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Darden Restaurants, Inc. (DRI)

Q2 2023 Earnings Call

CORPORATE PARTICIPANTS

Kevin Kalicak
Senior Vice President-Finance and Investor Relations, Darden Restaurants, Inc.

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

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

OTHER PARTICIPANTS

Eric Gonzalez
Analyst, KeyBanc Capital Markets, Inc.

Brian Bittner
Analyst, Oppenheimer & Co., Inc.

Andrew M. Charles
Analyst, Cowen and Company, LLC

David Palmer
Analyst, Evercore Group LLC

Jared Garber
Analyst, Goldman Sachs & Co. LLC

Brian Harbour
Analyst, Morgan Stanley & Co. LLC

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

Dennis Geiger
Analyst, UBS Securities LLC

Christopher Carril
Analyst, RBC Capital Markets LLC

Jeffrey A. Bernstein
Analyst, Barclays Capital, Inc.

Peter Saleh
Analyst, BTIG LLC

Lauren Silberman
Analyst, Credit Suisse Securities (USA) LLC

Sara H. Senatore
Analyst, BofA Securities, Inc.

Andrew Strelzik
Analyst, BMO Capital Markets Corp.

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

Danilo Gargiulo
Analyst, Sanford C. Bernstein & Co. LLC

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

John Ivankoe
Analyst, JPMorgan Securities LLC

Nick Setyan
Analyst, Wedbush Securities, Inc.

Jake Bartlett
Analyst, Truist Securities, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good day, everyone, and welcome to the Darden Fiscal Year 2023 Second Quarter Earnings Call. Your lines have been placed on listen-only until the question-and-answer session. [Operator Instructions] Today's conference is being recorded. If you have any objections, please disconnect at this time.

I will now turn the call over to Mr. Kevin Kalicak. Thank you. You may begin.

Kevin Kalicak

Senior Vice President-Finance and Investor Relations, Darden Restaurants, Inc.

Thank you, Todd. Good morning, everyone, and thank you for participating on today's call. Joining me are Rick Cardenas, Darden's President and CEO; and Raj Vennam, 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 the 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 includes certain non-GAAP measurements, and reconciliations of these measurements are included in the presentation.

Looking ahead, we plan to release fiscal 2023 third quarter earnings on Thursday, March 23, before the market opens followed by a conference call. During today's call, any reference to pre-COVID when discussing second quarter performance as a comparison to the second quarter of fiscal 2020. Additionally, all references to industry results during today's call refer to Black Box Intelligence's casual dining benchmark, excluding Olive Garden, LongHorn Steakhouse and Cheddar's Scratch Kitchen.

During our second fiscal quarter, industry same-restaurant sales increased 3.6% and industry same-restaurant guest counts decreased 5.7%. This morning, Rick will share some brief remarks on the quarter and our focus moving forward, and Raj will provide more details on our financial results and an update to fiscal 2023 financial outlook.

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

Ricardo Cardenas

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

Thank you, Kevin. Good morning and happy holidays, everyone. I'm pleased with our results this quarter. All of our brands performed at a high level by remaining focused on our Back-to-Basics Operating Philosophy, anchored in food, service and atmosphere.

At the Darden level, we continue to strengthen and leverage our four competitive advantages of significant scale, extensive data and insights, rigorous strategic planning and our results-oriented culture. Being brilliant with the basics starts with achieving and maintaining appropriate staffing levels in our restaurants. Across our brands, our teams are doing a great job of ensuring we are ready to run 14 great shifts a week. At each of our brands, we are fully staffed at the team member level, and manager staffing is at historic highs. As a result, our teams are executing more consistently, which in turn is driving strong guest satisfaction across our brands, according to both internal and external sources.

During the quarter, four of our brands achieved all-time high internal guest satisfaction ratings and the others remain near all-time highs. Also, within Technomic's industry tracking tool, Darden brand was ranked number one among major casual dining brands in each measurement category.

I am particularly proud of Olive Garden's performance. During the quarter, they brought back their most popular limited time offer, Never-Ending Pasta Bowl. As you may recall, when I talked last, I shared that any promotional activity our brands introduce should be evaluated with the following three filters. First, it needs to elevate brand equity by bringing the brand's competitive advantages to life. Second, it should be simple to execute. We will not jeopardize all the work we have done to simplify operations, which allows our teams to consistently deliver exceptional guest experiences. And third, it will not be at a deep discount. We are focused on providing great value to our guests, but doing that in a way that drives profitable sales growth.

Three years after it was last offered, the 2022 version of Never-Ending Pasta Bowl checked all three of these boxes. First, it leveraged Olive Garden's iconic brand equity by perfectly reinforcing their competitive advantage of never-ending, abundant, craveable Italian food. Next, it was amplified by only offering existing menu items with limited add-on choices, which made it easier to execute, resulting in great guest experiences. Finally, it was priced $3 higher than in 2019, which significantly improved the margin of this offer while still providing tremendous value for our guests.

Never-Ending Pasta Bowl exceeded expectations, and we saw a step change in Olive Garden's positive gap to industry traffic during the seven weeks at ramp. I'm even more encouraged by this performance, given that it was supported with about three-quarters of the media past years. Going forward, the team will build on their learnings and share insights across our brands, but this may be the only limited time offer we do at Olive Garden this fiscal year.

Across our brands, we continue to drive strong execution of the off-premise guest experience through ongoing investments in technology that reduce friction for our guests and our operators. For example, many of our guests still prefer to call-in there to-go order. However, taking payment over the phone or when the guests arrived is both inefficient for our teams and inconvenient for our guests. To help address this, we rolled out online payment for call-in orders during the quarter, enhancing convenience for our guests and making our To Go specialists more efficient.

To Go sales remain sticky across our core casual dining brand, accounting for 25% of total sales at Olive Garden, 14% at LongHorn and 13% at Cheddar's. Digital transactions accounted for 62% of all off-premise sales during the quarter and 10% of Darden's total sales.

The holidays are the busiest time of the year for our restaurant teams, and they have enjoyed welcoming even more guests back into their restaurants this season. In fact, The Capital Grille, Eddie V's and Seasons 52 enjoyed all-time daily sales record on Thanksgiving Day, and bookings for this holiday season are encouraging.

The holidays are also a great reminder that being of service is at the heart of our business and we embraced a higher purpose to nourish and delight everyone we serve, our guests, our team members and our communities. One of the ways we serve our communities is through our Harvest program. One in eight households in our country live without consistent access to food. To help fight hunger, our restaurants donate fresh, unused food to local food banks and non-profits in their communities on a weekly basis throughout the year. Since the inception of this program, more than 131 million pounds of food have been donated, which is the equivalent of more than 100 million meals. The impact of our Harvest program takes on an added significance during the holidays. And I am delighted that our teams are helping to make a difference in [indiscernible] (00:07:38) communities across the country.

I'm so proud of the focus and commitment our teams continue to display. Their disciplined approach in executing in our strategy is what enables us to succeed regardless of the operating environment. This is evidenced by the fact that just last week, we surpassed $10 billion in sales on a trailing 52-week basis for the first time in Darden's history. On behalf of our senior leadership team and the Board of Directors, I want to thank our 180,000 team members for everything you do to serve our guests and our communities. I wish you all a wonderful holiday season.

Now I'll turn it over to Raj.

Rajesh Vennam

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

Thank you, Rick, and good morning, everyone. Total sales for the first quarter were $2.5 billion, 9.4% higher than last year, driven by 7.3% same-restaurant sales growth along with the addition of 35 net new restaurants. This same-restaurant sales performance outpaced the industry by 370 basis points and our same-restaurant guest counts are performed even more as they exceeded the industry benchmark by 550 basis points.

