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Darden Restaurants, Inc. (DRI)

Q1 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Hello and welcome to Darden's fiscal year 2021 first quarter earnings call. All 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. Thank you so much.

Kevin Kalicak

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

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

As a reminder, comments made during this call will include forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. These statements are subject to risks and uncertainties that could cause actual results to differ materially from our expectations and projections. Those risks are described in the company's press release which was distributed this morning and in its filings with the Securities and Exchange Commission. We are simultaneously broadcasting a presentation during this call, which is posted in the Investor Relations section of our website at darden.com. Today's discussion and presentation includes certain non-GAAP measurements, and reconciliations of these measurements are included in the presentation. We plan to release fiscal 2021 second quarter earnings on December 18 before the market opens followed by a conference call.

This morning, Gene will share some brief remarks about our quarterly performance and business highlights and then Rick will provide more detail on our financial results and share our outlook for the second quarter. As a reminder, all references to the industry benchmark during today's call referred to estimated Knapp-Track excluding Darden, specifically Olive Garden and LongHorn Steakhouse. During our first fiscal quarter, industry same-restaurant sales decreased 26%.

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

Eugene I. Lee

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

Thank you, Kevin and good morning, everyone. Given the ever-changing environment we continue to operate in, I am very pleased with what we accomplished during the quarter. We're focused on four key priorities, the health and safety of our team members and guests, in-restaurant execution in a complex operating environment, investing in and deploying technology to improve the guest experience and transforming our business model. Progress we made in these areas combined with our operating results gave us the confidence to repay the $270 million term loan and reinstate a quarterly dividend. Let me provide more detail on the four priorities.

First, the health and safety of our team members and guests remains our top priority. Following CDC guidelines and local requirements, our teams continue to practice our enhanced safety protocols including daily team member health monitoring. We also continue to configure our dining rooms for social distancing to create a safe, welcoming environment while maximizing allowable capacity. A key part of this work is installing booth partition to enable us to safely increase capacity where permissible. At the end of August, we had completed installation in just over 500 restaurants in our total portfolio. Operating in this environment adds another layer of complexity to an already complex operation and I'm proud of the commitment our teams make every day to keep our guests and each other safe.

Second, we're laser focused on our back-to-basics operating philosophy to drive restaurant level execution that creates [audio gap] (00:03:44) guest experience, whether that's in our dining rooms, outdoors on our patios or in their homes, but it's not easy. Executing at a high-level is more complex today due to COVID-19 restrictions that vary by market. Additionally, the constantly changing mix between on-premise and off-premise plus expanded outdoor dining that is weather dependent leads to unpredictability in sales. This is why the work we continue to do to streamline our menus and improve our processes and procedures is so important. Removing complexity from our operations has allowed our restaurant teams to execute more consistently in this unique environment. Our operators continued to deliver great guest experiences by displaying a high level of flexibility, creativity and passion every day and I'm thrilled to see that reflected in our guest satisfaction metrics.

Third, we're continuing to invest in and implement technology to remove friction from the guest experience. This includes providing multiple ways for our guests to order inside and outside the restaurant across our digital storefronts. Additionally, we're deploying mobile solutions to make it easier for our guests to let us know when they have arrived to dine or pick up curbside order To-Go. We're also expanding mobile payment options, providing additional convenience for our guests. For our three largest brands combined, more than 50% of our off-premise sales during the quarter were fully digital transactions where guests ordered and paid online.

Finally and most importantly, we transformed our business model. Even with the sales declines we're experiencing, our restaurants continue to produce high absolute sales volumes. Therefore, we made the strategic decision to focus on adjusting our cost structure in order to generate strong cash flows while making the appropriate investments in our businesses. This provides as a stronger foundation for us to build on as sales trends improve. The first step in this process was to reimagine our offerings. This resulted in simplified menus across the platform, driving significant efficiencies in food waste and direct labor productivity.

Additionally, due to capacity restrictions, we significantly reduced marketing promotional spending, along with other incentives we have historically used to drive sales. We will continue to evaluate our marketing promotional activity as the operating environment evolves. Finally, we have further optimized our support structure which is driving G&A efficiencies. The results of all these efforts to transform our business model can be seen in the fact that we generated adjusted EBITDA of $185 million for the quarter.

Turning to our business segments, Olive Garden delivered strong average weekly sales per restaurant, $70,000 while significantly strengthening their business model, resulting in higher segment profit margin than last year. They were able to capitalize on simplification initiatives that strengthened the business model while making additional investments [ph] in abundance (00:07:01) and value. This work was critical to position Olive Garden to drive future profitable top-line sales as capacity restrictions eased. Olive Garden same-restaurant sales for the quarter declined 28.2%, 220 basis points below the industry benchmark. Overall, capacity restrictions continue to limit their top-line sales, particularly in key high-volume markets like California and New Jersey where dining rooms were closed for the majority of the quarter.

In fact, restaurants that had some level of dining room capacity for the entire quarter averaged more than $75,000 in weekly sales, retaining nearly 80% of their last year sales. Given the limited capacity environment during the quarter, Olive Garden made a strategic decision to reduce their marketing spend as well as incentives and eliminate their promotional activity. They will continue to evaluate their level of marketing activity as capacity restrictions ease. Additionally, off-premise continued to see growth with off-premise sales increasing 123% in the quarter, representing 45% of total sales. Thanks to technology investments we continued to make. Online sales made up almost 60% of total off-premise sales, more than tripling last year's online sales. Finally, Olive Garden successfully opened three new restaurants in the quarter which are exceeding expectations.

LongHorn had a very strong quarter. Same-restaurant sales declined 18.1%, outperforming the industry benchmark by 790 basis points. Their strong guest loyalty and operational execution helped drive their outperformance while they also benefited from their geographic footprint. In fact, same-restaurant sales were positive for the quarter in Georgia and Mississippi. Additionally, the LongHorn team made significant investments in food quality and operational simplicity which led to improved productivity and better execution.

They also took a number of steps to improve the overall digital guest experience. Off-premise sales grew by more than 240% representing 28% of total sales. Finally, LongHorn successfully opened two restaurants during the quarter. The brands in our Fine Dining segment are performing better than anticipated. While weekday sales continued to be impacted by reduction in business travel, conventions and sporting events, we saw strong guest traffic on the weekends and believe there will be additional demand as capacity restrictions begin to ease. And lastly, our Other Business segment also delivered strong operational improvement with segment profit margin of 12.8%.

This was only a 130 basis points below last year despite a 39% decline in same-restaurant sales. Yard Houses' footprint in California is impacting same-restaurant sales in this segment. Finally, I continue to be impressed by how our team members are responding to take care of our guests and each other. We know our people are our greatest competitive advantage with I want to thank every one of our team members. We're succeeding, thanks to your hard work and resilience. Now I'll turn it over to Rick.

Ricardo Cardenas

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

Thank you, Gene, and good morning, everyone. The encouraging trends in performance we experienced towards the end of the fourth quarter continued into the first quarter of fiscal 2021. Furthermore, the actions we took in response to COVID-19 to solidify our cash position, transform the business model, simplify operations and strengthen the commitment of our team members helped build a solid foundation for the future.

These actions and our continued focus on pursuing profitable sales have resulted in strong first quarter performance that significantly exceeded our expectations. For the quarter, total sales were $1.5 billion, a decrease of 28.4%. Same-restaurant sales decreased 29%. Adjusted EBITDA was $185 million and adjusted diluted net earnings per share were $0.56.

Turning to the P&L, looking at the food and beverage line, favorability from menu simplifications more than offset increased To-Go packaging costs. However, beef inflation of over 7% primarily impacting LongHorn drove food and beverage expense 20 basis points higher than last year for the company. Restaurant labor was 20 basis lower than last year with hourly labor as a percent of sales improving by over 350 basis points, driven by operational simplifications.

This was mostly offset by deleverage in management labor. Restaurant expense included $10 million of business interruption insurance proceeds related to COVID-19 claims submitted in the fourth quarter of fiscal 2020. Excluding this benefit, we reduced restaurant expense per operating week by over 20% this quarter. For marketing, we lowered absolute spending by over $40 million, bringing marketing as a percent of sales to 1.9%, 130 basis points less than last year.

