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Darden Restaurants, Inc. (DRI)

Q4 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the Darden Fiscal Year 2021 Fourth Quarter Earnings Call. Your lines have been placed on listen-only until the question-and-answer session. [Operator Instructions] The 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 & Investor Relations, Darden

Thank you, Regina. Good morning, everyone, and thank you for participating on today's call. Joining me on the call today are Gene Lee, Darden's Chairman and CEO; Rick Cardenas, President and COO; 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 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 on the Investor Relations section of our website at darden.com.

Today's discussion and presentation include certain non-GAAP measurements and reconciliations of these measurements are included in the presentation. Any reference to pre-COVID when discussing fourth quarter performance is a comparison to our fourth quarter of fiscal 2019 and the annual reference to pre-COVID is the trailing 12 months, ending February of fiscal 2020. This is because last year's results are not meaningful due to the pandemic's impact on the business as dining rooms closed and we pivoted to To Go-only model during the fourth quarter of fiscal 2020. We plan to release fiscal 2022 first quarter earnings on September 23 before the market opens, followed by a conference call.

This morning, Gene will share some brief remarks, Rick will give an update on our operating performance, and Raj will provide more detail on our financial results and share our outlook for fiscal 2022.

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

Eugene I. Lee, Jr.

Chairman & Chief Executive Officer, Darden Restaurants, Inc.

Thank you, Kevin. Good morning, everyone. As you saw from our release this morning, we had a very strong quarter that exceeded our expectations as sales quickly accelerated from the third quarter.

During our call a year ago, I talked about the resiliency of the full-service dining segment and the confidence we had in the industry's ability to bounce back from the impacts of the pandemic, and we've begun to see demand come back at strong levels.

As we think about the industry, our consumer insights team has done a lot of good work to better understand the size of the full-service dining segment. There are multiple sources of data that offers sales estimates for the restaurant industry. And the size of the industry and the full-service industry specifically, varies considerably across these sources. This year, we are adopting Technomic as our data source, which we believe better reflects the sales contribution from independent operators, provides a broader view of the restaurant industry, and aligns more closely with the census data.

Going forward, we will be referencing industry data provided by Technomic, which sizes the casual dining and fine dining categories for fiscal 2020 at $189 billion and for fiscal 2019 at $222 billion.

Given the strong demand we're seeing and the financial health of the consumer, we believe the categories will return to that size or greater despite having approximately 10% fewer units than before the onset of the pandemic.

Over the last 15 months, we have made numerous strategic investments. At the restaurant level, we've invested in food quality and portion size that will help strengthen long-term value perceptions for each brand. We also made considerable investments in our team members to ensure our employment proposition remains a competitive advantage. And we invested in technology, particularly within our To Go capabilities to meet our guests' growing need for convenience and desire for the off-premise experience. Our business model has evolved and is much stronger today.

As we begin our new fiscal year, we will remain disciplined in our approach to growing sales, more specifically our focus is on driving profitable sales growth. Given the business transformation work we have done and the demand we are seeing from the consumer, we are well positioned to thrive in this operating environment.

Before I turn it over to Rick, I want to say thank you to our team members in our restaurants and our support center. This was, without a doubt, the most challenging year in our company's history. But thanks to your dedication and perseverance, we have emerged stronger. On behalf of the board of directors and the senior leadership team, thank you for all you do to take care of our guests and each other. Rick?

Ricardo Cardenas

President & Chief Operating Officer, Darden Restaurants, Inc.

Thank you, Gene, and good morning, everyone. Our results this quarter are a culmination of the business model transformation work that Gene referenced as well as the simplification efforts we implemented throughout the year. Significant process and menu simplification at each brand has enabled us to drive high levels of execution and strengthen margins, further positioning our brands for long-term success.

As we began the quarter, our restaurant teams remained disciplined, while continuing to operate in a difficult and unpredictable environment. As restrictions continue to ease and dine-in traffic increased, our team successfully managed through it, thanks to their focus on being brilliant with the basics, ensuring we provided great food with outstanding service in an enjoyable atmosphere for all of our guests. This enabled us to deliver record-setting results.

For example, Olive Garden broke its all-time single-day sales record on Mother's Day. Additionally, both Olive Garden and LongHorn Steakhouse achieved the highest quarterly segment profit in their history.

Even as capacity restrictions eased, and we were able to utilize more of our dining rooms, off-premise sales remained strong during the quarter. Off-premise sales accounted for 33% of total sales at Olive Garden, 19% at LongHorn and 16% at Cheddar's Scratch Kitchen.

Guest demand for off-premise has been stickier than we originally thought, and this is driven by the focus of our restaurant teams and the investments we made to improve our digital platform throughout the year.

Technology enhancements to online ordering and the introduction of new capabilities, such as To Go capacity management and Curbside I'm Here notification, improves the experience for our guests, while making it easier for our operators to execute. As a result, during the quarter, 64% of Olive Garden's To Go orders were placed online and 14% of Darden's total sales were digital transactions.

Thanks to additional technology enhancements, we continued to see guests utilize our digital tools even when they were dining in our restaurants. Nearly half of all guest checks were settled digitally, either online, on our tabletop tablets or via mobile pay. The business model improvements we have made also reinforced our ability to open value-creating new restaurants across all of our brands.

During the quarter, we opened 14 new restaurants, and these restaurants are outperforming our expectations. While Raj will discuss specific new restaurant targets for fiscal 2022, we are working to develop a pipeline of restaurants and future leaders that would put us at the higher end of our long-term framework of 2% to 3% sales growth from new units as we enter fiscal 2023.

Finally, the strength of the Darden platform has helped our brands navigate near-term external challenges. The employment environment has been an issue for the industry. However, the power of our employment proposition, strengthened by the investments we have in our people, continue to pay off as we retain our best talent and recruit new team members to more fully staff our restaurants. So, while there are staffing challenges in some areas, we are not experiencing systematic issues.

Additionally, the strength of our platform has helped us avoid significant supply chain interruptions. Our supply chain team continues to leverage our scale to ensure our restaurant teams have the key products they need to serve our guests. Notably, the few spot outages we have experienced are related to warehouse staffing and driver shortages, not product availability.

To wrap up, I also want to recognize our outstanding team members. During my restaurant visits, I'm inspired by the positive attitude and flexibility you demonstrate everyday. Thank you for all you have done and continue to do to deliver great experiences for our guests.

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 fourth quarter were $2.3 billion, 79.5% higher than last year, driven by 90.4% same-restaurant sales growth and the addition of 30 net new restaurants, partially offset by one less week of operations this year.

The improvements we've made to our business model, combined with fourth quarter sales accelerating faster than cost, drove strong profitability, resulting in adjusted diluted net earnings per share from continuing operations of $2.03.

Our reported earnings were $0.76 higher due to a non-recurring tax benefit of $99.7 million. This benefit primarily relates to our estimated federal net operating loss for fiscal year 2021, which will carry back to the preceding five years.

Looking at our performance throughout the quarter, we saw same-restaurant sales versus pre-COVID improving from negative 4.1% in March to positive 2.4% in March – in May. And same-restaurant sales for the first three weeks of June were positive 2.5% compared to two years ago.

To Go sales for Olive Garden and LongHorn continue to be significantly higher than pre-COVID levels. We have seen a gradual decline in weekly To Go sales. However, that decline is being more than offset by an increase in dine-in sales.

Turning to the fourth quarter P&L, compared to pre-COVID results, food and beverage expenses were 90 basis points higher, driven by investments in both food quality and pricing below inflation. For reference, food inflation in Q4 was 4.3% versus last year.