Diluted net earnings per share from continuing operations were $1.52, an increase of 2.7% above last year. Total EBITDA was $330 million, and we returned $249 million of cash to our shareholders this quarter, consisting of $149 million in dividends and $100 million in share repurchases. Total pricing for the quarter was approximately 6.5%, 200 basis points below total inflation of roughly 8.5%.

Now looking at the details of the P&L compared to last year, food and beverage expenses were 240 basis points higher, driven by commodities inflation of approximately 13%, which significantly outpaced our pricing. As we expected, chicken, dairy and grains continued to be categories experiencing the highest levels of inflation. Produce especially lettuce was much higher than expected due to poor growing conditions and weather-related events in the quarter.

However, our scale and vendor partnerships help minimize this impact relative to the general market. Restaurant labor was 30 basis points better than last year, even with total restaurant labor inflation of 7%. Our restaurants continue to run efficient labor despite hourly wage inflation of 8.5%. Restaurant expenses were 20 basis points favorable as we leveraged higher sales that more than offset elevated inflation on utilities, as well as higher repairs and maintenance expense.

Marketing expenses were 30 basis points higher than last year as we increased media support for the reintroduction of Never-Ending Pasta Bowl. This was in line with our expectations heading into the quarter.

G&A expenses were 40 basis points below last year, driven by sales leverage and a lower incentive accrual, which was in line with our plan. This favorability was partially offset by higher mark-to-market expense on our deferred compensation. And as a reminder, due to the way we hedge this expense, this favorability is largely offset on the tax line.

Page 13 of our presentation illustrates the roughly 20 basis point reduction to operating income market – income from mark-to-market expense and the 150 basis point benefit to the tax rate. The effective tax rate of 12.1% this quarter would have been 13.6% without the impact from the hedge.

Now looking at our margin performance versus pre-COVID, we grew operating income margin by 160 basis points, while underpricing inflation by more than 500 basis points. Increased food and beverage costs were more than offset by improved productivity, reduced marketing and other cost savings initiatives.

Looking at our segment performance, all of our segments significantly outperformed their respective industry benchmarks on both traffic and sales. Sales at Olive Garden were 9.2% above last year, driven by same-restaurant sales of 7.6%. Average weekly sales at Olive Garden were 112% of the pre-COVID level.

LongHorn sales were 9.7% above last year with same-restaurant sales growth of 7.3%. Average weekly sales at LongHorn were 125% of the pre-COVID level. Sales in our Fine Dining segment were 7% above last year, driven by same-restaurant sales of 5.9% and average weekly sales were 117% of the pre-COVID level. Our Other segment sales were 10.5% above last year, with same-restaurant sales of 7.1% and average weekly sales were 109% of the pre-COVID level.

Turning to our financial outlook for fiscal 2023. We have updated our guidance to reflect our year-to-date results and expectations for the back half of the year. We now expect total sales of $10.3 billion to $10.45 billion, same-restaurant sales growth of 5% to 6.5%, 55 to 60 new restaurants; capital spending of $525 million to $575 million, total inflation of approximately 7%, and we plan to continue underpricing total inflation with annual pricing of approximately 6%.

Furthermore, we expect commodities inflation between 8% and 9%. An annual effective tax rate of approximately 13% and approximately 123 million diluted average shares outstanding for the year. All resulting in diluted net earnings per share between $7.60 and $8.

Looking at the third and fourth quarters, we expect the EPS growth rate year-over-year to be fairly balanced. In the third quarter, we estimate the outsized sales growth from lapping Omicron last year to be partially offset by underpricing inflation by approximately 50 basis points. In the fourth quarter, we expect inflation to further moderate and our pricing gap to reverse contributing to margin growth.

Now to wrap up, let me say that we're very pleased with how our teams are managing their businesses and delivering strong results. We remain disciplined in adhering to our strategy and providing value to our guests in the face of strong inflation. We're confident in the underlying strength of our business model and our team's ability to continue managing through this unpredictable environment effectively.

Now, we will open it up for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator instructions] We'll take our first question from Eric Gonzalez with KeyBanc Capital Markets.

Eric Gonzalez
Analyst, KeyBanc Capital Markets, Inc.

Q

Hey. Thanks for the question. Just a real quick one on the promotional strategy, I think you said that Never-Ending Pasta Bowl will be the only LTO that you run this year. But you also brought back that $6 Take Home offer, which I'm guessing you would consider to be an LTO. But – so maybe you could talk about your expectations for that offer, because if I remember correctly, that was a fairly strong comp driver in the past? Thanks.

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

A

Hey, Eric. Thanks for the question. Never-Ending Pasta Bowl, we said in our prepared remarks is maybe the only limited time offer, likely only been a limited time offer. As you talk about the $6 Take Home, that's on our core menu. So, it's not considered limited time, it's on our menu. But for competitive reasons, we're not going to discuss any more promotional plan details. And so, we're going to continue to use our filters that we mentioned, first, elevating brand equity by bringing the brand's competitive advantages to light; second, simple to execute; and third, not at a deep discount.

As you'll probably see on [ph] ATV (00:16:08) today, we're currently airing our oven baked pastas, which are core menu items for us. So, they're not a limited time offer, and it includes our new Ravioli Carbonara. None of these items are discounted. So, we're going to stick to our strategy, as Raj said, core growth, core guest count growth, and we're going to react accordingly.

Eric Gonzalez
Analyst, KeyBanc Capital Markets, Inc.

Q

And then just on the marketing spend, do you still expect to be in that 1% to maybe 1.5% range for the year?

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

A

Yeah, Eric, we're going to be closer to – I think that as we said, yeah, it should be closer to 1 – we said 10 basis points to 20 basis points above last year. That's how we think about it.

Eric Gonzalez
Analyst, KeyBanc Capital Markets, Inc.

Q

[ph] Great (00:16:44). Thanks.

Operator: Thank you. We'll take our next question from Brian Bittner with Oppenheimer and Company.

Brian Bittner
Analyst, Oppenheimer & Co., Inc.

Q

Thanks. Good morning. Congratulations on strong results. Question on Olive Garden also, the underlying same-store sales this quarter showed a clear inflection versus the last few quarters, and particularly relative to the other brands, the three-year comp accelerated to above 11%. And how much of this dynamic would you attribute directly to bringing back Never-Ending Pasta Bowl at the strong price point you did in? And how much would you attribute to other factors? And do you believe this kind of underlying trend on a three-year basis is sustainable? Or should we be tiny modeling a more conservative three-year term moving forward for Olive Garden?

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

A

Yeah, Brian. First, let me say how proud I am, the work Dan and his team have done working on keeping with our strategy at Olive Garden. As we mentioned in our prepared remarks, Olive Garden already had a positive gap in same-restaurant sales to the industry before Never-Ending Pasta Bowl, and that gap increased when we brought Never-Ending Pasta Bowl back for seven weeks. So, it ran about half of the quarter. We're not going to kind of talk about how much Never-Ending Pasta Bowl contributed to the quarter, but it was a good jump for us. And so, as we think about the rest of the year, our guidance contemplates continued strength in Olive Garden, but probably not at the strength that we had for Never-Ending Pasta Bowl.

Remember, this is an iconic limited time offer, uniquely positioned, and it covers all three filters that we mentioned. And as I said in our prepared remarks, we have exceeded our expectations. So – and that's a pretty pleasant surprise for us. If you think about given the higher price point, the lower media support, but it does speak to how iconic that brand offer is and the things that Olive Garden brings in such a compelling way.

And then finally, we haven't run in three years. So, guests were really excited for the return, and it fits really well in our second quarter. So, if you think about our lowest volume quarter of the year [ph] is up is (00:18:59) second quarter. Never-Ending Pasta Bowl helps keep our traffic a little bit higher, so that we don't have to think about bringing team members' hours down and then bringing team members back when the holidays go up. So, we really were appreciative and we really love with the work that Olive Garden did and where Never-Ending Pasta Bowl was. But not to say that our three-year stack is going to stay the same as it did in Q2.