As a result, restaurant level EBITDA margin was 17.8%, 20 basis points below last year, but particularly strong given a sales decline of 28%. General and administrative expenses were $10 million lower than last year as we effectively reduced expenses and rightsized our support structure. Interest was $5 million higher than last year, mostly related to the term loan that was outstanding for the majority of the quarter. And finally, our first quarter adjusted effective tax rate was 9%. All of this culminated in adjusted earnings after tax of $73 million, which excludes $48 million of performance adjusted expenses.

These expenses were related to the voluntary early retirement incentive program and corporate restructuring completed in the first quarter of fiscal 2021. Approximately $10 million of this expense is noncash and the remaining will be cash outflows through Q2 of fiscal 2022. This restructuring resulted in a net 11% reduction in our workforce in the restaurant support center and field operations leadership positions. It is expected to save between $25 million and $30 million annually.

We expect to see approximately three quarters of these savings throughout the remainder of fiscal 2021. Looking at our segment performance this quarter, despite a sales decline of 28%, Olive Garden increased segment profit margin by 110 basis points to 22.1%. This strong profitability was driven by simplified operations which reduced food and direct labor costs as well as reduced marketing spending. LongHorn Steakhouse, Fine Dining and the Other Business segment delivered strong positive segment profit margins of 15.1%, 11.9% and 12.8%, respectively despite the significant sales decline experienced in the quarter.

These brands also benefited from simplified operations, keeping segment profit margin at these levels. In the first quarter, 68% of our restaurants operated with at least partial dining room capacity for the entire quarter. These restaurants had average weekly sales per restaurant of $69,000 and a same-restaurant sales decline of 21.9%.

And while Olive Garden and the Fine Dining segment had fewer dining rooms opened than our average, these restaurants had the highest average weekly sales per restaurant of almost $76,000 and $90,000, respectively.

At the start of the second quarter, we had approximately 91% of our restaurants with dining rooms open, operating in at least limited capacity. Now turning to our liquidity and other matters, during the quarter as we saw steadily improving weekly cash flows, we gained confidence in our estimated cash flow ranges.

We fully repaid the $270 million term loan we took out in April. We ended the first quarter with $655 million in cash and another $750 million available in our untapped credit facility, giving us over $1.4 million (sic) [$1.4 billion] (00:15:35) of available liquidity. We generated over $160 million of free cash flow in the quarter and improved our adjusted debt to adjusted capital to 59% at the end of the quarter, well within our debt covenant of below 75%. Given our strong liquidity position, improvements in our business model and better visibility in the cash flow projections, our board reinstituted a quarterly dividend. The board declared a quarterly cash dividend of $0.30 per share. This dividend represents 53% of our first quarter adjusted earnings after-tax within our long-term framework for value creation. We will continue to have regular discussions with the board on our future dividend policy.

Our first quarter results were significantly better than we anticipated. The actions we took to simplify menus and operating procedures and capture other cost savings along with our choice to pursue profitable sales have yielded strong results. And now, with a full quarter operating under this environment, we have even better visibility into our business model.

For the second quarter, we expect total sales of approximately 82% of prior-year including approximately 100 basis points of headwind due to the Thanksgiving holiday moving back into the second fiscal quarter this year. We anticipate EBITDA between $200 million and $215 million and diluted net earnings per share between $0.65 and $0.75 on a diluted share base of 131 million shares. In this environment, we continue to focus on building absolute sales volumes week to week and quarter to quarter. This may result in variability in sales comparisons to last year as capacity constraints lead to less seasonality than we would have experienced historically. Said another way, if capacity and social distancing restrictions remain similar to where they are today, it will be challenging to dramatically increase our on-premise average unit volumes. Our second quarter is typically our lowest average unit volume quarter and our third quarter is typically our highest. Additionally, as capacity restrictions ease and sales normalize, we will be able to reinvest to drive the top-line and a better overall guest experience.

One last point before we take your questions. Based on our strong business model enhancements we now think we can get to our pre-COVID EBITDA dollars at approximately 90% of pre-COVID sales while still making appropriate investments in our business. And with that, we'll take your questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Andrew Strelzik from BMO. Your line is open.

Andrew Strelzik
Analyst, BMO Capital Markets Corp.

Q

Hey, good morning, thanks for taking the question. In the press release you mentioned on the execution that it was better than expected. I'm curious if you can just kind of dig in a little bit there more specifically either by brand or by cost bucket and subsequently how sustainable are some of the cost improvements if you can maybe give a sense for how much better you think margins could be if you were to get back to say 100% of the prior sales?

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

A

I will take the execution part and I'll let Rick talk about the margin piece. I think a lot of our execution is coming from the streamline menus and our ability to put out product with increased frequency of that product is helping our execution and our team members are becoming much better at doing that. When you limit your menu and you focus on key products, the quality of that product just continues to go up and I also think it transcended itself into the dining room and I think today we've got used to the complexity of operating with the COVID requirement and everyday I think we're running better and better restaurants. Rick, can you talk about the margins?

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

A

Yeah. Hey, Andrew. I'm going to start with the 90% number that we gave a second ago. We have made improvements in our cost structure as Gene has mentioned and significantly improved our business model. As sales improve, remember we assume that some of these costs will come back, but not all of them. The 90% contemplates some cost returning along with continued reinvestments and while the 90% sales level may change depending on the competitive environment and the economic backdrop. Now, I will say that if we get to 100% and we make some investments as we've been talking about, we could see margins improve by 100 basis points, maybe even a 150 basis points, but again that depends on the economic backdrop, the competitive environment and what do we have to do to get to that 100%. So, I wouldn't tie in the 100% to 150%, but I would at least get into the 90% based on our EBITDA – I'm sorry, getting our EBITDA back based on 90% of sales.

Andrew Strelzik
Analyst, BMO Capital Markets Corp.
Q

Okay, great. And if I could just squeeze one more in, I'm just curious if you think you've seen at all any impact from stimulus tapering off? Have you seen that or any other kind of regional or daypart differences that you have also seen? If you could comment on that, that'll be great. Thanks.

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

No, we have seen no falloff with the stimulus. Actually we're seeing average weekly sales across the system improve every single week. So, we're feeling pretty good about that. We're seeing some restrictions be eased throughout the country, so really nothing from a regionality standpoint. I think you just got to look at the mobility index and you got to [indiscernible] (00:21:19) or what's happening with restrictions and you can see guest traffic more along with that.

Andrew Strelzik
Analyst, BMO Capital Markets Corp.
Q

Great, thank you very much.

Operator: Your next question comes from the line of Andy Barish from Jefferies. Your line is open.

Andy Barish
Analyst, Jefferies LLC
Q

Yeah. Hey, guys. Just wondering on the kind of comments on on-premise dining and sort of driving same-store sales performance from here, what would it take to from a capacity constraint perspective help that number? Can you do more booth partitions and just the impact of seasonality starting with the outdoor patio business as well? Just trying to level set on all those areas.

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

Let me work backwards to your question. Outdoor capacity is really de minimis for us overall as a system. And the good news is that we haven't really been able to use it. A lot of our outdoor capacity in Florida, it's been raining every single day here for the last six weeks, so we're going to start getting that back. As we lose outdoor capacity up North, we'll pick up a lot more in Florida than we have been able to use. So for that when we think about outdoor capacity, it's really not that meaningful for us.

As far as what's going to drive in the short-term some more same-restaurant sales is additional capacity. We need to get California back. We need some other areas to increase their capacity from 25% to 50%. Once you get past 50% as long as the 6-foot rule is in place, you're still not going to really be able to really max out your dining rooms. In some areas, we're getting our bar tops back which are important, gives us more capacity inside the restaurant. And so I think it really comes down to just the incremental improvements in the capacity levels. We're going to probably continue to rollout booth partitions. We're probably close to double what we have right now and that gives us six to seven extra tables per restaurant in the jurisdictions that allow us to do that. Not every jurisdiction allows us to do that. And I think that our teams are being very respectful of the requirements in their operating environment and we're trying to create first and foremost a safe environment for our team members and our guests and we're not trying to push same-restaurant sales and risk that experience at all for our team members and guests. So, I would look at – getting California back is big in Olive Garden, we've got 100 restaurants there.