Restaurant labor was 190 basis points lower, driven by hourly labor improvement of 320 basis points due to efficiencies gained from the operation simplification and was partially offset by continued wage pressures. Marketing spend was $44 million lower, resulting in 200 basis points of favorability.

G&A expense was 30 basis points lower, driven primarily by savings from the corporate restructuring earlier in the year. As a result, we achieved record restaurant level EBITDA margin for Darden of 22.6%, 310 basis points above pre-COVID levels and record quarterly EBITDA of $412 million.

We had $5 million in impairments due to the write-off of multiple restaurant-related assets. And our effective tax rate for the quarter was 12%, excluding the impact of the non-recurring tax benefit I previously mentioned.

Looking at our segments, we achieved record segment profit dollars and margins at Olive Garden, LongHorn and the Other Business segment this quarter. Fine Dining improved segment profit margins versus pre-COVID despite sales decline. These results were driven by reduced labor and marketing expenses as we continue to focus on simplified operations, while also continuing to invest in food quality and pricing below inflation.

Fiscal 2021 was a year like no other. And despite the challenges of constantly shifting capacity restrictions and uncertain guest demand, we delivered $7.2 billion in total sales. The actions we took in response to COVID-19 to solidify our cash position and transform our business model, helped build a solid foundation for recovery and resulted in over $1 billion in adjusted EBITDA and over $920 million of free cash flow.

As a result, we repaid our term loan, reinstated our pre-COVID dividend and quickly built up our cash position. Our disciplined approach to simplifying operations and driving profitable sales growth positions us well for the future. As a result of our strong performance, cash position and the fiscal 2022 outlook, this morning, we also announced our board approved a 25% increase to our regular quarterly dividend to $1.10 per share, implying an annual dividend of $4.40. This results in a yield of 3.2% based on yesterday's closing share price.

Finally, turning to our financial outlook for fiscal 2022, we assume full operating capacity for essentially all restaurants, and we do not anticipate any significant business interruptions related to COVID-19. Based on these assumptions, we expect total sales of $9.2 billion to $9.5 billion, representing growth of 5% to 8% from pre-COVID levels; same-restaurant sales growth of 25% to 29% and 35 to 40 new restaurants; capital spending of $375 million to $425 million; total inflation of approximately 3% with commodities inflation of approximately 2.5% and hourly labor inflation of approximately 6%; EBITDA of $1.5 billion to $1.59 billion; an annual effective tax rate of 13% to 14%; and approximately $131 million diluted average shares outstanding for the year; all resulting in a diluted net earnings per share between $7 and $7.50.

And with that, we'll open it up for questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question comes from the line of Brian Bittner with Oppenheimer. Please go ahead.

Brian Bittner
Analyst, Oppenheimer & Co., Inc.

Q

Thank you. Good morning. Gene, you stated that Darden is well-positioned to thrive in this operating environment. And I think that's just a pretty powerful statement given all the labor challenges and cost issues that we're hearing from all of your peers. What is your reaction to these dynamics? And why specifically do you believe Darden is standing out from the crowd as it relates to the near-term impacts from these issues?

Eugene I. Lee, Jr.
Chairman & Chief Executive Officer, Darden Restaurants, Inc.

A

Well, let's start with – on the labor front. I mean, we've made significant investments over time in our people starting way back when we had the tax reform, we made the choice to invest in our people at that point in time. We've invested in our people throughout the pandemic. Our best people have stayed with us through this. We have an attractive employment proposition. We're able to attract people to our businesses, to work for us. We think that we're fairly well staffed right now.

And as the environment continues to improve, we see no reason why we're not the employer of choice in our businesses. I've been pretty clear saying, I think the restaurant industry is going to continue to struggle attracting workers, but there's enough great hospitality workers out there to staff all the Darden restaurants if we provide the best employment proposition.

And not just an employment proposition today, it's about potential growth. Our ability to promote from within, we're promoting 1,000 team members a year in the management. We're providing other opportunities through training and going out and opening new restaurants. I think our team members really love the experience.

And so I think that we're in great shape from an employment standpoint. We'll continue to invest. We'll manage – we'll do our great salary administration to ensure that we're paying competitive wages. And I think that we have the flexibility to manage the wage inflation because of our margin structure. And combined with our pricing philosophy, I think we have some room there, if need be, to offset that and to be able to increase wages if we need to.

As far as food inflation goes, I mean, our team has done a fantastic job. We're fairly long on the things that we need to be long on. And I think using our platform and our scale to our advantage through this has been a big advantage. And we feel like we're very well positioned to manage whatever inflation comes our way in the near term and even in the long term.

Brian Bittner
Analyst, Oppenheimer & Co., Inc.

Q

Thanks, Gene. And just a quick follow-up for Raj, we're no longer talking about 90% sales recapture, thankfully. We're on the other side. It feels in your guidance for 2022 is 5% to 8% above pre-COVID level. So, obviously, over 100% recapture. And I believe the EBITDA margins at the midpoint of that guidance are 16.5%, so 250 basis points above pre-COVID. So, what is the philosophy on communicating investments to us now and the philosophy on communicating how you're thinking about EBITDA margins now that this path for sales above pre-COVID levels is so much more clear?

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

A

Yes, Brian, I think as we look at where our guidance is, let me just start with that. When you think about what we guided this morning for fiscal 2022, that implies EBITDA margin growth of between 200 basis points on the lower end to 250 basis points on the higher end. And so, clearly, our sales have recovered. The – some of the flow-through, we're letting it flow to the bottom line. But we have made some investments – continue to make investments.

And as Gene mentioned, we are pricing well below inflation. In fact, I think this morning, we said we expect overall inflation to be around 3%. And our pricing is in the middle of our 1% to 2% target. So, we are pricing well below inflation. That's the biggest investment we're making, but also gives us some extra dry powder if there was additional inflation that was to come our way.

So, we do think the 200 to 250 basis points is a good target for us now. But as we think beyond that, I think we need to better understand the economic and competitive environment as we hone in on the business model. And I would say based on where we are today, we expect to retain most of that margin improvement we've seen – we'll see in FY 2022.

Brian Bittner
Analyst, Oppenheimer & Co., Inc.

Q

Thank you. Congratulations.

Operator: Your next question comes from the line of Eric Gonzalez with KeyBanc Capital Markets.

Eric Gonzalez
Analyst, KeyBanc Capital Markets, Inc.

Q

Hey, thanks for the question. My question is on the inflation outlook. Clearly, there have been some big moves in commodities in recent weeks. Can you talk about some of the key variables included in that 3% inflation? I think you said 2.5% on the food side? And perhaps how that might stage throughout the year? Do you expect inflation to be higher in the beginning of the fiscal year before perhaps leveling out towards the end? Thanks.

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

A

Yeah, hi, Eric. So, yes, as you look at inflation, we said commodities is around 2.5% for the full year. But it is – the front half of the year is somewhere between 3.5% to 4%. And then it's a little bit – it tapers off a little bit as we go into the back. And as I said in my prepared remarks, Q4 this year was 4.3%, which implies – which is where we think as we ramp on that next year, we expect Q4 to be more closer to flat. And so that's kind of the cadence.

And then about the drivers of commodity inflation, I'd say chicken and seafood are high and we're also seeing significant inflation in cooking oil, a little bit in dairy. And I'd say the other thing is packaging. Packaging continues to be – especially with resin costs going up, packaging is another factor. So, all-in-all, those are the big drivers of inflation on the commodity side. And on the labor side, overall labor, we expect to be somewhere between 4%, 4.5%. But wage rate itself, we expect that to be around 6%.