Brian Bittner
Analyst, Oppenheimer & Co., Inc.

Q

Thanks for that. And Rick, just more broadly, just you have a seat where you get to witness the consumer across multiple different brands. You have one of the best seats to kind of see how the consumer is behaving. There's obviously a lot of crosscurrents out there. And there's, a lot of different views on where the consumer is going into calendar 2023. Can you just maybe describe your view of the consumer? And how you're feeling about the overall consumer into 2023? And maybe some puts and takes?

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

A

Yeah, Brian, I won't necessarily talk about 2023. I'll just talk about what we're seeing, not being an economist, I listen to what they have to say. But as you all know, everybody on this call knows, consumer spending drives the US economy. The – we've seen a shift in spending though, from durable household goods or durable goods to leisure services, and the restaurant industry has benefited from that shift. Casual dining same-restaurant sales improved from Q1 to Q2. And our positive gap to the industry improved even more during that time. So, one of the benefits of our portfolio, as you mentioned, is we have a wide range of consumers. We serve a lot of them, across all, of the spectrum. And our data indicates the higher-end consumer hasn't seen the same impact as consumers at the lower end of the spectrum.

But if you think about the prepared remarks, sales at Thanksgiving were a record for Fine Dining and Seasons 52 and bookings for this holiday season are encouraging. So, seems like the higher end consumer is doing pretty well. And I know there's been a lot of talk over the year about consumers that's below $50,000 in income because high inflation impacts that consumer more disproportionately, but we've seen a little softness in that consumer over the last six months. But the mix of the $50,000 income and under is still above pre-COVID levels for us. Even though that shift has come down a little bit, we're still above pre-COVID levels at the $50,000 and below.

And I would say, keep in mind that a lot of our consumers below $50,000 are single, are retirees, are living in multigenerational households. So, maybe $50,000 goes a little bit farther for that consumer. But without commenting on the future, we have seen a pretty good performance across all of those consumers over the last few months other than the fact that the $50,000 below consumer is lower than it was six months ago, but still higher than it was pre-COVID.

Brian Bittner
Analyst, Oppenheimer & Co., Inc.

Q

Thank you.

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

A

[ph] Sure (00:22:07).

Operator: Thank you. We'll take our next question from Andrew Charles of Cowen.

Andrew M. Charles
Analyst, Cowen and Company, LLC

Q

Great. Thank you. Notwithstanding the strong 2Q performance and the higher fiscal 2023 guidance, but if we were to see some macro deterioration impact the industry in fiscal – in your calendar 2023, excuse me, what's kind of the pecking order or your preference of magnitude of how you'd respond to that? Should we expect perhaps a tighter – like tightening of the belt and just more of a focus on reducing overhead? Will we expect you guys to potentially invest more into marketing, potentially invest more to value? How do you think about the contingency plan if we were to see some deterioration in calendar 2023?

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

A

Andrew, this is Rick, again. If we see deterioration in the calendar 2023, we always look at ways to tighten and find ways to improve productivity and improve our administrative expenses. We think we're actually really good at doing that. So, if something gets really – shifts really badly in the wrong way, we're going to find ways to at least find places to tighten. On the marketing spend, Raj talked about what our marketing spend is for the rest of this year and for the whole year. We don't anticipate making a big change in that, no matter what happens over the next six months. We're going to continue to use the filters that we mentioned.

And I will say Olive Garden, as I said before will always have advertising in their mix, because of their scale. But we're going to stick to our strategy of core growth. We're going to react accordingly to whatever happens. And as we've said in the past, and Raj said it too, if and when we increase our marketing spend, we'll expect it to return – to earn a return compared to what it would have been without the spend. So, we're going to – as you've seen us in the past, we react when things happen, and we think we'll do the same thing going forward.

Andrew M. Charles
Analyst, Cowen and Company, LLC

Q

Very helpful. Thanks, Rick. And if I could sneak one into Raj, which of the small step hire in CapEx guidance as you maintain new store openings? Is that construction costs were perhaps running a bit higher than expected, there are some incremental investments in technology or something else we should be thinking about?

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

A

It's truly inflation on the construction cost and some equipment cost as well. So, it's really – a lot of it is new restaurant related. Some is on the – even on the facilities CapEx, there's a little bit higher inflation.

Andrew M. Charles
Analyst, Cowen and Company, LLC

Q

Thanks for that.

Operator: Thank you. We'll take our next question from David Palmer with Evercore ISI.

David Palmer
Analyst, Evercore Group LLC

Q

Thanks. Just a question on traffic, particularly on-premise. If you look at the industry numbers, on-premise traffic is down double digits for casual dining. And even Olive Garden is not back to where it was. I wonder how that informs your strategy. Do you feel like that's an opportunity? Or you just have to be patient, particularly with some lapsed users, maybe that under 75,000 household income user. But maybe this isn't something you want to chase either. So, I'm wondering, how you view that as opportunity that informs the strategy?

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

A

Hey, David, if you think about what we've done over the last few years, we have significantly reduced marketing spending at Olive Garden. And we've talked in the past at how that could be about a 10-point drop in traffic for us. But we're focusing on driving core users to Olive Garden, core guest versus promotional users. And so, what we see as an opportunity, we've got more capacity in our restaurants than we did before. But a lot of that in-restaurant experience has moved to the off-premise experience. As you see Olive Garden still at 25% off-premise, where prior to COVID, it was much lower than that. So, we see it as an opportunity to continue to focus on our strategy of pricing below our competition, pricing below inflation by finding other cost savings to help offset that, and give our consumers a great value, so they don't need a promotional message to come in, and they just get a great value every time they come.

David Palmer
Analyst, Evercore Group LLC

Q

Actually, on your slide deck, I just had a quick question on slide 20. Your food inflation outlook looks like it's less inflationary on many of those line items, beef, chicken, dairy/oil versus what you had previously. But your food inflation outlook is still the same at 7%. Is there some offset to what we're seeing? And I'll pass it on. Thanks.

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

A

Yeah, David, it's really the fact that [ph] first (00:26:50) two quarters were – 15% was our first quarter, second quarter was 13%. So, as you look at the back half, really, Q3, we're thinking it's going to be mid- to high-single-digits and then Q4 is closer to flat. So, if you do that, what that translates into on the year is closer to that 8% to 9%, that's really the difference. I think when we spoke in the last time, we expected a step change from the first half to the second half. And we are seeing that. However, it's not as big as we thought. It's still a pretty big change. I mean as I just mentioned, we're going from a mid-teens to high-single – mid- to high-single-digits as we get into Q3 and closer to flat for Q4. So, pretty big change, but there were a few that are – there are a few items that are higher than we would have expected, namely dairy, grains and produce, and quite a bit of this is weather-related, so – and so that's actually baked into our expectations going forward.

David Palmer
Analyst, Evercore Group LLC

Q

Thank you.

Operator: Thank you. Our next question comes from Jared Garber with Goldman Sachs.

Jared Garber
Analyst, Goldman Sachs & Co. LLC

Q

Great. Thanks for the question. I think this was the first quarter that we've seen or the largest quarter of opens at Cheddar's and maybe several years. So, I just wanted to get a sense of an update on the brand. I know it's a little bit of a lower income skew there as well. So, maybe some commentary on the performance there and what you're seeing from a customer standpoint and if there's anything in terms of regionality where these new units were opened. Just any update on the brand would be great. Thanks.