Andy Barish
Analyst, Jefferies LLC

Q

Okay. And just a quick follow-up for Rick if you could. I mean the same-store sales and the total sales gap in the 1Q were basically on top of each other, the 18% reduction in total sales. Is there a same-store sales analog for the 2Q we can kind of point to in terms of a gap?

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

A

Yeah, it's pretty close. It's not like we have a lot of new restaurants coming into play, so it's within 100 basis points.

Andy Barish
Analyst, Jefferies LLC

Q

Okay, thank you very much.

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

A

Marcella, we are ready for our next question.

Operator: Your next question comes from the line of Nicole Miller from Piper Sandler. Your line is open.

Nicole Miller Regan
Analyst, Piper Sandler & Co.

Q

Thank you and good morning. When I look back to slide 16 of the presentation, can you speak to the capacity in the first quarter? What was the average and was it higher or lower as you exited the quarter because that can help us kind of inform and understand the capacity in 2Q? I know 90% – 91% are open but I'm wondering what kind of capacity mandates or restrictions you're dealing with?

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

A

Well, most of the capacity restrictions are around the 50% range, 50% capacity, some were 100% but if you average out our company when you take the 6-foot rule et cetera, we're probably at the 50% capacity range even at the end of the quarter.

Nicole Miller Regan
Analyst, Piper Sandler & Co.

Q

Okay, okay. Super. And then it's not lost on us when you talk about the back-to-basics and I think there is obviously no one better than your team at that and it's the power of team. So if you think about the roles and the functions – for me like the chief officer role comes to mind. How are you really resourcing your team to be effective right now? Can you give us some concrete examples?

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

Well, I think our engagement with our team members goes all the way back to the beginning of COVID. I mean it actually goes beyond that, but I mean I think how we handled the situation with emergency pay and taking care of our people and staying engaged with them and paying their benefits. We invested over $100 million in that short period of time into our team members. So bringing them back to work has been fairly easy for us and I think our team members are really engaged in what they're doing. And so – we have a strong culture for a long time. And our team member retention is better than ever which is really exciting to see. I mean I am looking at retention numbers for our hourly team members that I never thought I would see in this industry.

I've been working in this industry for over 30 years. I've never seen retention like this which gives us the ability to execute at the highest level. And as we bring people back to work, we're bringing back our most productive and our most dedicated team members. So, I think the spirit is high in our restaurants. I think people are excited to be out there, they are making money. I think they are bringing happiness to people that come into our restaurants and I think that energy is, in this very difficult time, is transferring between the guest and the team member. I'm in our restaurants every day, and I'm in one of our restaurants most every day, sometimes twice a day. I would tell you that the attitude is just absolutely fantastic and our team members are doing a great job.

Nicole Miller Regan
Analyst, Piper Sandler & Co.
Q

Thanks, appreciate the commentary.

Operator: Your next question comes from the line of Brian Bittner from Oppenheimer. Your line is open. Brian, your line is open.

Brian Bittner
Analyst, Oppenheimer & Co., Inc.
Q

Sorry, I was on mute. Good morning, guys. When you talk about getting back to pre-COVID EBITDA levels on 90% of sales, can you just talk about your working assumption on that relative to G&A versus pre-COVID and restaurant level profits versus pre-COVID?

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

Well, Brian, I think on the G&A side, we talked about the voluntary early-retirement program and that's going to save us $25 million to $30 million a year on a rolling basis. And we would expect G&A to start coming back up as we start getting travel, et cetera. We didn't do a whole lot of travel in the first quarter, but most of our investments will be back in the restaurant, as you think about marketing spend and labor and other things. So, I would say that if you look at what we say on the 90% range, most of our investment will be back in the restaurant. Our G&A – we would hope our G&A would be at least below 5% for the foreseeable future.

Brian Bittner
Analyst, Oppenheimer & Co., Inc.
Q

Okay. And would you ascribe all of LongHorn's outperformance relative to Olive Garden, is that all to geographical mix and the 6 feet rule or is there anything else that you would point out as it relates to LongHorn's performance relative to Olive Garden?

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

A

Well, I think the majority of it is geographic and I think the brand strength in Georgia has been incredibly impressive and I think that it's just a market where there is a lot of loyalty to the brand. I think the market, Georgia – state of Georgia trust LongHorn and I think people are going to where they are really comfortably and so I do think that their consumer may be a little bit better off economically, but I mean their performance is impressive without a doubt, but it's been driven by Georgia – I mean it's being driven a lot by their footprint.

Brian Bittner
Analyst, Oppenheimer & Co., Inc.

Q

Thanks, Gene. And my last question just with Olive Garden we talked a lot last earnings call about the capacity restraints related to the 6 feet rule. Is there anything else if we stay in this environment for a while moving forward? Is there anything you are doing to improve the capacity based on the seating configuration within that 6 feet rule that we should know about?

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

A

Well, I think we continue to add temporary barriers. I think the team continues to look at how do you -can you move a few tables in the dining room to improve the overall capacity. So I think they continue to try to modify that. I think the thing when you think about Olive Garden is focus on the absolute volumes. It's $75,000 a week. These are healthy, healthy businesses and the off-premise business continues to thrive which is a place that we're going to restart putting some marketing money back into that business. It'll be focused on trying to drive off-premise not in-premise. We continue to evaluate what's the best way to go with that investment spend, when is the right time to use it.

The other thing I would tell you is that, this is going to probably be hard for you to believe but we have one restaurant that cost us 50 basis points in comps, that the Times Square Olive Garden. When we start, every single week $300,000 [indiscernible] (00:31:59) from a comp store basis. We're going to get 25% capacity back in Times Square on the 30th. You wake up every day and you're $300,000 short just in that one restaurant. That's our best restaurant in the Olive Garden system. We do over $15 million there and now we're doing $2,500 a day. And so we got some oddball things. Getting California back is going to be huge. California is a big market for us with high volumes, we have a higher check average and we can see because we're starting to get some counties back and we can see the impact on that on a daily, weekly basis.

Brian Bittner
Analyst, Oppenheimer & Co., Inc.

Q

Thanks, Gene.

Operator: Your next question comes from the line of Andrew Charles from Cowen & Co your line is open.

Andrew Charles
Analyst, Cowen and Company

Q

Great. Thanks. Question for Rick and question for Gene. Rick, the sales leverage in labor line was quite impressive during the quarter. I was curious how would you characterize what you view as permanent savings from the shift to online pick up and more streamlined kitchen operations and efficiencies versus maybe some of the temporary improvements that will persist in 2Q from volumes that are below peak?

And then, Gene, you kind of talked a little bit about it but just to hit it head on, the [ph] hundred partitions (00:33:16) that were implemented last quarter to improve seating capacity, I think you said you doubled it but curious what's been the learnings there, how has that helped and is that a key unlock for you in terms of where we're in the reopening or is that just a small tool? Thanks.

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

A

Yeah, Andrew, on the labor line, remember we have got two components of labor, one is the hourly labor which is where we saw a lot of efficiencies and the other one is the management labor which is more fixed in nature. We would expect the hourly labor to not be as favorable going forward just because of training expenses. We didn't have as much training in the first quarter and we're going to start having some training in Q2 and beyond but as our sales pick up, our management labor should be leveraged a little bit more than it was before. So I think there was a question earlier on where would you get to at a 100%, and that 100 basis point, 150 basis point improvement will mostly come out of labor and some cost of sales.

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

A

Hey, Andrew, on the partitions, depending on the restaurant foot – layout, you are going to get six to eight more tables and most of those will be four tops and the average party is 2.3. I wouldn't say it's not de minimis but some meaningful. You're getting – especially on the weekends, you're getting another two seatings on those tables, so every little bit helps because we have the demand for those tables but it's not going to move the top-line significantly.

Andrew Charles
Analyst, Cowen and Company

Q

Thanks.

Operator: Your next question comes from the line of Eric Gonzalez from KeyBanc Capital. Your line is open.

Eric Gonzalez
Analyst, KeyBanc Capital Markets, Inc.

Q

Hey, thanks. Good morning. Just on the promotional schedule, I think we're all sad to see that maybe never-ending possible is not being run this year. And I'm just curious what needs to happen from a capacity standpoint, restriction standpoint for that promotion to make sense and is there a limit that whether it be 25%, 50%, 75% worth of dining rooms reopen where it makes sense to have traffic driving promotions like that one? And then like later in the year is that a lever that you could pull and bring it back to drive people to the restaurants?