Eric Gonzalez
Analyst, KeyBanc Capital Markets, Inc.

Q

Very helpful, thank you.

Operator: Your next question comes from the line of David Tarantino with Baird.

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

Q

Hi, good morning. I'm wondering, related to Olive Garden or perhaps your overall sales, how much do you think capacity constraints are still in play in terms of weighing down the performance? And I guess, relatedly, what do you think the upside is, Gene, as you see the restaurants come back to full capacity now that you're seeing some of these To Go sales stick more than you thought they would?

Eugene I. Lee, Jr.
Chairman & Chief Executive Officer, Darden Restaurants, Inc.

A

Yeah, David, good morning. It is very limited capacity restrictions out there. There are still a few states and municipalities that have some restrictions on us, but we got California back last week and we got New York back. So, the big – there's – no major market has restrictions. I think that when I think – when we think about where we're at from a sales perspective, we think there's still more room inside the restaurants as we continue to work on – we think the work we do with all our menus and our business model are going to help us with throughput, which is going to enable us to, in these high-volume periods, get more volume to the restaurant.

I think Rick's comment in his prepared remarks about what the teams were able to do and execute on Mother's Day to have the biggest – the best Mother's Day we've ever had before, it says a lot about our ability to execute and get more people through our restaurants in a limited time period. So, I don't think we have any capacity restrictions. Obviously, we're seeing less sales growth on the weekends than we are – when we are mid-week just because there's less opportunity in a lot of our high-volume restaurants to get through extra volume.

So, I mean there's still – the word I use a lot is we're still in search of equilibrium, and we're not there yet. And I don't know when we're going to be there. When we see consumers really get into what I would call a normative behavior pattern, and we kind of get to where we understand what the in-restaurant dining is going to be, what the off-premise is going to be. Rick, in his comments, talked about that we're pleased with where the off-premise is leveling out, even though it's declining slightly.

But we – and I said this a while ago, and I think you guys – a lot of you guys disagree with me. I think you were right and I was wrong that some of this off-premise was stickier than what we thought. And I think a lot of that has to do with the capabilities we created through the pandemic to make it a lot less frictionless. But I'm searching – we're searching for equilibrium, understanding when and where the business is going to come from. I think we're still in the early innings of that. I think we still got a lot more upside.

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

Q

Thanks. Thanks for that, Gene. And then, I guess, one other follow-up question on this point is the gap between how LongHorn is performing and how Olive Garden is performing relative to pre-COVID is very significant. And I was wondering if you could give your thoughts on why either LongHorn is outperforming by so much or Olive Garden is kind of lagging the performance you're seeing for LongHorn?

Eugene I. Lee, Jr.
Chairman & Chief Executive Officer, Darden Restaurants, Inc.

A

Well, first thing I would say is Olive Garden is not lagging. I mean I'm just thrilled with their performance. When you're looking at 25.5% restaurant-level margins and getting back to pre-COVID sales levels, that's just amazing. That performance is unbelievable.

When you look at what's going on in LongHorn, we've been investing in that business for five years since Todd's come back. And he and his team have just done a great job of improving the value perception. When we look at where they are in Technomic and the ratings, they are number one in most categories. They moved from middle of the pack to number one. And so, I think LongHorn's performance is just a culmination of a lot of work over a great period of time.

And I also – I want to also recognize that the whole Steakhouse segment is moving. The whole Steakhouse segment has outperformed the other segments, and I believe that's because they have – the segment has high value perceptions. So, they're definitely getting a segment lift, but they've also done a great job and they're executing at an extremely high level.

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

Q

Great. Thank you very much.

Operator: Your next question comes from the line of Jeffrey Bernstein with Barclays.

Jeffrey A. Bernstein
Analyst, Barclays Capital, Inc.

Q

Great. Thank you very much. Two quick ones, actually. The first one, just on the first quarter as we now seemingly exit, hopefully, the pandemic, I think you said June, your month-to-date comps were up 2.5%. I think that's actually identical to what you said for May. I'm just wondering how does that compare to expectation, whether you would have expected further acceleration with additional markets, like you said, having recently reopened? Or any kind of thoughts you can give us having given us full year guidance? Just wondering I want to make sure with this being the first quarter of lapping full COVID, any thoughts on those sales or whether there's any parameters around the earnings that you want us to think about. And then one follow-up.

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

A

Hey, Jeff, this is Raj. So, when you think about the cadence, I mean, I think May to June, I mean, three weeks, 2.5%. That's – we feel pretty good about where we are on that in terms of same-restaurant sales. I would argue they're actually a little bit better than what we had expected going into the fiscal year.

And then as you look at the cadence of some of these, as the markets open up, as the capacity restrictions are lifted, we are seeing some movement, especially in California and places like that. But when you blend everything at the Darden level, some of these brands that are impacted the most are brands that are not a big portion – [ph] playing (00:27:42) a big part of our overall portfolio. So, it takes a lot to move the needle on our blended same-restaurant sales.

And then there are other factors you got to take into consideration, especially as you look at versus fiscal 2019, because we're not doing some of the promotional activity. We're not doing things that would have stimulated demand in the past that we're doing now, right? So, there is that we are basically comparing to a level that was different when we had a lot more spend in marketing and other stuff.

But as Gene said, I think with this continuation of the same theme that we are thrilled with where we are, and we're also thrilled with our business model how we're – and the fact that we're able to make investments not only in our people, but also in our guests through food quality, food portion and pricing. So, we're giving a lot back to the guests, while giving – while actually getting a strong business model. And so, I think that's how I would, I guess, address the question.

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

Great. And then just my follow-up, just wondering as you think about fiscal 2022, what do you think is the greatest risk? I mean seemingly, you're feeling quite good about current quarter-to-date trends and thriving in the outlook commentary. But in terms of risks to fiscal 2022, would you say it's more on the sales or the cost side? Maybe where you think yourself and/or the industry would be most vulnerable as we come out on the other side? Thank you.

Eugene I. Lee, Jr.
Chairman & Chief Executive Officer, Darden Restaurants, Inc.
A

Well, I think the greatest risk still is COVID. I mean I think we're getting to the point where we think we're getting to the other side of that. But when I look at what we've put out there for guidance and I think that – I think we – obviously, we think we can achieve that. But I look at the greatest risk as being external, not internal, and I don't see risk from a sales perspective or a cost perspective.

I think we've got the flexibility, and we've set this up to have the flexibility to deal with almost anything that is thrown at us, with the exception of another outbreak in COVID, where we had to have some restrictions on our business. To me, that's the greatest risk to what we look for.

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

Thank you.

Operator: Your next question will come from the line of Chris Carril with RBC Capital Markets.

Christopher Carril
Analyst, RBC Capital Markets LLC
Q

Hi, thanks. Good morning and thanks for the question. So, just in looking at the segment margins, holding aside the performance at Olive Garden and LongHorn, the Other Business segment margin was particularly strong and well above 2019. So, curious to hear what some of the key drivers of the performance were in that segment.

And maybe how much of a factor that segment's improvement is contributing to your 2022 outlook? And I know last quarter you had discussed the improvement at Cheddar's, so any additional color or update there would be great as well.

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

Yeah. So, I think as we look at our – Chris, as we look at the other segment, I'd point out a couple of the brands where the business model transformation was significant. I'll say Cheddar's is a big part of that and Bahama Breeze is another brand where we saw a significant improvement in the business model.