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

A

Hey, Jared, let me talk high level about Cheddar's and talk a little bit about the opening. Cheddar's has made significant improvements in their business model versus pre-COVID. Even with significant inflation, they had a lot of productivity enhancements with the simplified menu and a streamlined menu, so that we felt more comfortable opening restaurants at a quicker pace. Not only that, they have really built their leadership pipeline and have been able to staff all of these restaurants with managing partners that have run Cheddar's, and we have a pipeline of more ready-to-go as we open restaurants. So, yes, this was our highest quarter of openings for Cheddar's. We opened seven restaurants.

Jared Garber
Analyst, Goldman Sachs & Co. LLC

Q

Versus last year?

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

A

Yeah, versus last year. We had seven restaurants versus last year at Cheddar's, four in the quarter. And we – those restaurants are performing really well. So, they're primarily in markets close to where Cheddar's already exists. It's not like we're – we have a lot of restaurants opening in brand new markets. But we are looking at newer markets to open Cheddar's in. But as we mentioned early on in the acquisition of Cheddar's, we thought we had more room to infill markets that they already have restaurants. So, that helps us leverage our scale in those markets that helps us leverage our supply chain and our people.

But again, high level, really proud of the work that JW and his team have done at Cheddar's, really proud of the progress they've made in staffing their restaurants, building their pipeline, and we're seeing some pretty strong performance in these new restaurants.

Jared Garber
Analyst, Goldman Sachs & Co. LLC

Q

Great. Thanks Rick.

Operator: Thank you. Our next question comes from Brian Harbour of Morgan Stanley.

Brian Harbour
Analyst, Morgan Stanley & Co. LLC

Q

Yes. Hi. Good morning guys. Maybe just to follow-up quickly on the commodity comments. Do you see any kind of risk to the second half just based on some of those items that are – have kind of surprised to the upside recently? Or are those things that can't necessarily be contracted? How do you feel about that at this point?

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

A

Yeah, Brian, I think there's always risk. As you think about, that's why we have a range of 8% to 9% as our assumption going in. We'll have to see how this plays out, right? I mean some of the stuff, like I have mentioned earlier in my prepared remarks, Q2, the impact on how to produce, especially lettuce, no one expected that. It came out of nowhere. It was weather related. There were two hurricanes in Florida, two hurricanes in Mexico, they just really destroyed the crops. And that cycle stuff is always a risk. We contemplated some of that in our guidance.

Brian Harbour
Analyst, Morgan Stanley & Co. LLC

Q

Okay. Thank you. And then you made the comment about just sharing some of the lessons from Never-Ending Pasta Bowls at your other brands. What are you thinking about there? Is it kind of a change to promotional architecture? Or are there things you're not doing at some of those brands that you could be doing to kind of echo Never-Ending Pasta Bowl?

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

A

Yeah. As you think about Never-Ending Pasta Bowl, there were other things that we did during that time. We did a little bit more digital testing and those kind of things that we can leverage across our brands. But more importantly, those filters that we used on what we're going to communicate, we're very strong and helped our brand – helped Olive Garden continue to build their business, elevating brand equity, very important, and we've learned that, simplified the offer. We've learned that and [ph] not at Eddie V discount (00:32:10).

So, all the investments we've made over the last few years to price below what the consumers are seeing in inflation means that we don't have to really go [ph] into these (00:32:20) discounting range. The Never-Ending Pasta Bowl was $3 more expensive than it was in the past, and it was still a strong promotion for us. But that's not to say that everybody is going to be on television now, right? So, Olive Garden is the one that has the real scale to be on television. The other brands have learned things about the digital testing that we did and just the fact of the construct of the promotion.

Brian Harbour
Analyst, Morgan Stanley & Co. LLC

Q

Thank you.

Operator: Thank you. Our next question comes from David Tarantino of Baird.

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

Q

Hi, good morning. My question is on unit development and your comment, Raj, about construction costs escalating. And I just wondered, if you could comment specifically on the returns you're getting on the recent openings or the expected returns you're getting on your upcoming openings. I know there's a lot of moving parts and I guess the main question is, is the numerator of the return equation keeping up with the escalation in the denominator? And are you seeing similar returns? Or are you getting to a point where the returns are starting to come down? Any color there would be great.

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

A

Yeah, David, let me start by saying pretty much on average. Our new restaurants exceed cost of capital by quite a bit. We had a big margin to begin with. Now, the construction costs have gone up, so have our unit economics. So, if you look at overall performance of where we are, I just mentioned earlier, our operating income this quarter was 160 basis points higher than pre-COVID. So, our four-wall unit level economics have gotten better that helps mitigate some of the construction cost increases.

Now, with that said, we already – we obviously want to continue to maintain the pace of opening, but we continue to monitor inflation in construction costs. And we are being very disciplined. There are a few times where we have walked away from some deals because the cost was too high even though that would have probably exceeded our cost of capital. We're just being a little bit more selective on that front. Now, all that said, we're starting to see some green shoots on the construction side. The last few bids, I think were more closer to or below – slightly below our elevated budget, but at least it's a positive sign. So, we think there are – there's some – potentially this could lead to some decrease in the level of inflation over time.

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

Q

Great. And I guess a follow-up to that is, are there projects going on inside the company to try to trim costs out of the box. And I know – I think a prior question commented, the dine-in traffic has been softer for the industry. Are you thinking about building smaller dining rooms or anything of that nature to get the cost equation down?

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

A

Hi, David, as we think about our prototype designs for the future, we always look for ways to trim costs out of our prototypes and find new ways to build the new materials to use. We have built some slightly smaller prototypes, at all of our brands, not necessarily because of the To Go versus the dining room, but because it makes the To Go experience a little easier by shifting where that To Go area is. Remember, the dining room is the least expensive part of the building, right? So, if you really want to take a lot of the cost out of the building, you got to take the cost out of the kitchen. And we think we've got a great kitchen, but we'll find ways to rightsize the prototypes for the market that they're in without overcomplicating, so that we have 50 different prototypes.

But we, as I said, our development team is focusing on finding the most efficient building in the markets that we compete in. We've also taken some existing sites as restaurants have closed or their leases have expired for other brands. We've actually gone in and infill those restaurants, which are slightly less expensive because you don't have some of the framing costs and some of the plumbing. So, it helps us in that respect.

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

Q

Great. Thanks for the perspective.

Operator: Thank you. Our next question comes from Dennis Geiger with UBS.

Dennis Geiger
Analyst, UBS Securities LLC

Q

Great. Thanks guys for the question. Curious as it relates to pricing, if you could speak a bit more to kind of what you've seen to-date as it relates to the customer response to the pricing, obviously, with the strong sales trends, I'm assuming not a whole lot. But any thoughts with respect to resistance or customer feedback to pricing and how that impacts how you think about pricing going forward?

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

A

Hi, Dennis, I think the reaction is not that dissimilar to historical meaning we are getting a pretty decent flow-through from pricing north of 90%. And so, really not seeing any major pushback. We haven't seen any moderation on the check mix. There have been things here and there where maybe advertiser pricing, we may not have gotten the exact level of flow-through. But overall, when you look big picture, it doesn't look like there's a lot of resistance. Now, we are pricing a lot less than our competitors. So, I don't know what is happening with the industry itself, but our pricing is well below the industry. And maybe that's part of what – why we're not seeing a lot of resistance.

Dennis Geiger
Analyst, UBS Securities LLC

Q

Great. I appreciate that, Raj. And just one more. Just wondering, if you could speak a bit more to the staffing situation and the execution in restaurant. I think very encouraging that you spoke to being fully staffed, manager staffing levels at all-time highs, feedback scores from the customers sound strong. But as it relates to the level of execution currently versus the potential, is there anything with respect to maybe tenure of your average employee right now, may be shorter than pre-COVID and that can build going forward? Anything there as it relates to where operations are now versus maybe where you would – where they can go or where you'd like them to go. Thank you.