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

A

Yeah, I think on those high-volume, high-traffic promotions, we're going to feel – we've to feel comfortable that we got pretty much a 100% capacity unless the promotion – unless we come up with promotions that drive off-premise experience. When I think about marketing and the team things about marketing, I think that we want to try to get as far long as we possibly can through this crisis or cycle and then fully understand what the competitive set is going to be, what the economic backdrop is going to be and then we'll figure out how to appropriately layer back in all our promotional marketing and promotional activity and our incentives. We think we can layer those back in smarter and more effective than we had them in the system before. This is a terrible thing that we're going through, but we're trying to find, okay – we are trying to find the positives in this to really rethink how we go to market with our businesses and this is a once in a – unfortunately a once in a lifetime option to be able to do things that we probably couldn't do while we were – where we were pre-COVID.

So I think long-term we're going to look at the situation and we will decide when we layer in our best promotional options and we may have to re imagine and revisit some of those promotional options to our guest so that we can maybe do it at a higher margin rate, but we have lots of questions and lot of work to do around that.

Eric Gonzalez
Analyst, KeyBanc Capital Markets, Inc.
Q

Thank you. That's really helpful. And then you mentioned in your remarks earlier that the off-premise mix was a moving target, can you maybe dig into that a little bit more and talk about what sort of the cannibalization rate looks like as dining rooms reopen or maybe what happens when restrictions are put back in place?

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

There is nothing concrete there because each market is behaving differently and so when you see restrictions change and maybe your capacity goes from 25% to 50% in certain markets, that volume just switches from off-premise to on-premise and other markets it doesn't and it depends what's happening. We believe there is a good percentage of our off-premise today being generated by people coming to the restaurant that can't get in because the wait is too long and there is no place to wait inside our restaurants. And so we think that those people have a tendency to just opt into the off-premise experience. So we really can't quantify that for you because every market is different.

Eric Gonzalez
Analyst, KeyBanc Capital Markets, Inc.
Q

All right. Thanks.

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

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

Hi, good morning. I have two questions. First, on the second quarter guidance, I just wanted to clarify the guidance on the top-line. Is that similar to how you're running quarter-to-date or are you expecting to see further improvement as states like California start to open up?

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

Yeah, David, our guidance for sales for Q2, remember it incorporates a 100 basis point headwind for Thanksgiving. So we are running a little bit better than that quarter-to-date, but not by much. And so we do anticipate an increase of about 10% of average weekly sales from quarter one. It doesn't contemplate any significant change in capacity restrictions other than the ones that we already know, other than the ones that have already been approved. But it also doesn't contemplate any significant change in sales due to a second wave or a vaccine approval. So that – we thought 82% was fairly prudent. It's slightly below where we're running today but it does take into effect the 100 basis point swing from Thanksgiving.

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

Q

Great, thank you for that. And then, Gene, I was wondering just philosophically how you think about what Darden might look like as we exit the pandemic and I guess what I'm specifically wondering is, is that your goal to drive the sales volumes back to 100% of where you were before the pandemic or do you think you'd take less sales with a better, simpler, operating model that's easier to execute?

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

A

I would take – I want both. I want a simpler operating model and I want higher sales and I think that we're setting up for that because I think there is a few dynamics that are in our favor. Number one has definitely been a capacity, it will be capacity coming out of the system and we believe that we're well-positioned to take share and we think that the simplified operations will help us improve execution, we'll get better throughput and so we think there is a pathway to both higher sales, better margins, I think our teams have done an incredible job of reimagining almost every aspect of their business through this and I see a pathway to get there.

I think Rick keeps bringing you back to the 90% only as a way to communicate where we think margins are going to be at a future sales level. We're not setting a target saying that we'll be happy with that. We see a pathway for our sales to get above that and we see a pathway for our margins to be above pre-COVID levels at that time.

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

Q

That's helpful. Thank you very much.

Operator: Your next question comes from the line of Jeff Bernstein from Barclays. Your line is open.

Jeffrey A. Bernstein
Analyst, Barclays Capital, Inc.

Q

Great. Thank you very much. One follow-up and then a separate question. The follow-up just on the comments you made a moment ago regarding your guidance for fiscal 2Q does not assume any second wave of re-infection. I'm just wondering as you think about it in the short term, what are you seeing with comps in markets where there are spikes in infection rates, whether you see a step back or whether you see capacity pullback. Trying to get a sense for the worst case scenario if we were to see a second spike in terms of what you are seeing thus far or what learnings you have had and then I had one follow-up?

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

A

So far, Jeff, we have seen no change in demand based on COVID levels in a market unless capacity restrictions change. So if your example were in South Florida when we had the spike after the 4th of July and the restaurant restrictions were very limited, we definitely saw – we saw demand drop, but that was not because of the consumer, it was more because of the restrictions the local municipalities put on us.

We see a pretty resilient consumer out there. I know that's hard for you guys in New York to imagine but the rest of the country is not operating that way. And so I would tell you that what we're seeing is, it's all being controlled by the local municipalities that they're managing demand more than the consumer.

Jeffrey A. Bernstein
Analyst, Barclays Capital, Inc.

Q

Interesting. And then the other question was just on the – I think you alluded to it earlier in terms of what the industry is going to look like in capacity going forward. So I'm just wondering as you think about the independents and the crisis that we're all going through, what are you seeing thus far in terms of, I guess you'd call it permanent closures or the impact you see for the industry going forward, maybe the supply/demand imbalance or whether it's real estate availability or market share opportunity, just trying to get a bigger picture thought on what you're seeing thus far for the outlook for primarily the independents?

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

A

Well, I think the independents have – obviously have a tough time, right, and as we think about it, we think somewhere between 5% and 15% of capacity will come out of the system during this, maybe a little bit more but a lot of people will get recapitalized quickly and get some of those boxes back open. Obviously that's going to benefit us in the short-term and the long-term.

As far as real estate so far has been one of the things that my hypothesis has been – I've been a little bit off on. We have yet to see a meaningful change in what we can acquire real estate at. I thought that being one of the only bidders out there that we would see costs come down. I think we're still going through the price discovery process on that and we'll see how that plays out long term. I got to believe that we will benefit from availability and hopefully price. Availability is already there, it's just trying to get to what we think the property is worth versus what the reader or the landlord thinks the property is worth. So that's going to – that will have some impact and help us grow, get to our 2% to 3% unit growth over time.

Jeffrey A. Bernstein
Analyst, Barclays Capital, Inc.

Q

Thanks, Gene, appreciate the color.

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

John Glass
Analyst, Morgan Stanley & Co. LLC

Q

Thank you and good morning. One of the biggest – two of the biggest shifts I guess during COVID, right, has been this growth in the off-premise business across the industry and second has just been the pickup in delivery – not delivery but the digital business overall. So, can you first just talk about the off-premise business? How do you think you need to or do you need to change the format of the restaurant or some other sort of structural change that you think they can facilitate a better off-premise experience or is what you're doing kind of working in the operational changes are working or do you think there is more sort of you need either pick up windows or some other permanent changes to the way the restaurants are structured to facilitate that?

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

A

That's a good question, John. I think going into this that we did the majority of our pick up with someone coming into the restaurant and picking up the food. We set up our process because we believed and we've proved out that accuracy and on time were the two most important things that the off-premise consumer wanted. Through this, we had to go to a different experience which was we morphed very, very quickly to curbside and what we have learned through this is that curbside is a better option and that the burden of on-time and accurate needs to get on us and we need to have better systems to be able to deliver the same level of accuracy that we were delivering pre-COVID.

What that means is and a lot of our restaurants were on a path to build better capabilities to handle the in-restaurant pick up and now as we pivoted to curbside, the capabilities that we need to build inside are different. The good news is that they're cheaper because they are really not consumer facing and so will cost us a little bit less to be able to create those capabilities. But technology and the expectation of the consumer is for curbside experience and we have taken a lot of friction out of that experience over the last 12 weeks and we're in the middle of really rolling out some technology today to really make that experience a whole lot better as just about notification when you're in our parking lot versus we had a very manual procedure that we had to implement in the beginning of this and eventually will get the geofencing and will catch up to what some of the bigger retailers are doing.