And part of this is going back to the simplification. We had a chance to kind of break down everything, rebuild back up and kind of figure out a way to transform the business model. So, those two brands are primarily contributing to the significant – to the growth we have in the Other segment.

And as we look at next fiscal year, they still play a decent role, right? I mean when you look at the Other segment, it's about 20% of it. So, they're not going to be a huge contributor. But related to their size, they are going to be outperforming on the segments – segment margin.

Eugene I. Lee, Jr.
Chairman & Chief Executive Officer, Darden Restaurants, Inc.
A

Yeah, Chris, on Cheddar's, I would just say that we're extremely pleased with this business at this point. As Raj indicated, the biggest improvement in the business model and all of our business came in Cheddar's. We continue to focus on strengthening the restaurant leadership teams to be able to handle the future growth. But overall, we're very pleased with where this business is at today and very excited about the potential.

Christopher Carril
Analyst, RBC Capital Markets LLC
Q

Great. Thanks for that detail and I'll just pass it along here.

Operator: Your next question will come from the line of James Rutherford with Stephens. Please go ahead.

James Rutherford
Analyst, Stephens, Inc.
Q

Yes, thanks. I wanted to start off with a technology question for Rick. Last quarter, you mentioned being in the middle of developing a new three-year road map for technology. And I wanted – I was curious if you – where you expect to see the biggest returns, whether it's consumer-facing in the box, online, back-of-the-house, support center kind of or in some other area, I mean where are the biggest opportunities and priorities for the next three years on the tech side?

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

Yeah, James, thanks for the question. We have completed our three-year road map and what we're working on. And we look at it in a few places. But the primary – I would say, the primary theme is reducing friction. So, what we're doing with technology is reducing friction in the guest experience, in the team member experience and in the manager experience in what we do. And so that would mean continuing to enhance our off-premise capabilities to make it easier for guests to order repeat orders and to pick up their off-premise experience.

In the restaurant, we're looking at a revamp of our point-of-sale system. It's a pretty old system that we developed years ago. We're going to revamp that to make it much easier for our team members to handle the guest experience and to handle off-premise. And for the managers, we're simplifying the way things look in the back-of-the-house. So, a lot of our systems, while they have great back-ends, very great back-ends, the user interface isn't as great. So, we're working on improving the user interface. But all of those are under the theme of reducing friction.

James Rutherford
Analyst, Stephens, Inc.
Q

Okay. Excellent. And then Raj, just one follow-up. I think last quarter, you said you were sitting at 115,000 hourly employees across the company. Could you update us on where you stand today and where you view full employment given the demand environment here today?

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

I don't know that we're comfortable sharing the total number of employees at this point, but I'd just say we have made significant progress. In fact, going back, I don't know that we – I don't remember if we said 115,000, I think it was a little bit more than that. But anyway, at this point, I'm not so sure we want to get into the exact number of employees other than just let you know that we feel pretty good with where we're staffed, and we don't see any gaps.

James Rutherford
Analyst, Stephens, Inc.
Q

Okay. Excellent. Thank you so much and congratulations.

Operator: Your next question comes from the line of Andrew Charles with Cowen.

Andrew Charles
Analyst, Cowen & Co. LLC
Q

Great. Thanks. Raj, you guys impressively raised your dividend 25% to $1.10. And if we think about the historical 50% to 60% target payout ratio, this would imply EPS of $7.33 to $8.80 versus the formal guidance of $7 to $7.50. Can you help rectify that a little bit? Is it just conservatism reflected in the formal guidance?

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

Okay. Great question. Let me start with, when you think about how we look at our dividend, the 50% to 60% is our target range, right? But at this point, given where we are with our cash on the balance sheet, we felt pretty good about going to the higher end of that range.

So, as you pointed out, if you look at 60%, then we're right – it's closer to the middle of our guidance. So, if you take the middle of our guidance, we're basically at 61% payout. So, that's not that – I would argue that's not that different from the 50% to 60%, especially given we're sitting on a $1.2 billion cash flow, and we expect to still generate significant free cash flow. And at the end of the day, when we look at our business model, this will only –

the proposed dividend or the dividend that we actually announced this morning, only it's up about 50% of our free cash flow.

So, feel really good about where we are. And also, just remember, the target is over time. We had a year where we were below the target. So, think of this as a way to kind of make up for a little bit of that.

Andrew Charles
Analyst, Cowen & Co. LLC

Q

That's fair. Thank you.

Operator: Your next question comes from the line of Jeff Farmer with Gordon Haskett.

Jeffery Daniel Farmer
Analyst, Gordon Haskett Research Advisors

Q

Thank you. On the March earnings call, you reported that hourly labor productivity had improved by, I think, you said over 20% for the system. So, I'm just curious, two things. How are you measuring in labor productivity? And I think you touched on it a little bit earlier, but how have you driven this level of improvement in productivity?

Ricardo Cardenas
President & Chief Operating Officer, Darden Restaurants, Inc.

A

Hi, Jeff, this is Rick. Yes, we did mention that productivity was about 20% better across the system. And we measured on an hour per guest basis. So how many guests can we serve per hour – per labor hour? And we're still seeing significant labor productivity improvements.

As Raj mentioned, we had a significant improvement in labor per – labor margin even with inflation. And the way we did it was what we've been talking about for the last year, is continue to improve our processes from the food coming into the backdoor to getting to the table, which means significant menu, design work, significant prep design work, which took a lot of the steps and procedures out of the kitchen.

And what I would say is we are never done with that. We redesigned our processes over the last year. We have to look at them again and do we have to redesign again. So, we're going to continue to do that, to drive efficiencies where we should drive efficiencies so that we can reinvest those savings in our plate and give a better experience for our guests.

Jeffery Daniel Farmer
Analyst, Gordon Haskett Research Advisors

Q

And then just as a quick follow-up, and I might have missed this earlier, I apologize. But of the 25 states or so that have ended the supplemental unemployment benefits early, what has the hiring or staffing dynamic looked like since that's happened in those states?

Ricardo Cardenas
President & Chief Operating Officer, Darden Restaurants, Inc.

A

Yeah, Jeff, a lot of those states announced something either late May or early June that would take effect sometime in June. And I think the first date took effect maybe last week.

And anecdotally, we have seen a little bit of an improvement in the trends of applicant flow, but we've seen it all across the country, not just states that have eliminated the UI, but even states that haven't yet.

It could be because the states that haven't yet are actually starting to open up. And so, you're going to see applicant flow. But we feel really good about our applicant flow into our restaurants. We're hiring – we're [ph] net (00:38:30) hiring a lot of people every week, we had a record hiring quarter in the fourth quarter. And we feel really good about where we are.

Jeffery Daniel Farmer
Analyst, Gordon Haskett Research Advisors
Q

All right. Thank you.

Operator: Your next question comes from the line of Brett Levy with MKM Partners.

Brett Levy
Analyst, MKM Partners LLC
Q

Great. Thanks for taking the call and good morning. I guess just two separate questions. You're obviously talking about some significant EBITDA margin expansion. How should we be thinking about that from a split between the recovery of G&A spending as well as the unit level profitability? And does this – does the progress you've seen of late, change what you think the longer-term ceilings are for your restaurant-level margin?

And then, the second question is on the development side. We've obviously seen a lot of news out there of delays of inflation of labor availability. Are you – what are you seeing on those fronts? And how confident are you about either the cadence of the [ph] 35 to 40 basis points (00:39:31) or the ability to reach the higher-end? Thank you.