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

A

Hey, Dennis, we have a lower tenure today than we did before COVID because of the turnover over the time through COVID. Our turnover is still elevated from the pre-COVID levels, but it's getting better and it's getting –

we're working on getting it closer to what our pre-COVID turnover levels were. As we've mentioned in prior calls, our focus is on training these new team members and getting them more efficient and getting them more productive. And as we continue to get our turnover levels down, that will continue to be a focus for us. Also training our existing team members to make them better and give them more opportunities to learn and grow. So, we will continue to train. But your point on a slightly lower tenure that is true. And we think as our tenure gets back to more historical levels, which is going to take a little while. But as it does get back to historical levels, then we will improve our productivity slightly from there, too.

Dennis Geiger
Analyst, UBS Securities LLC

Q

Great. Thanks, Rick.

Operator: Thank you. Our next question comes from Chris Carril of RBC Capital Markets.

Christopher Carril
Analyst, RBC Capital Markets LLC

Q

Thanks. Good morning. So, clearly, a lot of focus on Olive Garden this morning, but I was hoping you could provide some more thoughts on LongHorn and just the continued momentum you're seeing there. Maybe just any thoughts on how the brand is performing relative to the category? And then just anything else you're seeing that's driving the continued strong sales there?

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

A

Yeah, Chris. Todd and his team, as we've said in the past, have been on a journey, investing in quality and portion and that continues to pay off. They had over 7% same-restaurant sales this quarter coming off a very strong result last year, right? So, it was a pretty strong performance for LongHorn. Raj mentioned average weekly sales of LongHorn are 25% above the pre-COVID levels. Now the state categories benefit over time, but LongHorn is holding their own in that state category. They're doing really well. I would say traffic, unlike most of casual dining traffic in the LongHorn dining room is up versus pre-COVID. And it's – I think, one of the only full-service restaurant companies out there that have positive traffic in the dining room of anybody of scale. So, we're really proud of what they've done. Remember, they were on the journey of simplification before COVID. So, they're ahead of everybody else in our portfolio on where they were. And so, they didn't have to worry about kind of flushing out that promotion guest that already happened.

So, really proud of what they're doing. I will also say the state category in general is doing well because they've got a great value. The state category in general has a great value. If you think about what we put on the plate for the dollars you spend, the consumers know that. And so, we're going to continue to provide a great value at LongHorn and at all of our brands, but particularly at LongHorn with the quality focus they've had, the simplicity that they've always had and the culture that Todd is building.

Christopher Carril
Analyst, RBC Capital Markets LLC

Q

Great. Thanks for that. And then maybe just following up on the earlier comments around the consumer. Can you provide any more detail in terms of like what you're seeing regarding mix contribution to the comp? Any kind of trade up or trade down? Any shifts in behavior there, if any? Thanks.

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

A

Yeah, Chris. If you think about the mix, we're not going to comment as much about the mix impact to comp. We did have a strong performance for Never-Ending Pasta Bowl that helped our comp. But we're not seeing – as Raj said earlier, we're not seeing a big check management. We're not seeing a lot of shifting in mix because we've got a very strategic way, methodical way we price, so that we don't get mix changes when we take price because we've learned this system over time and it's proprietary way we do it, we use it with our data scientists here. So, we haven't seen a whole lot of mix shift. And as I said in the beginning, we've seen – and the economy has seen a shift from good to services. So, that could be why you haven't seen a whole lot of shift in mix in our business and maybe in other – maybe in our competitors' businesses.

Christopher Carril
Analyst, RBC Capital Markets LLC

Q

Great. Thanks so much.

Operator: Thank you. Our next question comes from Jeffrey Bernstein with Barclays.

Jeffrey A. Bernstein
Analyst, Barclays Capital, Inc.

Q

Great. Thank you, very much. Two questions. The first one just on the competitive outlook. I'm just wondering whether you've seen any change in competitive behavior. Again you're obviously servicing all ends of the spectrum here. So, just wondering, what you're seeing from the competition. I know some are concerned of a potential uptick in discounting to drive traffic if commodity inflation were to continue to ease. I know that's contrary to your strategy, make sure not to deep discount. But just wondering what you're seeing across the competitive landscape. And then I had one follow-up.

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

A

Yeah, Jeff. We haven't really seen a lot of deep discounting in the competitive landscape. There aren't many that are even on television. We've got one of the brands that had come off of TV over the years that have indicated they might come back on, but they're not talking about the deep discounting when they do that. I think, as Raj mentioned, our margins are about pre-COVID levels. I think we were maybe one or two companies in the public space that have had improvement in margin versus pre-COVID. And most of them are talking about trying to improve their margins. So, I'm not going to talk about what I think they'll do, but I'll get you back to what we're going to do.

We're going to continue to focus on our filters to evaluate our promotional messaging or any messaging that we do, elevating brand equity, simple to execute, not at a deep discount, sticking to our strategy of core guest growth and reacting accordingly. So, whatever the – whatever our competitors do, we'll watch, but we're going to stick to what we've been doing.

Jeffrey A. Bernstein
Analyst, Barclays Capital, Inc.

Q

Understood. And then the follow-up is, broadly speaking, as you look at your fiscal 2023 guidance, whether Raj, on the specific numbers or Rick, just in terms of the broader thought process. But what do you think is the – you prioritize the best to worst line of – or in terms of all your guidance components, whether it's comps, inflation, earnings, prioritize the best to worst line of sight to any of those. Just wondering what you find more or less difficult to potentially forecast as you think about the next few quarters going into potentially slowing economy. Thank you.

Rajesh Vennam
Senior Vice President, Chief Financial Officer & Treasurer, Darden Restaurants, Inc.
A

Well, I think the biggest – the one that's going to have the most uncertainty is the traffic. I mean what kind of traffic are we going to see? And we – obviously, we've used a wide range of – roughly 3% on the back half to accommodate some consumer shifts, but there's a meaningful change. That's – obviously, that's something that could have an impact. That's really the big one. Then it's – inflation has been [indiscernible] (00:45:58). I mean there have been multitude of factors that have been impacting inflation, right? You start with – start off with the supply shortages and other things, labor impact. But now as labor starts to calm down or get into a better shape, you've got weather events, obviously, global events. So, there's a lot going on. So, inflation is probably the second one. And to me, those are the two things. Outside of that, I think everything else was probably pretty well buttoned up.

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

Thank you.

Operator: Thank you. Our next question comes from Peter Saleh with BTIG.

Peter Saleh
Analyst, BTIG LLC
Q

Great. Thanks for taking the question. Just two questions. First, on the Never-Ending Pasta Bowl promotion. Do you feel like the – you get the benefit of that Never-Ending Pasta Bowl promotion? Does that extend beyond the promotional window, the seven weeks? Are you able to hold on to those guests, even though they might be purchasing something else on the menu?

Ricardo Cardenas
President, Chief Executive Officer & Director, Darden Restaurants, Inc.
A

Yeah, Peter, as we think about any promotional activity or any limited time offer activity more specifically, we want to make sure that, that limited time offer still elevates brand equity as we've said before. And so, we think there is a little bit of a halo over that. Now is it going to be as strong as when you've got the promotional message coming out there, a limited time offer message, probably not. But as we've said, I think, we said in prepared remarks our year-to-date – our quarter-to-date comp sales are equivalent to our year-to-date comp sales. So, it's not like we've seen a big slowdown since we stopped Never-Ending Pasta Bowl. Now that's across Darden, not necessarily across Olive Garden. But I think that's the idea of marketing or messaging is that should endure longer than the limited time offer, and we think this one did.

Peter Saleh
Analyst, BTIG LLC
Q

Great. And then just on competitive environment as it relates to new restaurant formation, there's been a lot of discussion around the surge in construction costs. Can you talk a little bit about what you're seeing more specifically on new restaurant formation from the competition, maybe more specifically independents? Are you seeing more or newer restaurants being built? Or is there a pullback in development given the surge in construction costs? Any insight on that would be helpful.