So, we actually think that there is a big benefit in this consumer shift because we're going to take all these people that were in our dining room – I mean in our front door picking up food and they'll never enter our building again which makes it a better experience for our dining guests. So that's really the big change, John, that has to happen and right now we have the benefit of some of our – having the extra space inside our restaurants that enables us to stage some of this off-premise work but as we gain more capacity, we will need to modify some spaces and actually add some, like in LongHorn, we're going to have to bump out of the side of the building to be able to handle this extra demand, but I see it as all positive. We think we can do curbside much more cost-effectively than we can do picking up the food inside the restaurant.

John Glass
Analyst, Morgan Stanley & Co. LLC

Q

Thanks for that. And then just picking from the second thread on digital. So you've got a significant amount of growth in the digital business particularly on the To-Go business. What have you learned from that? Are these different consumers, for example, do you think about now your promotional – your marketing spend differently because digital is just growing so significantly as a channel? And I'm also curious, Gene, your view on other brands have decided to use digital and various ways to delivery as a way to expand the restaurant into other brands, adding products, adding new brands specific to a category that doesn't relate to their existing brand. Is that a viable path for Darden?

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

A

So there are two questions in there, John, and I will get to the virtual brand in a second. The first question is obviously the data is richer when we are capturing the data from our digital guest, which feeds into our huge database and our ability to market to them. So, if we can figure out through that and through our tokens that these are our off-premise guests only, then we can tail all our marketing towards that guest and towards that experience. We understand what they are buying and what they want to buy and so we can get smarter with that.

We were pretty smart prior to this. We just have more information today. And with our data sciences, we'll be able to use that and market effectively. Let me just pivot to virtual brands. I am shocked it took this long to come up, but let me give you my take on this. Everybody around the room is very nervous right now, but I think people are in different places and they are trying to approach this and deal with this moment in time differently. For us, this is not the right approach. We want to focus on brands that we have got 20-plus years and hundreds of millions of dollars invested in trying to build and we want to make sure that they are executing at a high level.

I think brands are going to matter and I think brands are developed over a long period of time around delivering the promise to a consistent promise to a consumer. I think you have to have a functional need and an emotional need and I think that's what our brand builders have done for decades. And to get out on a digital platform and try to do that, I think people are going to try to do what they want to do. I'm not saying it's a good idea or a bad idea. It's not for us. Brands are going to matter and we think it's a distraction.

John Glass
Analyst, Morgan Stanley & Co. LLC

Q

Thank you so much.

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

Dennis Geiger
Analyst, UBS Securities LLC

Q

Great. Thanks. Gene, wondering if you could talk about where sort of customer satisfaction scores are at the moment. I think you might have alluded to it earlier, but kind of just based on some of the technology, the other – friction reducing initiatives and maybe some of the other customer experience investments that you spoke to, if you're getting credit for that, if you've seen a notable increase there in kind of to some extent, how that's driving some of your go forward thoughts on share gains, et cetera? That's question one.

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

A

So I'll be very clear. Our guest satisfaction scores are improving dramatically. I want to put some context around that which is what we don't understand is it just the consumer expectations are maybe different through this experience. We're happy directionally where they're going and we're happy directionally where they're going compared to our competitors but at the same time we're not patting ourselves in the back too much because this is definitely a different environment and the consumer feedback is different. So we don't know what the expectations are, but we're very pleased directionally where we are heading with our own internal and some of the industry stuff that we're seeing and how we're comparing to competitors.

Dennis Geiger
Analyst, UBS Securities LLC

Q

Got it. And just kind of as a follow-up to that. I know it's not the biggest needle mover right now, but just as it relates to Cheddar's and kind of any improvements that you've been able to make in this environment and whether that's resonating? Just curious if you could speak to that at all and more broadly if the current environment at all has – and emerging from the current environment and your thoughts there, if that changes at all how you are thinking about future M&A strategy in anyway if you are able to speak to that? Thank you.

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

A

Okay. You guys are getting really good at getting multiple questions in one question. Let's talk about Cheddar's first, then I'll come back to thoughts on M&A. From our business models standpoint, Cheddar's has had the biggest transformation. The work that John Wilkerson and his team have done has been transformative and I couldn't be more excited about directionally were they are healing. Tactically, one of the biggest changes and one of the things that we had to really speed up was off-premise capabilities. We had very limited capabilities going into COVID. We only had two phone lines going into most of our restaurants. We couldn't even take the demand over the phone, we didn't have online ordering. So, the team rallied. This was supposed to be an initiative that was going to go all the way through fiscal 2021, really wasn't supposed to be fully operational until 2022.

They got together and they have been able to real quickly upgrade their phone lines. They have four phone lines coming in. We now have online ordering, new packaging is being rolled out as we're speaking and they've developed a native app that's actually getting some pretty good adoption. And so that piece of it has been really exciting that they have been able to move as quickly as they possibly can. Their in-restaurant dining has held strong, they still don't have a huge robust off-premise business but we need to build that. It wasn't something that people thought of Cheddar's for, but we think there's a big opportunity there. So, I'm thrilled directionally with what they're doing and the transformation they have made in their business model.

Just briefly on M&A, there is nothing new to report here. We continue to evaluate opportunities and discuss with our board. We're very happy with our current portfolio and we believe that we can achieve our growth targets and our value creation metrics with the portfolio that we have. We believe there is great opportunity for all our brands.

Dennis Geiger
Analyst, UBS Securities LLC

Q

Thanks, Gene.

Operator: Your next question comes from the line of Chris Carril from RBC. Your line is open.

Christopher Carril
Analyst, RBC Capital Markets LLC

Q

Hi, good morning. Thanks for the question. So I just wanted to circle back to margins and specifically on Olive Garden. So the margins at Olive Garden were particularly impressive this quarter despite the sales decline. So how are you thinking about the margins for that brand longer term? Obviously as the marketing and potential reinvestment spend builds that will create a drag, but how much of the savings that you found do you think you could hold on to?

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

A

Yeah, Chris, as we mentioned, Olive Garden segment profit margin was 100 basis points better than last year. We have got a pretty good improvement in cost of sales partly because of the question that was asked earlier about never-ending possible that actually dragged a little bit margin for us, the cost of sales a little bit better, we improved our foodways significantly because of the operational changes that we've made. That said, [ph] a 23% (00:56:43) margin on the sales level they have, we're going to start reinvesting eventually, we've got marketing that was down about $20 million year-over-year for Olive Garden and as capacity starts to come back online, as Gene mentioned, we will look at our promotional cadence and our marketing cadence, but [ph] 22% (00:57:02) is a pretty strong margin, so I wouldn't anticipate significantly getting better than that as we continue to reinvest to get back to a point of getting back over 100% of our sales. Our goal is to drive our sales profitably and we have enough room to invest to drive those sales profitably.

Christopher Carril
Analyst, RBC Capital Markets LLC

Q

Thanks. And then, Rick, in the estimate of recapturing pre-COVID EBITDA dollars at 90% of pre-COVID sales, how does off-premise versus on-premise mix factor into that estimate? Does that contemplate higher off-premise mix versus pre-COVID levels?

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

A

It does contemplate higher off-premise mix than pre-COVID but not significantly higher. I mean, as Gene mentioned, Cheddar's should be higher, Olive Garden should be higher and LongHorn should be higher, but we're not going to be at 40% or 50% of sales off-premise when we have got full capacity dining rooms. As we open – as Gene mentioned, as we open dining rooms, we start seeing that To-Go business shift back in restaurant but we still are – right now we're still retaining 60% of our peak premise sales.

Christopher Carril
Analyst, RBC Capital Markets LLC

Q

Got it, thank you.

Operator: Your next question comes from the line of David Palmer from Evercore. Your line is open.

David Palmer
Analyst, Evercore ISI

Q

Hi, good morning. How much higher do you think To-Go sales might be at your big two brands after the COVID crisis? And I'm wondering if you have any clues that you would care to share in terms of informing that thinking such as these To-Go sales being new customers or perhaps how that off-premise mix states and the reopened states as your on-premise rebuilds? And I have a follow-up.

