Q

Thanks, Gene.

Operator: Our next question comes from the line of Jared Garber with Goldman Sachs. Go ahead, please. Your line is open.

Jared Garber
Analyst, Goldman Sachs & Co. LLC

Q

Good morning. Thanks and congratulations to the team on respective promotions as well. Just a quick one for me. Wanted to get an understanding of potential opportunity in the sort of the family ordering or catering business, is that something that over the long term. When things normalize and consumers tend to come back to the restaurant, is that another business that can be, maybe bigger than it was in the past as we think about consumers maybe adopting more of a non-at-home occasion and an in-restaurant dining occasion?

Eugene I. Lee
President, Chief Executive Officer & Director, Darden Restaurants, Inc.

A

Yeah. We're very strong in that in Olive Garden already. Obviously, we sell [ph] panned lasagna, panned (01:22:48) fettuccine. So, that's a big part of our business. Where we're seeing some growth right now as in Cheddar's. With that business with family packs. We've also had some success in our upscale brands being able to sell family packs or steaks and sides that you can – that are – steaks aren't prepared, but the sides are prepared and we'll give you instructions to reheat. And so, we're calling family meals or family packs that are working very well. So, I think it's something that we had some penetration in an Olive Garden. I think it'll be bigger as we move forward and it's providing us an opportunity in some of our other businesses to get in that business.

Operator: Our next question comes from the line of James Rutherford with Stephens, Inc. Go ahead, please. Your line is open.

James Rutherford
Analyst, Stephens, Inc.

Q

Hey, thanks for taking the question. Just one quick one for me. Gene, with the technology investments that you all have made around online ordering and curbside, has your view changed at all in terms of long-term mix of off-premise or perhaps it does end up being a material higher mix longer term compared to where it was pre pandemic or is the view still this is maybe a slight bump, but not huge kind of pre- and post-pandemic? Thank you.

Eugene I. Lee
President, Chief Executive Officer & Director, Darden Restaurants, Inc.

A

Yeah, I think it's a slight bump from pre-pandemic levels. I think that – I mean, listen, this was a growing piece of everyone's business as convenience became more and more important. Maybe there's an opportunity for us to take more share in Olive Garden than I think because the experience is going to be so frictionless. But we're going to see what the consumer demand is. What I'm confident in and especially on the Olive Garden side and somewhat to Cheddar's, is that we will get our share in this business. We will get our share of the off-premise pie. And I think we'll do a really good job with it and it will continue to grow over time.

Operator: Our next question comes from the line of Brian Vaccaro with Raymond James. Go ahead, please. Your line is open.

Brian M. Vaccaro
Analyst, Raymond James & Associates, Inc.

Q

Thanks, and I echo the congrats on your promotions. Just two quick ones for me. I wanted to circle back on the labor discussion and you spoke to some tech investments and I'm curious what role you think server handhelds could play in the coming years with Florida and others potentially moving towards the [ph] path to 15 (01:25:22)? Or perhaps there are other adjustments in the service model that you could see maybe implementing while protecting the guest experience, just curious to get your thoughts there?

Eugene I. Lee
President, Chief Executive Officer & Director, Darden Restaurants, Inc.

A

Yeah, I'm not a big believer in trying to gain too much efficiency on the service side. I mean, I think every time you say you're going to gain efficiency there, you're really saying you're going to cut service. And we're a full service restaurant. So, when I think about the handhelds and technology for the service, I'm thinking more about speed of service for our guests than saving money. I've been doing this a long time. And I'm just – every time I've tried to increase the efficiency in that part of the restaurant, it doesn't end well for me.

And so, I'm committed to keeping the service levels up. I think service is a big part of the value creation. That's a differentiator when you come into our restaurant versus going to a fast casual or fast food, is we got to provide a service. And there's a level that – you don't want to get to that minimum level, you want to do it better than your competitors and you want to earn your business that way. So, I see the technology solution more as a benefit to the consumer, not a benefit to us from a cost standpoint.

Brian M. Vaccaro
Analyst, Raymond James & Associates, Inc.

Q

Understood. All right. That's helpful. And then shifting gears quickly on the store margins. Rick, could you provide a little more perspective on the other OpEx line, some more specifics on cost that are starting to normalize versus the lower spend levels in your fiscal Q2? And it looks like your guidance for Q3 embeds store margins that are in the ballpark of Q2. I know you mentioned emergency pay, but are there other changing cost dynamics that we should be mindful of specifically in Q3 versus Q2? Thank you.

Ricardo Cardenas
Chief Financial Officer & Senior Vice President, Darden Restaurants, Inc.

A

Yeah, Brian. The one cost that will continue to go up is repairs and maintenance. As I mentioned, when we have dining rooms closed, we don't have as much beating of our dining rooms. And so, we'll have R&M start to tick up and it already started to tick up in Q2 as dining rooms reopened. It also gives us the time to actually do some of that repair and maintenance, while the dining rooms are closed. So, we will have some of that coming up. Utilities go up as your dining rooms open. You've got more utilities going that way. But again, that's all contemplated in everything that we have in our guidance.