Ricardo Cardenas
President, Chief Executive Officer & Director, Darden Restaurants, Inc.
A

Yeah, Peter there are always new restaurants being built. The question is how many are closing to offset the new restaurants being built. As trade areas move, you're going to see restaurants open. But as we think about the number of units that have closed since pre-COVID, it's still double-digits. We're not seeing that number get smaller or bigger, right? So, it's starting to level off a little bit. But some strong competitors still opening restaurants on a net basis. We are opening restaurants on a net basis, but we're not seeing a whole lot of net unit growth in total for the full service restaurant space. Now as the construction costs start to wane as Raj mentioned, maybe you'll see a little bit about that. But I think the margins make it a little bit more challenging.

Peter Saleh
Analyst, BTIG LLC
Q

Thank you very much.

Operator: Thank you. Our next question comes from Lauren Silberman with Credit Suisse.

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

Thank you very much. Rick, you mentioned four of the brands are running at all-time high internal guest satisfaction levels. What do you think is driving these record levels? And any sense of how this might compare to guest satisfaction across the industry broadly?

Ricardo Cardenas
President, Chief Executive Officer & Director, Darden Restaurants, Inc.
A

Well, Lauren, I would say, what's driving it is the things that we've been doing over the last few years. We talk about simplicity and how simplicity makes it easier for our teams to do what they do. And if they don't have a lot of different things they have to learn and execute, it gets easier. As we streamlined the menu over the last few years, Gene even mentioned it about a year ago, streamlined the menu, you have more items being – fewer items being made more often. That means the team gets better at those items versus having these one or two items that you sell in a week. So, that helps experience.

Our team members have left to learn on the selling side because there's fewer items. So, they get – they understand the items more. Now what we've seen in our performance is our performance in our brands are getting stronger. We're not necessarily seeing the competitor situation move. They might have been flattening out or maybe a couple here or there have gone a little bit on the negative side. But our satisfaction, we're really proud of it. We're proud of both the internal measures and the external measures.

And then finally, I will say we've made significant investments over the last few years in our food and in our people. And that will eventually show up in guest satisfaction, and it has. So, we feel really good about what we're doing. And our brands having – being number one in all of the categories for Technomic, having a Darden brand being number one [ph] if you get (00:51:18) the first time ever. That's amazing news for us. And we're going to continue to do what we've done to improve satisfaction, to make it easier for our restaurant teams to do what they do and to invest in our people and invest in our food.

Lauren Silberman
Analyst, Credit Suisse Securities (USA) LLC

Q

Great. Thank you for that. And just a follow-up on the holiday season. Gift card sales are generally pretty important for early calendar 2023. Anything you can share on what you've seen with gift card sales so far this season?

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

A

I'd say they're pretty consistent with last year. I don't – I mean, again, there's also gift card sales, the day before Christmas matters a lot. So there's still a little bit of time to go. And then we haven't discounted. We – a lot of – before COVID, we used to have some offers for gift cards. We have stop doing that. So, pretty much all of our big brands, we don't discount. We don't provide any additional discount to buy gift cards. So, for us to see the strength we are seeing without any discounts, we feel pretty good.

Lauren Silberman
Analyst, Credit Suisse Securities (USA) LLC

Q

Great. Thanks so much.

Operator: Thanks. Our next question comes from Sara Senatore with Bank of America.

Sara H. Senatore
Analyst, BofA Securities, Inc.

Q

Thank you. Just a follow-up on the capacity comments. I appreciate the detail on sort of net growth. I guess, my sense is though that there's growth coming from chains and shrinkage coming from independents. So, maybe capacity, if you will, hasn't come down quite as much as unit count would suggest, given the chains tend to, I think, have bigger boxes and higher volumes. So, I guess I'm just wondering if you have any kind of thoughts on that, this idea, there's this notion that maybe it's been more of the chains that have gotten hurt and therefore, there's still a fair amount of capacity out there being added.

And then I just have a quick follow-up question on labor, that was, I guess, in line with expectations of the wage inflation, but we've been seeing such a moderation in wages, I guess, I'm trying to understand – for some concepts, perhaps. So I'm trying to understand if there's maybe a difference across markets or geographical or segments, full service versus maybe limited service where statutory minimum wage increases have more of an impact. Just any color you can give on that, because I would have expected, I guess a bit more moderation there? Thanks.

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

A

Hi Sara, this is Rick. I'll take the capacity question and I'll give Raj to get the labor question. So, on the capacity, you're absolutely right. We've seen more independents which some – in some places are a little bit smaller in total seats than the chains. But I don't know if you can get 11% of the restaurants to come out and have capacity in seats grow. We have seen the chains that still are – still opening restaurants, but not at the level they were before, and it's not helping offset all of the other capacities coming out of the system. And with the inflation on construction costs and the margins that a lot of folks have, it's a little bit harder to open restaurants. As Raj said earlier, we've actually walked away from deals even though they were above our cost of capital because we thought we had some better deals. We're not quite sure that everybody can do all of that and still get – open their restaurants and still get the same kind of returns they were getting before.

So, long answer to your question, but capacity is impacted by what kind of restaurant is opening or closing. And you're absolutely right. The independents is generally a little smaller. And so, capacity seats are probably not down as much as units are down.

Sara H. Senatore
Analyst, BofA Securities, Inc.
Q

Thank you very much.

Rajesh Vennam
Senior Vice President, Chief Financial Officer & Treasurer, Darden Restaurants, Inc.
A

Yeah. And on the labor, Sara, as you look at where we started the year, the hourly wage rate in our first quarter was mid-9. So, I think we said 9.5%. Second quarter was 8.5%. So, you saw like a full point change in the rate of inflation. We expect that to continue to go down maybe 50 basis points a quarter for the next two quarters. So, we are seeing moderation. Obviously, this takes time in terms of once you give somebody an increase, that's there, that impact for the full year. And then as we bring on new people, we are seeing that there's not as much pressure on the starting wage as it used to be. It's still high. It's still way higher than pre-COVID, but it's not – it doesn't continue to go -- it's not continuing to go up. And so hopefully, that answers your question.

Sara H. Senatore
Analyst, BofA Securities, Inc.
Q

Yeah, both answers. Very helpful. Thank you so much.

Operator: Thank you. We'll take our next question from Andrew Strelzik with BMO.

Andrew Strelzik
Analyst, BMO Capital Markets Corp.
Q

Hey. Good morning. I just had two questions going back to kind of the food cost outlook. The first one, as you move towards flattish commodity inflation or what have you in the fourth quarter, is there an opportunity to be a little more aggressive locking in where you can to improve that visibility on the cost side? Or are there still challenges doing that or maybe you think prices are going even lower, and so that's at play. So curious, how you're thinking about that, number one.

And number two, it seems like you're maybe a bit more optimistic on where food inflation is headed than some of the commentary from your peers recently. I know there's the food basket, there's timing differences. But I'm curious, if there's anything else maybe that's driving that divergence, in particular, I'm wondering if maybe this is the scale benefits playing out. So curious, how you think about that as well. Thanks.

Ricardo Cardenas
President, Chief Executive Officer & Director, Darden Restaurants, Inc.
A

Andrew, there's a lot in there. So, I'm more to try to just address all the pieces. Let's start with the ability to lock in. I think for some products we have that, for some we don't. Like if you think about beef, for instance, I don't think -- I think lot of suppliers are innovating more. They want to see what's going to happen with supply and really understand the price. So, at this point, very few suppliers are willing to lock beyond 90 days. So, that's truly a structural issue in terms of really the ability, I guess, on that.