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

A

Yeah, David, I have got no empirical evidence to support this but my theory is that once we open up the dining rooms and say we get back to a normal environment where we have concerts and everybody is going to football games and noted – I actually think off-premise will dip down below where it was. I think there is going to be a huge surge for on-premise dining. I think people are tired of this experience, they are utilizing this experience right now but when I talk to people and we do some research, people want to get back out and socialize. I do think then it comes back, it comes back higher than where we were. I think our thought process is it's a little bit higher but not terribly higher and it will continue to grow overtime as it has been, but I don't think that this is some big change that we're going to wake up and Olive Garden can be doing 35% off-premise if we're going to concerts and having football games.

David Palmer
Analyst, Evercore ISI

Q

Wow, that's interesting take. I wonder just on the – in how you communicate with consumers. You have obviously made a lot more connectivity digitally with those consumers. Are you going to advertise less on TV after this is all over? Is this a source of margin leverage for you going forward?

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

A

I think that we have to go back to what I said earlier. We have to understand what the competitive set is, we have to understand what the economic backdrop is, we'll have to analyze how well we can get to our consumer through television. We still believe that we can do that. We participate – we're still participating in the upfronts, we think it's a good mechanism for us and that's part of our scale benefit with Olive Garden, right? We can advertise on a national platform and we have some efficiencies and I think that we will still use that in the near term, but it will all depend on what the competitive set is and the economic backdrop. If we pull enough restaurants sales, we may not have to advertise for a while.

David Palmer
Analyst, Evercore ISI

Q

Yeah. Thank you very much.

Operator: Your next question comes from the line of Chris O'Cull from Stifel. Your line is open.

Q

Thanks, guys and good morning. This is [ph] Patrick (01:01:18) on for Chris. I know you spoke briefly to lapping seasonal increases that really began after this coming quarter, but I was hoping if you could provide a bit more color on just your base case thinking currently on how that plays out and what you're expecting to see based on customer behavior that you see today and the capacity constraints that are in place and what levers you think you can pull if you do see a much more muted seasonality in average weekly sales as you move into the back half of the year? And then I have one follow-up.

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

A

Yeah, [ph] Patrick (01:01:46). I'll start with – we have shown week to week we're continuing to build our average weekly sales and as I mentioned earlier, Q2 is our lowest seasonal quarter and Q3 is our highest. So it does a take a lot of increase in average weekly sales to get to the same comp level Q3 as Q2. But what we're going to do and what we continue to do is evaluate the situation as restaurants open, as dining room capacities open, I mean as Gene mentioned, if dining room capacities don't continue to expand, we still have some levers to pull in the off-premise side. So that's what we will do. We will continue to advertise off-premise if it's what we need to do to continue to build sales but as long as we do that profitably. Our intention is to grow our sales profitably from where we are today and so that's what we will do. We will continue to focus on off-premise. Now if dining rooms reopen completely, we should see an increase in sales.

Q

That's helpful, thanks. And forgive me if I missed this, but it still sounds like menu simplification is – it sounded relatively permanent and so I was wondering if you could provide a bit more detail on exactly the margin improvement you're seeing from that initiative in particular. And then how do we think about as sales normalize moving forward a little farther into the future should we expect to see some adding back to the menu and some additional complexity come back on or is this something you're thinking now that is completely permanent even as sales normalize? Thanks.

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

A

Well, the biggest driver of the cost savings is waste [ph] and that – that's menu that's lacking (01:03:25) promotional activity, there are some other things that are influencing that. I think that the challenge for the teams is if they need to add menu items to fulfill a need, can they do that without adding complexity? I think they have to – I think in their calculus prior to this, there wasn't enough weight put on the complexity of adding new menu items. There wasn't enough – no one thought about that and I think today that's part of the thought process is they think about adding something, how do we do this and make sure we maintain our productivity and do not increase our waste.

So I think a better way to say that is, as we do menu development, it's going through a better filter today that I think will have a long lasting impact on our ability to maintain these cost savings.

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

Peter Saleh
Analyst, BTIG LLC

Q

Great, thank you. Gene, can you just elaborate a little bit on where the cost savings are coming from for doing curbside versus the in-store pickup? Is it cheaper labor or is it just less spend on CapEx in the store to build out the area for pickup? Just trying to understand where the cost savings may be coming from.

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

A

Well, it's the technology that's creating it. It's no one taking the answer on the phone. We're dropping. Consumers letting us know when they're in the parking lot and we're just dropping the bag in their car, so there is just a lot less interaction there. The cost is just purely productivity efficiency. Thinking about a line of five or six people at a desk or at the bar top in a restaurant waiting to get to go versus having someone just pull up to a car and put a bag in the trunk, that's where the efficiency has come, and technology is enabling all that.

Peter Saleh
Analyst, BTIG LLC

Q

Understood. Okay. And then just on the Fine Dining segment. I think this quarter you guys mentioned that the weekends you saw strength. I think that was also similar to what you saw last quarter. Are you seeing any sort of change in consumer behavior in Fine Dining during the week or is it more of the same?

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

A

Well, I think obviously we're missing the business travel and those types of dinners. So I mean that was a big part of Capital Grille, especially in your central business districts. You're always soft in your suburbia restaurant during the week, and you made up for on the weekends. Just another interesting tidbit is that when you look at Capital Grille comps, you're starting every week with over a $1 million shortfall just in the three restaurants in New York. We're doing $3,000 a day there where there are 10 seats. Those restaurants do well over $1 million a week and so. You just get – there's just so much geographical differences in those businesses. We have some Capital Grilles that are performing fairly well especially in suburbia, but I'm confident as I see the sales volume on the weekends, I know we're turning away a lot of people. And as soon as we can get a few more tables, we can continue to grow that business and I'm confident those businesses are going to be cash flow positive going forward.

Peter Saleh
Analyst, BTIG LLC

Q

Great. Thank you very much.

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

Jeffery Daniel Farmer
Analyst, Gordon Haskett Research Advisors

Q

Great. Good morning. Just wanted to follow up on a couple of questions very quickly. So what level of same-store sales performance are you seeing in California? And if you don't want to get the specific, I'm just curious potentially what the headwind for Olive Garden consolidated same-store sales are related to the California partial closures?

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

A

Yeah, Jeff, for the quarter we were down somewhere around 50% in California. Now remember they were open for a little bit of time and then they re-shut down, but we are seeing some pretty good unit volumes in California. And I was talking Olive Garden more than any other brand but, and as Gene mentioned, Yard House is significantly impacted in California, but we were down. And if you take California out of Olive Garden, it's a 200 basis point swing for the quarter.

Jeffery Daniel Farmer
Analyst, Gordon Haskett Research Advisors

Q

Okay. And then as a follow-up, I think this was touched on earlier, but I asked you this in late June and I believe you guys said that there were about 10 to 15 restaurants that were posting positive same-store sales even with that 50% capacity constraint in place or limit in place. Where does that number stand now?

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

A

Yeah, what I would say is instead of getting into individual restaurants, let's talk about a couple of states. I mean LongHorn was positive in Georgia. The entire system was positive in Georgia for the quarter. We have a lot more restaurants that are positive now than we did going earlier. The last couple of weeks it's been even better than that. So without getting into individual restaurants, we have it all contemplated in our guidance for Q2, and so I would rather leave it at that.

Jeffery Daniel Farmer
Analyst, Gordon Haskett Research Advisors

Q

All right. Thank you.

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

Brett Levy
Analyst, MKM Partners LLC

Q

Great. Thank you. Good morning. Thanks for taking the call. When you think about the great job you're doing right now in terms of managing the hourly labor, when you think about labor just overall, what are you seeing in terms of inflation, your ability to hire, and also the integration of all of the different techs you've talked about on the technology front? You've spent a lot of time talking about the customer facing, but what about on the operational side? And then just the managing of how you're balancing the in-store and the off-premise. Is it the same servers? Is it the other front of house? You've had one of your competitors talk about how the off-premise transaction is an hourly as opposed to a tip. So I'll stop there for now.

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

A

Well, Brett, you've got a lot in there [indiscernible] (01:10:09) you've got more. I cannot wait. Let's talk about hiring. Hiring is very local. There are different pockets of the country that are more stressed than others. I will make a global comment. I have been amazed that how well the hospitality workforce was absorbed into other areas during COVID and so there hasn't been like – there is still stress in that environment, we're still seeing. We still expect wages to rise somewhere between 3% and 5% for the year. As far as technology goes, the adaptation is easy today, right, and we're doing that. We haven't done – we haven't focused a lot on improving technology in restaurant. All of our stuff has really been – all of our effort has been focused on the consumer right now. We do have some – we will get back to some projects that will modernize some of our tools in restaurant that will hopefully help increase productivity. And as far as off-premise, I mean we're using for off-premise for us our tipped employees, but they've got a higher average [ph] weight (01:11:26), but they do collect some gratuities on their service.