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

Hi, Brett, let me start, and then I'll hand it over to Rick for the development question. So, as you look at our margins, I'd argue a lot obviously – the margin that you saw in Q4, where bulk of it came from the restaurant level, there's a little bit at the G&A. I say a little bit. It's actually 30, 40 basis points, which is huge.

So, I think as you look forward, I think the way to think about it is G&A is probably going to be in that somewhere around 40 basis points of favorability, but then the rest is going to come from the restaurant-level margins. And the way I would kind of categorize that is that really restaurant labor and marketing are going to have an – see an improvement. However, you're going to – we're going to continue to see some increase in food cost because of the investments. That's a deliberate choice we made. And then – so that's how I'd kind of categorize that.

And then the restaurant expenses line should be a little bit better, but not as significant, because that's one – because – especially because we're not pricing in line with overall inflation. You got to just have an impact on all the line items across the P&L. Rick.

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

Yeah, Brett, on the development side – this is Rick. On the development side, we have a couple of things. One is, we shut down our pipeline at the beginning of COVID, and we restarted the pipeline during this fiscal year as we saw us coming out of that. We feel really good about the 14 restaurants we opened.

But I would say, you hear a lot about labor shortages in construction and about product shortages in construction, we're getting out in front of that. So, we're ordering product a lot further in advance than we used to, so, to make sure that we've got the stainless steel in the kitchen to do the things that we need to do.

The good news is you're seeing some of these input costs come down. So, hopefully, by the time we're starting to build our restaurants, those input costs are back to more reasonable level. That said, the margin improvements we've made in our restaurants – in our restaurant profitability has really helped, even if the inflation was where people are hearing about it.

In terms of cadence of openings, as I said, we got in front of this and started ordering product earlier for our restaurant. But we typically open mid-teens restaurants in the fourth quarter. And of our 35 – 30 to 40 restaurants we're going to open this year, we'll probably have mid-teens in the fourth quarter, and the other ones will be kind of spread throughout this fiscal year.

Brett Levy
Analyst, MKM Partners LLC

Q

Great. Thank you.

Operator: Your next question will come from the line of Lauren Silberman with Credit Suisse. Lauren, you may be on mute. We can hear you now.

Lauren Silberman
Analyst, Credit Suisse Securities (USA) LLC

Q

Hey, can you hear me? Okay, great. So, on the To Go, you talked about To Go being stickier than perhaps you originally thought. Are you seeing any discernible differences across markets that have recaptured more on-premise sales? And then, is there anything that you can share on how consumers are using the To Go occasion? And whether that's a replacement for on-premise versus in that home meal?

Eugene I. Lee, Jr.
Chairman & Chief Executive Officer, Darden Restaurants, Inc.

A

Well, I think the – for off-premise, they're using it as a home meal replacement or maybe in the workplace during the day, I think there's no behavioral change there at all. And there's no – there's really no difference in what's happening throughout the country as more restaurants, more dining rooms open.

It's been the kind of the same kind of shift. You took down a couple hundred basis points and you pick more of that up in the dining room. Again, I think that, as I said earlier, I just think this – I think it – I'll give the analyst community credit on this, this was stickier than what we thought.

We know we've reached some new consumers here. And the experience is very, very good. And so, I think that we don't know where it's going to net out. It's going to net out a lot higher than it was pre-COVID. And I think it's something that's part of our business, we have to pay a lot more attention to as we move forward.

Lauren Silberman
Analyst, Credit Suisse Securities (USA) LLC

Q

Great. And just if I could do a follow-up on June running at 2.5%. Are there any seasonality considerations in June relative to May? Or are you largely seeing similar average weekly sales?

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

I'd say, yeah, the similar average weekly sales once you take out the noise of the holidays.

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

Thank you very much.

Operator: Your next question will come from the line of Chris O'Cull with Stifel.

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

Thanks. Good morning guys. Raj, I believe you stated that demand came back at a faster pace than cost. I was hoping you could elaborate on what those costs were given staffing hasn't been an issue? And maybe the impact of that timing dynamic?

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

Well, I'd say a little bit of it was staffing. We had to catch up on staffing through the quarter as they accelerated faster than we hired. But by the end of the quarter, we're in a good place. So, there was a little bit of that.

But beyond that, it's I think as you look at our P&L, you can see, obviously, the marketing didn't grow as we had sales come in. We didn't have – the level of travel was a lot less. Some of these costs that we have, the other cost is really more around growth cost that we said we're going to want to bring back, especially because we want to kind of have the right pipeline of talent for new openings.

And those costs are – we were holding off on some of these to wait for the sales to get back to the levels where we thought we were delivering the right level of the returns. And so – now that the sales are at the levels that are above the pre-COVID, some of these costs will have – we want to put that back into the P&L. And that's part of the guidance that we provided this morning.

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

Can you quantify the impact to the store level labor that – from that timing mismatch during the quarter?

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

I'd say it's in the 10, 20 basis points. It's not huge.

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

Great. Thanks, guys.

Operator: Your next question comes from the line of Jon Tower with Wells Fargo.

Jon Tower
Analyst, Wells Fargo Securities LLC

Q

Great. Thanks for taking my question. Rick, I just wanted to circle back on a comment you made about unit growth in fiscal 2023, potentially being above – or sorry, towards the higher end of the 2% to 3% range that you've historically guided to.

I'm just curious how sustainable do you feel that level of growth is into the future beyond just fiscal 2023 in terms of that potentially being a catch-up year of growth from this kind of more disruptive period?

And then perhaps you can dig into the components of that growth. Obviously, Olive Garden's been a bigger piece of the gross new store – excuse me, a bigger piece of growth historically, but going forward, how should we think of that relative to the other brands in the portfolio?

Ricardo Cardenas
President & Chief Operating Officer, Darden Restaurants, Inc.

A

Jon, thanks. First of all, on the sustainability of the growth going forward, the only thing that's going to slow us down in growth after this kind of ramp-up is having enough people to open our restaurants, right? Having enough general managers ready and able to open our restaurants. We believe that we can stay in the higher end of our range for a little while.

Now, the economic environment could be different in a year or two, that might change that. But we feel really confident that we can get closer to the higher end of our range because of the business model improvements we have made, and it gives us the ability to open even more Olive Gardens, right?

So, when we were opening an Olive Garden before, we would impact many Olive Gardens around them. But with the business model enhancements Olive Garden has made, we feel even more confident being able to open some of those.

Raj had already mentioned Cheddar's and how much they've improved their business model. That has given us more confidence in being able to open more Cheddar's. So, that gives us the ability to get towards the higher end of that range.

But every one of our brands has the ability to grow and that's the important thing. We've made significant improvements in the business model at Bahama Breeze, while someone asked about the other segment. I want to tell you that Seasons 52 has also made a huge business model improvement, even though their sales growth wasn't as strong as Bahama Breeze because of their clientele. That's all coming back. We've opened some pretty darn good Seasons 52s recently, and we opened a great Bahama Breeze recently. So, we feel really good about our ability to open all of our brands and be at the higher end of our range for the foreseeable future, unless the economic environment changes.

Jon Tower
Analyst, Wells Fargo Securities LLC

Q

Got it. And then just following up to the comments on To Go business, I think you had mentioned that 64% of the To Go on were – To Go orders were online. And I'm just curious to get your thoughts on how you're communicating with those customers today? I mean is this essentially opening up a new channel of marketing that you've already put in place? Or is that something that you're not necessarily even doing today but down the line could harvest as a new marketing channel?