But there are other products where we can lock in and we are locking in. So, we are continuing to kind of look at wherever there's opportunity to lock in at a good price, we're doing that. That's why you saw that for chicken, for example, we're 90% coverage for the back half. So, we did find a price that we thought was good and we – and closer to flat to last year as we get to the – into the Q4 of this year. So, we locked some of that in. And so, we are playing it by the year. Our supply chain team does a great job, kind of really thinking through the best strategy to minimize inflation for us while leveraging the relationships. Obviously, as you mentioned, scale helps. Our contracts are bigger and that gives us the ability to have a little bit more leverage. And again, this is a big part of – this is long-standing relationships our teams have built with the suppliers that help us get to a better number overall rate that we pay.

Andrew Strelzik
Analyst, BMO Capital Markets Corp.

Q

Great. That's helpful. Thank you very much.

Operator: Thank you. Our next question comes from Chris O'Cull with Stifel.

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

Q

Yeah. Thanks. Good morning, guys. My question relates to margin. And Raj, EBITDA margin has been up about 110 basis points, I think, relative to 2019 in the first half of the year. And I think your guidance kind of implies that the margin could be up 120 basis points or more in the second half of the year. I'm just wondering if you're expecting G&A to continue driving that improvement. Or are you looking for the restaurant margin to become a bigger contributor to the back half improvement?

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

A

Yeah. I would say that G&A actually, the way – because of the way we do incentive accruals, G&A is going to be probably higher in the back half than the first half. The restaurant-level margin should improve relative to pre-COVID in the back half versus where it was in the front half. But overall, if you step back, look at overall, your point is right. We do expect growth in the back half now. I'll point out that the starting point is way higher for the back half because our margins were very high in the back half to begin with before COVID. So, we had more room to grow in the first half, and you saw that. But G&A, definitely, we expect G&A in the back half to be higher as a percent of sales than it was in the front half.

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

Q

And just secondly, the segment margin at Olive Garden, I think compressed about 320 basis points year-over-year this quarter. Can you help parse out what drove that? And how much of it was intentional in terms of menu or labor investments? And how much of it was just due to inflationary pressure?

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

A

It's really inflation. If you think about the three items I mentioned that have the highest inflation – had highest inflation in the quarter, chicken, dairy and wheat, well, that's Olive Garden for you. We got 20-plus-percent. They have a little over 20% inflation on the commodities this quarter. So, that – when you take that into consideration and look at the fact that we only had 6.5% pricing at Darden level and Olive Garden, obviously, would be pretty close to Darden's price – price levels. That's the biggest piece. And then one other piece, I mentioned on the call was lettuce, while we did not experience the same level of inflation as the general market, it was a big surprise. It was, call it, $4 million to $5 million impact in the quarter, that's meaningful.

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

Q

Thanks.

Operator: Thank you. Our next question comes from Danilo Gargiulo with Bernstein.

Danilo Gargiulo
Analyst, Sanford C. Bernstein & Co. LLC

Q

Thank you. Good morning. So, I was wondering, in the context of potentially slower market environment, what give you the confidence to raise the outlook for same-store sales? And in particular, on which brands you are elevating your expectations.

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

A

Well, so actually, let me kind of explain how we got there. If you think about our pricing, we had, in the earlier guidance was 5%. Now we're at 6%. We raised the top end of our sales by half a point. So essentially, we're saying on the top end, we've actually brought down traffic by about half a point. And then on the bottom end, we basically raised it by the full point, which kind of gets to that pricing. So, that's really the driver of our change in guidance. And then the costs, [ph] out of the (01:02:08) the cost that we have some visibility into costs and we have some ranges around the ones where we have some risk, and that's how we came up with this guidance.

Danilo Gargiulo
Analyst, Sanford C. Bernstein & Co. LLC

Q

Thank you. And can you also provide some context on perhaps the frequency of visits of your consumers by brand and whether you're seeing the frequency differently today versus historical averages, maybe by some type of consumer cohorts or brands?

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

A

No. I think look, our casual dining average frequencies and call it in that low, you know, three to four times. And what we see with the core, all of our brands are seeing overtime, the investments we've made pay off and transmitting into a slight tick up in frequency. But again, this is a slow build. We always believe that we – that's our bet, is that, this takes time. But we are seeing – it is – we're seeing signs of positive momentum. And I think is the fact that we outpaced the industry by over 500 basis points on traffic, tells you that things we've done over time are translating into some increased frequency.

Danilo Gargiulo
Analyst, Sanford C. Bernstein & Co. LLC

Q

Thank you.

Operator: Thank you. Our next question comes from Brian Vaccaro of Raymond James.

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

Q

Hi. Thanks for squeezing me in. My question is on Olive Garden. I think you said it was outperforming the industry comp, even before the launch of the Never-Ending Pasta, which I think is a change versus the last several quarters. And just curious, what do you attribute that to? Have you seen the lower end consumer trade down in recent months? Anything in your data there or maybe its execution [indiscernible] (01:03:52) that are starting to kick in and really gain traction on traffic maybe some other dynamic you might offer up.

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

A

Yes, Brian. Olive Garden outperformed in Q1 as well. Just the outperformance got a little bit better. When you think about where we were last year, I would say that Olive Garden was probably more fully staffed than maybe some of the other brands in the first quarter of last year. And so, other brands may have had a little bit of benefit from more team members. We continue to believe that the investments we made in Olive Garden will continue to pay off overtime. And their staffing levels are back to where they were pre-COVID. There are improvements that they've made since pre-COVID in their food. And then finally, Olive Garden, California last year was a big jump for us, and we have a lot of restaurants in California, maybe there wasn't as much across the industry. And so, that's why we believe that our gap to the industry got better from Q1 to Q2, even though it was positive in Q1.

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

Q

All right. That's helpful. And Raj, sorry, if I missed it, but on pricing, what was menu pricing in the second quarter? And what's the reasonable expectation moving through Q3, Q4 on menu pricing, just how you're thinking about that?

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

A

Yeah, Brian, it was approximately 6.5% in Q2. And for the full year, we're saying it's going to be closer to 6%. So, the way to think about it is Q3 is likely going to be low-6s, and Q4 is likely going to be 5s, closer to 5%.

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

Q

Very helpful. Thank you.

Operator: Thank you. Our next question comes from John Ivankoe with JPMorgan.

John Ivankoe
Analyst, JPMorgan Securities LLC

Q

Hi. Thank you. Guys, it's nice to see you coming back to brilliant with the basics. I mean, I think we probably first used that maybe 20 years ago or so. So, it's definitely like a trade markable quote for you guys. And especially in the context of increased turnover, and I'm just curious in terms of like where you're seeing that, why you're seeing it first? Are you seeing some of the very high kind of unexplainable like fast quits like some others are? Or are you seeing – is that six-month turnover, 12-month turnover, 24? Is it happening in front of house, back of house? And is there anything that you can do to, I guess – and the answer might be no, but can you make it a better job for them? And when they are leaving Darden, are they going to other restaurants? Or are they just going to other types of employment?

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

A

Hey, John...

[indiscernible] (01:06:29)

John Ivankoe
Analyst, JPMorgan Securities LLC

Q

Yeah, I mean what is [indiscernible] (01:06:32) I'm trying to determine what is you guys, what is the industry versus just what is the [ph] changed employee (01:06:36)? Thanks so much.

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

A

Yeah. No problem. Yes, brilliant with the basics, it's been here since the [indiscernible] (01:06:41) days. I remember when that was coined a long time ago. So, we've been talking about reeling with the basics for quite a long time. And we believe that, we got a little bit more basic, which is the right thing, right? So, we're simplifying our menu, we went to the basic things and we did that better. That said, if you think about our turnover today versus what it was pre-COVID, a lot of the turnover, at least over the last six months was 90-day turnover, right? So, you come in and start work and then you leave within 90 days. A big chunk of our turnover was during that time period. So, we – all of our general manager conferences happen in August. And the focus and theme, August and September, I guess, the theme of those conferences were making Brand X, Y or Z an even better place to work. How do we continue to make the team member experience better by giving them the tools that they need to do their job, treating them with respect and listening to their concerns. Our turnover is improving.