Brett Levy
Analyst, MKM Partners LLC

Q

Thank you.

Operator: Your next question comes from the line of Lauren Silberman from Credit Suisse. Your line is open.

Lauren Silberman
Analyst, Credit Suisse Securities (USA) LLC

Q

Thank you. A follow-up on your commentary regarding industry closures. Are you seeing any noticeable difference or do you expect to see any difference in the level of closures in states that reopened earlier or maybe urban versus suburban markets? And how's that informing your future development pipeline?

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

A

Well, I think that the markets that have had the tightest restrictions are going to have the most closures if I think that's where – I think some of these urban environment they just don't have the capital to hang on. I don't think it changes our development philosophy at all. I mean I think good trader has good trade areas. I mean, there is a lot of talk about migration out of some of the bigger cities and we'll see how that plays out. I think eventually we're going to have some really good opportunities to do some work in Manhattan as an example. I think it was very difficult from a cost standpoint pre-COVID to justify building more restaurants there, but I think post-COVID we might have some opportunities. So I don't think from a development standpoint it has a tremendous amount of impact. We'll continue to look. We know where we have holes in each brand from trade areas, and we're going to try to fill them.

Lauren Silberman
Analyst, Credit Suisse Securities (USA) LLC

Q

Great. And you touched on this a bit with regards to the Fine Dining brands and maybe the Yard House as well. To what extent are these brands driven by tourism or large business conventions and how you're thinking about that recovery and do you need some of these exogenous factors to return to a full sales recapture?

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

A

No, absolutely. We've got a bunch of Yard Houses tied to baseball stadiums and football stadiums and L.A. Live's our best Yard House in the system and that's been decimated because of what's happening with sporting events. So yeah, I mean there is a few of our brands – a few of our restaurants that are tied to that and they'll come back. I'm a big believer that we're going to get back to normal. These are going to be great restaurants. But for the time being, we just have to run them as efficiently as we possibly can, and do the best we can with what we have.

Lauren Silberman
Analyst, Credit Suisse Securities (USA) LLC

Q

Thank you very much.

Operator: Your next question comes from the line of James Rutherford from Stephens. Your line is open.

James Rutherford
Analyst, Stephens, Inc.

Q

Hey, thanks for getting me in here. So a quick question on the capacity bottleneck with Olive Garden specifically. It seems like it would be key to drive traffic at nonpeak times and certainly there are things you're doing around that, but are there any kinds of incentives you can do to bring people in during those shoulder periods or is it a situation where you're really fully utilizing that capacity already during the off periods as well?

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

A

No, I mean I think that's something we've faced pre-COVID with how do you increase your capacity at certain downtimes of the day. I think that's a high activity exercise with very low payout. I think that one of the important things about a restaurant is that downtime to help you prepare for the break between lunch and dinner is important, so you can get ready for dinner. I mean there's part of us. We have cycles in our business and they're important. I think that we've been very disciplined in this process to make sure that we're not chasing what I would call this a low return activity. And so I don't think there is a whole lot there. I do think that what happened is as your business starts to improve especially midweek or early week is that your lunch lasts 15 minutes longer, your dinner lasts 15, 20 minutes longer. That's important. Trying to drive people into your restaurant at 2 o'clock, 30 years, I found that to be a waste of time and money and effort.

James Rutherford
Analyst, Stephens, Inc.

Q

Great. Thank you.

Operator: Your next question comes from the line of Sara Senatore from Bernstein. Your line is open.

Sara Harkavy Senatore
Analyst, Sanford C Bernstein & Co., LLC

Q

Thank you. I had a sort of a related question on [indiscernible] (01:15:53) on Cheddar's, but on the capacity, I guess, as I think about 50% capacity across the system that seems pretty [indiscernible] (01:16:03) for a lot of restaurants and I appreciate [indiscernible] (01:16:06-01:16:11). How should I think about 50% capacity for say an Olive Garden versus maybe competitors? [indiscernible] (01:16:18-01:16:48) capacity than most of the other competition. I don't know if there are any numbers about that. And then I guess I'll just have a quick follow-up on Cheddar's please?

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

A

Hey, Sara, it's Rick. You were breaking up quite a bit, so let me see if I get the gist of your question. I think it was about most restaurants are at this 50% capacity level, but how does that impact Olive Garden versus competitors. And I think the way I would frame it is just average unit volumes. Olive Garden last year was probably using a lot more of its capacity than some of our competitors were using at that time last year. And so as we think about AUVs and think about the comp differential maybe even between Knapp-Track, we think that's some of the impact is that while we're at 50% capacity today and we were at 100% capacity last year, we were using much more of our capacity maybe than someone else. I think that was the gist of your question, but it was really hard to hear and I think you also had a question on Cheddar's.

Sara Harkavy Senatore
Analyst, Sanford C Bernstein & Co., LLC

Q

Yes, that was actually exactly my question, but I wasn't sure if you had any sense of what the average capacity might look like through the industry just to help us sort of think through that. But the real question on Cheddar's is, you talked about off-premise, that have been sort of slow to turn. I think we were starting to see some improvement in the comps and then this pandemic hit. Could you talk a little bit about any kind of metrics and maybe in particular I think that's where you've seen a [audio gap] (01:18:20-01:18:36) just a little bit more color on that?

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

A

Yeah, Sara, broken up again, but I think I caught most of it until the end. I think you were asking about the impact for Cheddar's and how we've improved margins at Cheddar's versus maybe the rest and Gene mentioned – I think that was your question. So Gene mentioned that Cheddar's had the biggest transformation in our business model on an hourly labor basis. We said we had about 350 basis points for Darden improvement in hourly labor. Cheddar's was close to three times of that and so it was a very big improvement at Cheddar's in their margin structure because of the simplification they did and the work they have done and the fact that they went from maybe less than 5% To-Go sales to over 20% in a short period of time and we think we'll continue to build that To-Go volume, but Cheddar's did make the biggest transformation in their margin structure and we think a lot of that will stick.

Sara Harkavy Senatore
Analyst, Sanford C Bernstein & Co., LLC

Q

Great. You're excellent at interpreting mumbled questions, so thank you very much [indiscernible] (01:19:39).

Keith Orford

A

I have triplets. I interpreted mumbles a long time.

Sara Harkavy Senatore
Analyst, Sanford C Bernstein & Co., LLC

Q

You should talk to my 4-year-old, probably would do better than I do.

Operator: Your next question comes from the line of Gregory Francfort from Bank of America. Your line is open.

Gregory R. Francfort
Analyst, BofA Securities, Inc.

Q

Hey. Thanks for sneaking me in. The question I had was back on the margin and is probably for Rick. I think you have talked in the past about margins at Olive Garden above 20% at the level which you reinvest and I think you were there, right around there pre-COVID. And so, as you think about the 100 basis point, 150 basis points of margin upside, is that going to be spread relatively similarly across brands or do you think it overweighs to the LongHorn and other businesses just given where the segment margins were pre-COVID? Thank you very much.

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

A

Hey, Greg. I think it overweighs to other brands. I mean, we should still see a little bit of margin improvement at Olive Garden just because the environment is very different today than it was pre-COVID. I mean, I think a lot of brands are out there improving their margins in some way, shape or form with simplification and we just want to make sure our gap to the rest of the industry doesn't grow significantly, but we do believe that Olive Garden will see a little bit of margin improvement from where they were before. We just think that the improvement will come even greater in some of our other brands, Cheddar's and some of our other brands in the Other segment.

Gregory R. Francfort
Analyst, BofA Securities, Inc.

Q

Thanks for the thoughts.