Brian M. Vaccaro
Analyst, Raymond James & Associates, Inc.

Q

All right. Thank you.

Ricardo Cardenas
Chief Financial Officer & Senior Vice President, Darden Restaurants, Inc.

A

Sure.

Operator: Our next question comes from the line of Jake Bartlett with Truist Securities. Go ahead, please. Your line is open.

Jake Rowland Bartlett
Analyst, Truist Securities, Inc.

Q

Great. Thanks for taking the question. And also congratulations to all. My first one is a quick one on LTOs and marketing. You mentioned that your marketing dollars would largely recover post-COVID. Do you expect to go back to the same sort of cadence you had on LTOs? Or are you rethinking kind of your promotional strategy longer-term?

Eugene I. Lee
President, Chief Executive Officer & Director, Darden Restaurants, Inc.

A

We're totally rethinking our promotional strategy and how to effectively use that. There was a lot of good in what we did, and we've realized there was a lot of bad in what we did. And there's a lot of activity that goes into those. And as we evaluate that after the fact, we believe there's a better way to do that. It doesn't mean that we're not going to do LTOs. But we've been out of them – we were out of LTOs in LongHorn for almost two years pre-pandemic and we have been able to make that adjustment.

As we look at Olive Garden, we'll continue to try to figure out what's the best way to use our scale advantage and market that business effectively, but also considering, do we need to do six LTOs a year? Or are there other ways to do that more effectively.

Jake Rowland Bartlett
Analyst, Truist Securities, Inc.

Q

Got it. And then my second and last question is, you talked about improvements to the business and kind of coming out of COVID, I think it was a better business model. How do you think about – or I don't know if you're ready yet to talk about it, but how do you think about the long-term growth algorithm that you've talked about in the past as it pertains to unit growth or maybe margin expansion opportunities? Are we still kind of thinking the 7% to 10% EBIT – EBT growth or you think we should think about that differently longer-term?

Ricardo Cardenas
Chief Financial Officer & Senior Vice President, Darden Restaurants, Inc.

A

Yes, Jake, this is Rick. I think if you – as you think about our long-term framework, we haven't adjusted our long-term framework. So, as of now, we still believe we can get to those numbers over the long run. But as we've always said, any one year could be above or below that. And so, I would hope that FY 2022 would be above that because of where we were in FY 2021, but in FY 2021, we're going to be below it. So, in the long run, which is what we talk about to all of our investors and to all of you, we believe we can hit our long-term framework.

And I will remind everybody that we've been a public company since 1995. We've never had a 10-year period where our average annual TSR has been below 10%. And even when we – or fiscal period. So, even last year, when we had the worst fourth quarter, I think, of any industry and of anyone, at least for us, we still had a 10-year TSR of over 10% on average.

Jake Rowland Bartlett
Analyst, Truist Securities, Inc.

Q

Great. Thanks a lot.

Operator: Our next question comes from the line of Priya Ohri-Gupta with Barclays. Go ahead, please. Your line is open.

Priya Ohri-Gupta
Analyst, Barclays Capital, Inc.

Q

Great. Thank you so much for squeezing me in, and let me just add my congrats to the three of you as well. I was just curious if you could give us some thoughts around how you're broadly thinking about the dividend. I know you mentioned sort of 50% payout relative to the quarter's EPS, but just in light of the upcoming guidance and some of the continued volatility that we're seeing in the external environment, how should we anticipate the dividend sort of progressing going forward? Thank you.

Ricardo Cardenas
Chief Financial Officer & Senior Vice President, Darden Restaurants, Inc.

A

Yes, Priya. As we know that dividends are important to our shareholders, we also know that the dividend policy is important to our bondholders. And as you think about our dividend and what we do, we typically set it within our long-term framework of 50% to 60% of our earnings. And the quarter that we just ended was at the low-end of that at 50%.

We're going to continue to work with the board on what our dividend is going forward. But going further than this quarter, it's kind of hard for me to say because the board is the one that decides the dividend. But we did contemplate what we think our guidance was in Q3 when we set our dividend in Q2. So, we always look forward to see what we think our cash flows are going to be to ensure that the dividend is safe. And so that's why we set the dividend at $0.37 this quarter.

Priya Ohri-Gupta
Analyst, Barclays Capital, Inc.

Q

That's helpful. Thank you.

Ricardo Cardenas
Chief Financial Officer & Senior Vice President, Darden Restaurants, Inc.

A

Thanks, Priya.

Operator: And ladies and gentlemen, that concludes today's Q&A session for the call. I would like to turn it back over to Mr. Kalicak.

Kevin Kalicak
Vice President, Investor Relations & Corporate Analysis, Darden Restaurants, Inc.

Thank you, everyone, for participating. That concludes our call for today. I'd like to remind you that we plan to release third quarter results on Thursday, March 25, before the market opens with a conference call to follow. Thank you, and Happy Holidays.

Operator: Ladies and gentlemen, this concludes today's conference call. We thank you for your participation. You may now disconnect.