Eugene I. Lee, Jr.
Chairman & Chief Executive Officer, Darden Restaurants, Inc.
A

Hey, Jon. Because they're ordering online, we do get a little bit more information about them than we would on a phone order or other orders. And that gives us the ability to market to them in the future. We haven't really done a whole lot of marketing in the last year, right? Olive Garden has done their TV because we bought that media already, we've done some digital marketing just to keep the digital marketing moving, but we haven't really started focusing on those new customers and speaking directly to them. As we start thinking that we need to ramp things up, that's a great source of people to market to now that weren't coming to us before.

Jon Tower
Analyst, Wells Fargo Securities LLC
Q

Got it. Thank you very much.

Operator: Your next question comes from the line of Dennis Geiger with UBS.

Dennis Geiger
Analyst, UBS Securities LLC
Q

Great. Thanks. Gene, I appreciate the commentary on the industry and the industry size and shrinking supply. Just wondering if there's anything more that you can share on whether you've been able to identify gains for your brands from the restaurants that have permanently closed? Or if you have any updated thoughts going forward on how you're thinking about your opportunity to gain share from that percentage of supply that's going away?

Eugene I. Lee, Jr.
Chairman & Chief Executive Officer, Darden Restaurants, Inc.
A

Yeah. I think, Dennis, I think our opportunity to gain share is gets back to our ability to execute at a really high level. And the fact that we have continued to invest in portion size and quality, I think that's the key. I think this is all about running great restaurants and executing at a high level. And I think we have a huge opportunity to gain share in all of our restaurants, through comp store sales growth and through organic growth. That's why we're excited about the ability – our ability to add a lot of new restaurants.

Dennis Geiger
Analyst, UBS Securities LLC
Q

That's great. And then just kind of building on that, just one more, if I could, on Olive Garden, kind of just following up on the solid recovery that the brand has seen already. If you could talk just a bit more about some of the drivers of the continued AUV growth over, let's say, the near to medium term. Just want to make sure that I understand correctly that it's probably not really a function of further capacity increases from the brand from here. But if it's kind of specific drivers, if it's the marketing that you were just talking about turning that on, if it's potential promotional activities that you have in your back pocket, if it's digital, it's probably all of that and more. But Gene, just curious if you could kind of speak to some of those drivers perhaps.

Eugene I. Lee, Jr.
Chairman & Chief Executive Officer, Darden Restaurants, Inc.
A

[indiscernible] (00:51:18) I think is one significant driver, and that's we have to improve the cravability of the food. And we continue to do that by investing in portions and quality. The team is laser-focused on this. And I think that's the best driver of overall profitable sales growth.

Dennis Geiger
Analyst, UBS Securities LLC

Q

Thank you.

Operator: Your next question comes from the line of Peter Saleh with BTIG.

Peter Saleh
Analyst, BTIG LLC

Q

Great. Thanks. Yeah. I just wanted to follow up on Dennis' question, Gene, around the industry. I know you said there's been about 10% fewer units coming out of the industry, yet we're seeing a labor shortage. And just curious if you're seeing any sort of benefits on rent or availability of real estate or anything more specific around development that may be a benefit to Darden.

Eugene I. Lee, Jr.
Chairman & Chief Executive Officer, Darden Restaurants, Inc.

A

No. There's tremendous speculation in the real estate market driving prices up.

Peter Saleh
Analyst, BTIG LLC

Q

Okay. And then just lastly, on menu innovation, how are you guys thinking about menu innovation and expanding the menu? Is the labor squeeze right now – I know you guys said it's not really as much impacting you guys, but is that keeping a little bit on menu innovation? You guys still focusing on some of the core? Any thoughts there?

Eugene I. Lee, Jr.
Chairman & Chief Executive Officer, Darden Restaurants, Inc.

A

We're focused on the core. All innovation right now is trying to improve the products the majority of our consumers buy. We love that focus. We think we're improving cravability. We're continuing to keep our restaurants simplifying and we're sticking to one-on, one-off. The teams have great discipline around that right now. And I think that that's key to our ability to execute at a high level. And as Rick talked about the improvement in productivity and it's resulting in these record level restaurant-level margins.

Peter Saleh
Analyst, BTIG LLC

Q

Thank you very much.

Operator: Your next question will come from the line of Nicole Miller with Piper Sandler.

Nicole Miller Regan
Analyst, Piper Sandler & Co.

Q

Thank you. Good morning. I wanted to ask about the Specialty Restaurant Group of [indiscernible] (00:53:40), specifically around the higher end. I was wondering if you could just, kind of, give an indication of which brands are above 2019 and which ones are slightly below maybe? And really getting at the ones that are above, what is the likelihood of that structurally being the new run rate? Or is there some reason that demand could pull back? Thank you.

Eugene I. Lee, Jr.
Chairman & Chief Executive Officer, Darden Restaurants, Inc.
A

Well, I don't think there's any reason why demand would pull back. I mean demand might shift from suburban to urban a little bit as business travel starts to reignite. I've been thrilled with the recovery in the last six to seven weeks in Fine Dining. I was surprised how resilient the business was in suburbia through the pandemic. We've still got seven or eight really large restaurants in what I would call the heavy urban core that are starting to come back slowly.

But overall, I think this business is doing really, really well. And the one business that has started to come back in the last couple of weeks was Seasons 52, which was hit pretty hard when you think about who their consumer was. And so, upscale Fine Dining is performing well above where we thought it would be, and it's coming back very quickly as we get our three major restaurants in New York City back up and running and downtown Boston and downtown D.C. Those five restaurants are core to what we do, and they're starting to come back quickly.

Nicole Miller Regan
Analyst, Piper Sandler & Co.
Q

And anything you would change in the – or excuse me, comment briefly on the customer profile, same guests, different guests, eating differently, coming at different times, or just more of the same like it used to be? Thank you.

Eugene I. Lee, Jr.
Chairman & Chief Executive Officer, Darden Restaurants, Inc.
A

Well, I think, again, we're seeing a little bit – on the suburban business, we're seeing a little bit more weekend business than what we did. We've seen a little bit of shift without the business travel and what midweek looks like. But overall, that's dynamic, and I go back to my overused word of equilibrium, not transitory. Equilibrium, we'll wait for equilibrium in that business. And we're going to get there over the next six months, so we'll understand what the new norms are. But I think we've exposed a lot of people to our Fine Dining brands through this. And I think that they really love the experience.

Nicole Miller Regan
Analyst, Piper Sandler & Co.
Q

Thanks again. I appreciate it.

Operator: Your next question comes from the line of Andrew Strelzik with BMO.

Andrew Strelzik
Analyst, BMO Capital Markets Corp.
Q

Hey, good morning. Thanks for taking the question. First, I wanted to just clarify quickly on the margin commentary, the 200 to 250-basis-point improvement. Is that from an [ph] AUV (00:56:17) perspective relative to pre-COVID levels? Is that at fiscal 2022 levels, just some context around that?

And then my other question is just on the off-premise business. Yeah, I think there's some uncertainty about how to think about the growth of that channel after kind of the step function we've seen over the last 12-plus months. So, kind of what's the growth rate that you would expect from To Go, kind of, over the next 18 to 24 months or maybe longer term, however you want to think about that and the drivers behind it? Thanks.