Now, I think about where the turnover happens. It generally happens in more of the entry kind of jobs. Our higher turnover is generally in the host area, dish area. And generally, in the kitchen, we have more turnover than in the front of the house. That said, we've just completed our engagement survey with Gallup, and we feel really good about the engagement in our team and we're going to continue to make our brands better places to work by continuing to invest in our team and continuing to teach them and give them opportunities to grow. So, where they're going? Don't know, right? So, we don't necessarily do exit interviews for every hourly team member on where they're going. But I would guess many of them are leaving the industry. We do have a lot of people that come to work for us that have worked for others. So, I can't say that, we don't have people leave us to go work somewhere else.

John Ivankoe
Analyst, JPMorgan Securities LLC

Q

And gosh, over an hour ago, you guys – one of the first comments you made on the call was manager staffing, I think at historic highs. I mean is that GM and all assistant manager positions or just give a little bit more color in terms of the stability in that essential role?

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

A

Yeah, John, that is all manager positions in our restaurants. So, General Manager, well, general manager, it's a little bit harder to be all-time high, if you have one general manager for every restaurant...

John Ivankoe
Analyst, JPMorgan Securities LLC

Q

Yes. That makes sense.

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

A

But we're pretty close to that. So, if you think about our restaurant manager staffing, it's at all-time high. We have more managers per restaurant today than we did before COVID. And part of it is because we are giving them opportunities to grow and we are proud of the fact that we do a lot of promotions from within. So, when somebody knows the brand they're working for and they become a manager there, there's a little bit more loyalty to that brand. So, – and then the other thing, when you think about all the things we did during COVID, we made sure that our managers were – we didn't really eliminate our manager teams during COVID. We left – we kept them on because we knew how important they were to bring our team members back. And that's why we feel like we're well staffed and we're fully staffed at manager level.

John Ivankoe
Analyst, JPMorgan Securities LLC

Q

That's great. Thanks for taking the question.

Operator: Thank you. We'll take our next question from Nick Setyan of Wedbush Securities.

Nick Setyan
Analyst, Wedbush Securities, Inc.

Q

Thank you. Just a follow-up to an earlier question. I think you said you expect total restaurant labor inflation to go down by 50 bps sequentially through the end of the year from the 7% that we saw in that Q2. That would imply for the year something around 7%, maybe slightly lower than 7%. But your total inflation guidance is 7% with 8.5% commodity inflation at the midpoint. So, just maybe reconcile how we get from the combination of where total labor inflation and commodity inflation guidance is versus the total inflation guidance?

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

A

Yeah, I think the point here is you have to look at other line items. So, utility is probably in that mid-teens – low- to mid-teens. That's part of it. And then we are seeing all other costs being in the low- to mid-single-digits. So when you take that into consideration, the total inflation of 7% is what we're expecting. So, yeah, you're right, total restaurant labor inflation is approximately 7%. When you combine that with 8.5%, the midpoint of that 8% to 9% of food and beverage. And then utilities in that mid-teens and all other costs low- to mid-single-digits, that's how you get to 7% on the total. So, we're talking about the total cost base. That includes everything.

Nick Setyan
Analyst, Wedbush Securities, Inc.

Q

Got it. Thank you. And then as we kind of think about the inflation gap versus food at home, the gap has been pretty favorable for restaurants, for a few quarters now, and that's potentially narrowing and maybe even may reverse next year in terms of calendar 2023. How are you thinking about the promotional cadence and the overall competitive environment as that grocery gap maybe even reverses?

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

A

Yeah, Nick, if you think about what people get when they go to a full-service restaurant, they get more than just the food. They get the experience. And that was – that's what people are coming to us for. We've got a great value already, but there's more than just the commodity that we put on the plate. It's all of the service, all of the other things that people get to do and being able to sit and spend time with their family and friends. And so, yeah, if there's a little bit of a shift in away-from-home versus at-home, we still think we've got a great value proposition. That said, we're not going to get into what happens if promotional cadence happens, right? So if our competitors start doing significant discounting promotions, can't say what I think they'll do. I just think their margins are – makes it a little harder to do that. We're going to react the way that we've been talking about. We're going to continue to focus on driving our core guests, driving profitable sales growth, and that's our focus for now in the near future.

Nick Setyan
Analyst, Wedbush Securities, Inc.

Q

Thank you very much.

Operator: Thank you. Our next question comes from Jake Bartlett with Truist Securities.

Jake Bartlett
Analyst, Truist Securities, Inc.

Q

Great. Thanks for taking the question. My first one is on the commentary of expecting less traffic than before. So, taking the traffic assumption down by 50 basis points. And just really want to understand what is driving that? It seems like the – in the second quarter, it seemed pretty solid or not diversion from expectations. So, are you – the question really is your outlook for the next two quarters a little bit less than you were thinking before? We've seen when [indiscernible] (01:13:54) put out for November, the slight deceleration year-over-year, but also a deceleration versus 2019. So, if you could maybe comment on that, on the industry and what – how concerned investors should be about a deceleration just on the industry-wide in November?

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

A

Hey, Jake, I think you're activating too much signs to this method here because when we look at how we do this, the midpoint of our guidance is about 75 basis points higher than last time with 1% pricing. So really, what we changed the midpoint by 25 basis points on traffic. That's within the margin of matter of many models we build. I mean, I wish we only had a 50 basis point margin effect around our models. It's obviously a lot wider. I hate to admit it. But I don't think – we're not experts at prognosticating this business on. So, we're doing the best we can and that's our best estimate at this point.

Jake Bartlett
Analyst, Truist Securities, Inc.

Q

Okay. And maybe just within that, if you could talk about just what you assume in your guidance for a macro environment. We're seeing, obviously, continued wage inflation. But if you build in – others have talked about a modest recession or what have you. What is your basic framework on a macro perspective that's embedded in your sales outlook?

Rajesh Vennam
Senior Vice President, Chief Financial Officer & Treasurer, Darden Restaurants, Inc.
A

Well, I think what we're incorporating is some potential shifts, changes in consumer behavior. That's why you have a range of three percentage points on traffic. If you look at the back half and if you look at – translate that into the guidance range we have, that implies a range of three points, that is to accommodate potential changes in consumer behavior, but not a step change. And I said earlier, if there is a major step change, that's not really contemplated in our guidance.

Jake Bartlett
Analyst, Truist Securities, Inc.
Q

Great. And then quick question on G&A as a follow-up. I believe the guidance kind of before you've been talking about $400 million as being a good number for the year. You're running significantly behind that run rate in the first half, you commented that you expect it to go higher. But just roughly, what should we expect for just G&A as a whole for the year in 2023 – fiscal 2023?

Rajesh Vennam
Senior Vice President, Chief Financial Officer & Treasurer, Darden Restaurants, Inc.
A

Yeah, Jake, at this point, our best estimate is $390 million.

Jake Bartlett
Analyst, Truist Securities, Inc.
Q

Okay. Thank you so much.

Rajesh Vennam
Senior Vice President, Chief Financial Officer & Treasurer, Darden Restaurants, Inc.
A

Yeah. Welcome.

Operator: Thank you. At this time, it appears we have no further questions in queue. I'd like to turn it back to management for any additional or closing remarks.

Kevin Kalicak
Senior Vice President-Finance and Investor Relations, Darden Restaurants, Inc.

Thanks Todd. That concludes our call. I'd like to remind you that we plan to release third quarter results on Thursday, March 23 before the market opens with a conference call to follow. Thank you for participating in today's call. Have a great holiday and Happy New Year.

Operator: This will conclude our call today. We thank you for your participation. You may disconnect at any time.