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

John Ivankoe
Analyst, JPMorgan Securities LLC

Q

Hi, thank you. Gene, your answer to David Palmer's questions on off-premise I think is going to be like one of the great discussed topics probably of this month. So thank you for that. The question – gosh, thanks for this long call. It's helpful for all of us. I would imagine it's nearly impossible to get a staffing model right just kind of anticipating how customers are going to come back what have you especially with the amount of labor hours that you took out of the store. I just wanted to see like how honed in that model actually is? I mean, what are you kind of seeing in terms of the variations of margins relative to you having too much labor at any point in time to can't imagine too little labor at any point in time where, gosh, you're just not staffed to the amount of customers that for whatever reason decided to come in at 5 o'clock on a Tuesday that maybe could have led to some longer table times that could have actually in some way actually impaired your ability to drive the traffic that you could have until that labor model gets more fine-tuned?

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

A

You know, John, I think for Olive Garden because we're not doing a lot of outdoor dining, we don't have the capability there, that business is a little bit easier to predict. The leadership of all of our businesses err on the side of more labor than less and we're tracking number of servers per restaurant per day, trying to understand – as the business starts to grow, making sure that we have the appropriate staffing. Where it gets more difficult is in some of the Yard Houses where we have a lot of outside dining that doesn't have any covers and if it starts to rain, if it doesn't rain, I mean that's where life gets a little bit more difficult for our operators. But I would say in the two big casual brands, they have gotten pretty good and they need what I would say a change in what's happening in the environment. In other words, if we go from 25% to 50%, that's going to change the flow of mix. That's going to change what's off-premise, on-premise and it takes them a few days to figure that out. But we're erring on this side. Believe it or not, I know our labor results are really strong, but we're erring on the side of more labor, not less.

John Ivankoe
Analyst, JPMorgan Securities LLC Q

Understood. Thank you.

Operator: Your next question comes from the line of Matthew DiFrisco from Guggenheim. Your line is open.

Matthew DiFrisco
Analyst, Guggenheim Securities LLC Q

Thank you so much. My question is with respect to Georgia and the positive comps. I guess it sounds like you are saying the consumer obviously will have known us for a while, where consumers are a little different than New York. However, is that also a byproduct of PPP sort of slowing down and having a lift or have we seen some closures happen there? I'm trying to get a picture of Georgia being a positive, is it a positive market or is it just positive for Olive Garden and LongHorn, or is the entire – are dollars up for restaurant spending in the state of Georgia year-over-year or is it just a smaller pie [indiscernible] (01:24:27) consolidate a lot of that share? Thank you.

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

A couple things. First of all, the majority of the restaurants that are positive in Georgia are LongHorn, not Olive Garden. Olive Garden performing well in Georgia but nowhere near what LongHorn is. I mean, LongHorn has had a strong footprint. I mean we've got 45 restaurants in the city of Atlanta. Every 3 miles we have got a restaurant. And we have always done extremely well there and the brand is loved there. So, the brand strength there is fantastic. That's one component. The other component is that especially when you get 50 miles outside of the city, life is pretty – is normal there, it's not pretty, it's normal there. And I landed at an airport the other day and not one person had a mask on. I was in a hotel, I went to a rooftop deck and it was too deep at the bar, so I mean, it's just a different life in Georgia. I know it's hard for you guys in New York to even imagine that, but you still can't get around Georgia, there is so much traffic around the city of Atlanta. So, in the city area, there is a little bit more but I would tell you that – and I think if you look at other parts of the country and different states, behavior is fairly normal.

Matthew DiFrisco
Analyst, Guggenheim Securities LLC Q

So, I guess that would be then the industry on a year-over-year basis also for or the peers, it seems like it is a rising tide, they just haven't taken as much of a dip down?

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

A

Well, I think they haven't taken as much of a dip down, but I think LongHorn is significantly outperforming most people in that market and they always have, John, (sic) [Matt] (01:26:14). I mean, it's always been the core of that brand.

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

A

And one other thing, remember Georgia was one of the first to open, right, so they have been dealing with reopen for a long-time, a lot longer than other states, so the longer a restaurant or a market is open, the more people start feeling a little bit more comfortable.

Matthew DiFrisco
Analyst, Guggenheim Securities LLC

Q

Okay. Just on that I mentioned PPE also, can you guys talk about sort of what [indiscernible] (01:26:41) what your outlook is for the potential amount of seats maybe to leave the casual dining market, so say when we're in this time next year, how many seats might have exited?

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

A

We're comfortable to believe in somewhere between 5% and 15%. I think there is some other industry folks saying more than that. But I think 5% to 15%. I think – remember once a restaurant is a restaurant, lot of these will get recapitalizing in the next few years, but I definitely believe that we will be competing against less competition on the other side of this crisis.

Matthew DiFrisco
Analyst, Guggenheim Securities LLC

Q

Excellent, thank you so much.

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

Jake Rowland Bartlett
Analyst, Truist Financial Corporation

Q

Great, thanks for taking the questions. I really had two quick ones. In the first, on the menu simplification, can you quantify how many less items for instance that is just so we can have a sense as to the scale of the simplification? And then, Gene, I'm not going to ask you about third-party delivery, I think I know the answer, but I'm curious about your experience with in-house delivery and lowering the minimum check or the minimum order for instance. Is that something you want to lean into a little bit, maybe continue to lower that to increase your in-house delivery?

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

A

I think the answer to the second one is that we will continue to evaluate that. We don't see a big upside there. What was the first? On the menu simplification, each brand is very, very different. We range somewhere between 20% reduction to 40% reduction in one brand. The easiest thing to do is to go find the menus.

Jake Rowland Bartlett
Analyst, Truist Financial Corporation
Q

Got it. Thank you very much.

Operator: Your next question comes from the line of Brian Vaccaro from Raymond James. Your line is open.

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

Hey, thanks, guys and thanks for the extra time. Rick, could you just provide a little more color on the other OpEx line, obviously down around 20% versus pre-COVID levels? Just walk through some of the more significant cost reductions have been and how you expect those costs to come back? And then would you be willing to provide the fiscal 1Q comps for the individual brands within the Fine Dining and Other Business segments? Thank you.

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

Yeah, on the restaurant expense line, I just want to give you a couple of tidbits. One, we talked about business interruption of $10 million, that was a proceed that we got, that hit our restaurant expense line. We did have some rent reductions in the quarter, cash rent reductions were bigger than the P&L impact. The P&L impact was about $3 million. We had – most of our savings are in utilities, in smallwares, in repairs and maintenance and we would expect that as dining room start to reopen as they get busy again, we'll have [ph] R&M (01:29:36) start to increase as well as smallwares and utilities, those savings are maybe not as permanent, right, because those are just because their volumes are down. Another point to mention is we are spending money on PPE for masks [indiscernible] (01:29:56) gloves, chemicals, et cetera and that's about $4 million to $5 million a quarter.

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

Okay, and then the comps for Fine Dining and Other Business segments?

[indiscernible] (01:30:09)

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

Yeah, on the comp side, we mentioned about a year ago that we were going to start providing comps only at a segment level and this was our first quarter that that was the case and so we're going to continue with that.

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

Understood, thank you.

Operator: Your last question comes from the line of Jared Garber from Goldman Sachs. Your line is open.

Jared Garber
Analyst, Goldman Sachs & Co. LLC
Q

Good morning. Thank you for taking the question. Just a quick one from me. As you think about longer-term capacity, maybe if we just focus on Olive Garden, is there a level of average weekly sales or AUVs, however you want to talk about it, that's sort of a limit for Olive Garden? Obviously the off-premise business can be quite additive, but as you get back to sort of that 100% in-dining room capacity, how should we think about the longer-term sort of cap if you will on AUVs in that brand? Thanks.

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

A

Well, I think there is no cap. I mean, I think that if you reach your – as you start to reach your capacity for guest count, you'll have pricing power and you can move your AUVs that way. I think pre-COVID we were getting close to – we were over $5 million average unit volumes. So I think that we definitely hopefully can get back there and get past that. I don't ever think of a cap for a concept. Now, we know that when you start adding new units, they are not going to come on at the average. Usually we can create a strong IRR with restaurants that come in a little bit below the average, but over time we have been able to get that average to a pretty good level of $5 million.

Jared Garber
Analyst, Goldman Sachs & Co. LLC

Q

Thanks so much.

Operator: There are no further questions at this time. I will turn the call back over to the presenters.

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

Thank you. That concludes our call. I would like to remind you that we plan to release second quarter results on Friday, December 18, before the market opens with a conference call to follow. Thank you for participating in today's call.

Operator: This concludes today's conference call. You may now disconnect.