Eugene I. Lee, Jr.
Chairman & Chief Executive Officer, Darden Restaurants, Inc.
A

I'll take the off-premise question, then Raj can take the margin question. I think on off-premise, until we understand where equilibrium is and where do we get to balance, where is the new level, then we can think about growth. We do think we have more avenues to grow that business. We've learned a lot about that business through the pandemic that we can use to, I think, grow it into the future. Convenience – consumer desire for convenience is not going away, and I think we can fulfill that need with our brands and our technology.

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

And Andrew, on the margin question, we are referencing pre-COVID. So, I think the way to think about it is our EBITDA margin at the pre-COVID was around 14%. I think it was actually 14.1%. So, the 200 to 250 basis points is relative to that.

Andrew Strelzik
Analyst, BMO Capital Markets Corp.
Q

Great. Thank you very much.

Operator: Your next question comes from the line of John Ivankoe with JPMorgan.

John Ivankoe
Analyst, JPMorgan Securities LLC
Q

Hi. Thank you. Obviously, you have – you doubled your off-premise sales per unit at Olive Garden, basically fourth quarter 2021 versus fourth quarter of 2019. So, that does leave a pretty substantial amount of capacity that kind of remains for on-premise dining. So, I wanted to ask a few points on that.

You mentioned that much of off-premise is being used as a home meal replacement that would suggest, I guess, the lack of cannibalization for on-premise dining. But can you possibly update those if you know the cannibalization numbers between the percentage of off-premise sales that are coming from on-premise?

And I guess, at this point, I mean, do you think it's opportunity – a necessity to basically bring back those on-premise customers, or was Olive Garden just so busy before that maybe people weren't getting to eat at the times that they want? But just to think about you getting that off-premise sales per – on-premise sales per unit back to the 100% level that you previously had in 2019. And if there's anything that you can talk about, whether it's age cohort, that level of vaccination state by state, what have you, that shows different levels of success of achieving on-premise sales 2021 versus 2019? Thanks.

Eugene I. Lee, Jr.
Chairman & Chief Executive Officer, Darden Restaurants, Inc.
A

Yeah, John, that was – there's a lot in there. All I would say, and I want to be brief here is we're going to do whatever we can to drive as much on-premise dining inside Olive Garden as we possibly can, profitable sales in the dining room. And we're going to try to grow as profitably as we can in the off-premise channel.

We also have to recognize at this point in time, there's still a lot of people out there in our trade areas that aren't comfortable going into restaurants yet. And so, we still have a ways to go to understand where that natural sales level for Olive Garden is going to level out and a lot to learn. And so, we haven't been that granular yet to understand who the consumer is. We'll get there once we reach this new place. But our goal is to drive as much business as we possibly can – profitable business as we can in restaurant and do as much profitably as we possibly can off-premise.

John Ivankoe
Analyst, JPMorgan Securities LLC

Q

And do you have a sense of the amount of sales transfer between on-premise and off-premise? Or is that data that still needs to come?

Eugene I. Lee, Jr.
Chairman & Chief Executive Officer, Darden Restaurants, Inc.

A

I mean this data that needs to come. I mean the environment is so dynamic, and we will need to analyze that. We've got the analytics to be able to really look at that once we get to this equilibrium that I'm talking about.

John Ivankoe
Analyst, JPMorgan Securities LLC

Q

Fair enough. Thank you, Gene.

Operator: Your next question comes from the line of David Palmer with Evercore ISI.

David Palmer
Analyst, Evercore ISI

Q

Thanks. I'm actually going to follow up on that. If we assume the 15% sales mix at Olive Garden pre-COVID was off-premise, you're looking at something like down high-teens on-premise on a two-year basis. If that sounds about right, what constraints do you think we're on the on-premise business in May? And is it really this consumer comfort that that's driving that decline? And how are you thinking about those factors as we go through 2022? I'd be curious to hear whether you think there are any constraints that you would imagine to the on-premise business getting back to, you say, flat or even higher than 2019?

Eugene I. Lee, Jr.
Chairman & Chief Executive Officer, Darden Restaurants, Inc.

A

Well, I mean, I think you have to think about what our promotional and marketing strategy was. Right now, we're just – we're out there on television just doing some brand advertising. We've been able to remove all incentives and all discounts from the business, and we'll continue to analyze when might be the right opportunity to put some of that back in. I mean this is a complicated question.

Olive Garden has never ever operated at these margin levels at this sales volume. And so, we need to move slowly. And I don't think that we're looking at what capacity was in 2019 and trying to triangulate this the way you guys are talking about it. We're trying to drive as much profitable sales as we possibly can. And so – and we're just extremely pleased with where this business is. And we're not going to run the business and try to chase an index and get back to some level that – and deal with and look at our business – we're going to look at our business differently than maybe others are looking at it. And I just couldn't be happier where we've repositioned the Olive Garden business and the record profitability that this business is throwing off.

David Palmer
Analyst, Evercore ISI

Q

I'm thinking back to some of our earlier conversations on these earnings calls, and I know you were thinking that you might actually have this on-premise swell where you would overshoot on the on-premise. It's – I wonder if we might be a couple quarters away from that if the comfort levels continue to build. If that happens, do you think the capacity in terms of labor, the seats, the lack of cannibalization from off-premise, I mean, do you think that that could happen? Do you still see that potential?

Eugene I. Lee, Jr.
Chairman & Chief Executive Officer, Darden Restaurants, Inc.
A

I think that there's – let me just – let me clarify one thing. This is not – this isn't being held back by labor. I mean our restaurants are fully staffed on the weekends. We're doing our 3 to 4 turns in an Olive Garden. I think the issue is – if you told me that we could get back to 100% of sales in Olive Garden and spend $100 million less in advertising, I didn't think we could do that. And I'm thrilled with where we're at based on what we're spending and how we're – and what our profit is per guest at these levels. And we'll continue to focus on driving profitable sales growth and where that ends up, that ends up.

David Palmer
Analyst, Evercore ISI
Q

Thank you.

Operator: Your next question comes from the line of John Glass with Morgan Stanley.

John Glass
Analyst, Morgan Stanley & Co. LLC
Q

Thanks very much. First, just, Gene, back on the industry and your outlook, capacity is being reduced, your margins are high, how do you think about M&A in the portfolio right now? Is this a good time to think about adding brands? Or is pricing difficult? Are you just very pleased with the current business and portfolio that you really don't think about M&A in this environment?

Eugene I. Lee, Jr.
Chairman & Chief Executive Officer, Darden Restaurants, Inc.
A

Well, we're always talking with the board and the senior management about what the possibilities are to add a brand to our portfolio that would benefit from being – I mean our platform, being on our platform, and we would benefit if they would come on to our platform. So, we're always thinking about that. But more so today, we're thrilled with the business model transformations in our business. And we're very happy to invest our capital into our businesses and capture the return that we're getting today on those new businesses.

John Glass
Analyst, Morgan Stanley & Co. LLC
Q

Thank you. And Raj, if I could just clarify, you said you thought in 2023, you could hold most of the gains in margins that you got this year. Historically, Darden has talked about 20 to 40 basis points maybe of margin gain year-on-year just a natural leverage. Is there some reason why 2023 and beyond may be different, like maybe if marketing may be a risk that you've got to add some of that [ph] back (01:05:34)? How do we think about beyond the current year in terms of margin expansion?

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

Yeah. I think, John, that's where I think there's still some time until we get to fiscal 2023 and beyond. And really, I think we need to better understand the economic and competitive environment. And just we got to get holding on to this business model, where the real – I will use Gene's term of equilibrium is, and just kind of really want to get find that. But I think where we are today, given the dry powder we have, whether it's with pricing or other levers we can pull, we do feel confident we'll be able to keep most of the margin gains. And like I said, we'll kind of – we'll let it play out and we'll have more to share next time.

John Glass
Analyst, Morgan Stanley & Co. LLC

Q

Thank you.

Operator: Your next question comes from the line of Jake Bartlett with Truist Securities.

Jake Rowland Bartlett
Analyst, Truist Securities, Inc.

Q

Great. Thanks for taking the question. Gene, I was wondering, it's great to see the recovery with Olive Garden. But as a percentage increase versus 2019, it is less than some of the other publicly traded companies that have reported. Can you just maybe give us a couple of the reasons why you think that is? I imagine because you were at high capacity in 2019 or you have less marketing but maybe just help us understand why Olive Garden has recovered, I think, to a less degree than a lot of the others?

Eugene I. Lee, Jr.
Chairman & Chief Executive Officer, Darden Restaurants, Inc.

A

Well, because we're not participating in giving our way of food through third-party channels. We're not discounting heavily. We're not discounting our cash like others are through selling gift cards. And we're running a business here to drive profitable sales growth. We've got a business that's doing over $5 million for average unit volumes. In the fourth quarter, we put up 25% restaurant-level margins. Isn't our job to try to drive profitable sales growth? And that's what we're focused on. And so, there are a lot of reasons why we're not keeping up with where some of the other people are going.

There's a lot that's changed in two years and how they're handling their businesses. All of them have virtual brands and all this other stuff that's out there. I mean, guys, you got to get off this. I mean this is the best business in casual dining, not even by a little bit anymore, by a lot. And we're doing $5 million in average unit volume, with 25%-plus restaurant level margins and growing. And we've got – our guests are loving the experience. They love the credibility of the food. They love the changes that we made, and we're executing at a very, very high level. I think we're going to continue to grow. But I'm not...

[indiscernible] (01:08:12)

Jake Rowland Bartlett
Analyst, Truist Securities, Inc.

Q

Great. No, I really...

Eugene I. Lee, Jr.
Chairman & Chief Executive Officer, Darden Restaurants, Inc.

A

...I'm not chasing an index, so we're not chasing where we were in the past. We loved our position today.

Jake Rowland Bartlett
Analyst, Truist Securities, Inc.
Q

Great. I appreciate that. And I guess also just a question about the industry and about the kind of the cadence of the comps from April to May to June. We've seen people getting vaccinated, capacity restrictions being lifted. Why don't you – why do you think the cadence is not increasing? Why don't you think May versus – June versus May versus April is increasing? What are the offsets to some of the benefits, which are capacity restrictions being lifted and people getting vaccinated?

Eugene I. Lee, Jr.
Chairman & Chief Executive Officer, Darden Restaurants, Inc.
A

I'm not sure I understand. We did see sequential improvement throughout these months. These look like pretty strong numbers as I look at them across. We saw Fine Dining go from 12% down to 6% in May, that's without our New York restaurants. So we've gone from Other Business, 8% to 4% from 14% in March. I mean we're seeing sequential improvement.

And again, I think that as we think about it, this has been a very, very fast recovery. And as people start to live more normal – get back to some normal behaviors, we think it's implied in our guidance that we're going to get back to a pretty good level here.

Jake Rowland Bartlett
Analyst, Truist Securities, Inc.
Q

Great. I appreciate it.

Operator: Your next question will come from the line of Jared Garber with Goldman Sachs.

Jared Garber
Analyst, Goldman Sachs & Co. LLC
Q

Hi. Thanks for the question. Gene and Rick, you talked a little bit about the technology initiatives and some of the success you're having with the tabletop tablets. And I think last quarter, you talked also about how this is maybe attracting a younger consumer to some of the brands. I just wanted to know if you had any update there on what you're seeing on consumer side related to some of this technology? And maybe if you think the next kind of several years out, what are some of the consumer-facing technologies do you think you'll see or we'll see enter the restaurant space in the in-dining room part of the business? Thanks.

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

Jared, thanks. This is Rick. The investments that we've made is really recently is more about the off-premise experience, right? And so, there are – just anybody is coming to our restaurants off-premise, the people that used to come inside that may not still feel comfortable to come inside are going to off-premise. And we are getting a new consumer.

At Cheddar's, we have a new consumer that didn't come to Cheddar's before. I don't want to get into the details on that, which gives us more confidence in their ability. They do have the tabletop tablets. I am not going to say that their consumer is younger or older because of the tabletop tablets. It's because they're learning about Cheddar's.

And so, we're going to continue to invest, as I said, in removing friction to make it easier for our guests to eat where they want, when they want and how they want, and make it easier for our team members to serve them. And so, that's what we're going to continue to do without getting into the detail on the new guests or if technology is driving new guests. I'm not going to say technology is driving new guests.

Operator: Our next question will come from the line of Brian Vaccaro with Raymond James.

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

Q

Hey. Thanks and good morning. Gene, I just wanted to quickly circle back on the positive industry view in a post-COVID world and kind of ask specifically, how do you expect consumer behavior to normalize as it relates specifically to cooking at-home versus ordering-in? And also how you see that considerations that may have expanded for the average consumer to utilize casual dining for an off-premise occasion where that was not in the consideration set pre-COVID? Anything in the Technomic data or other data to sort of size that opportunity to capture share of previously at-home cooking occasions?

Eugene I. Lee, Jr.
Chairman & Chief Executive Officer, Darden Restaurants, Inc.

A

Brian, I'm not sure I can quantify that, but I think you answered – maybe you answered your question, and your question is that, yeah, casual dining off-premise experience definitely got more exposure through COVID. And I think people that would have never used that experience probably because they weren't casual dining users, and [indiscernible] (01:12:25) that's a really good option for a home meal replacement.

So, I think that's an area where you're going to be able to actually hold on to this new consumer and maybe continue to market to them effectively. We don't have a whole lot of insight on cooking in home and home meal replacement. I do think that you're seeing mobility increase significantly, especially in the states that were heavily locked down. And I spent a lot of time in the Northeast the last couple of weeks. It's still very quiet compared to what I see in Georgia and Florida when I travel. So, mobility still has the opportunity to increase in these marketplaces.

And I don't know where – I think we've still got another six to nine months to understand what – if we don't have any more problems with COVID, what are going to be the normal behaviors that are going to develop out of this, and what was an adaptive behavior and what was normal. And we'll get through over the next 6 to 12 months, and we'll have a better understanding of consumer behaviors. And then I think you start developing your marketing plans and you get tactical on how to get to these folks and try to get them into your restaurants or use you as an off-premise dining occasion.

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

Q

That makes total sense. And a quick follow-up on the guidance, and Raj, sorry if I missed it, but what does the guidance embed in terms of G&A and marketing spend in fiscal 2022? Thank you.

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

A

We did not necessarily share that detail, but I'll just tell you, like I think the G&A is – you could expect to get leverage on G&A, and we expect marketing to be significantly reduced from pre-COVID. Without getting into the exact numbers, that's what I tell you.

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

Q

Thanks.

Operator: And I'll now turn the conference back over to management for any final remarks.

Kevin Kalicak
Senior Vice President-Finance & Investor Relations, Darden

Thank you. That concludes our call. I'd like to remind you, we plan to release first quarter results on Thursday, September 23, before the market opens with a conference call to follow. Thanks and have a great day.

Operator: Ladies and gentlemen, that will conclude today's call. Thank you all for joining. You may now disconnect.