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Darden Restaurants, Inc. (DRI)

Q1 2022 Earnings Call

CORPORATE PARTICIPANTS

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

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

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

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

OTHER PARTICIPANTS

John Glass
Analyst, Morgan Stanley & Co. LLC

Andrew Charles
Analyst, Cowen & Co. LLC

Jared Garber
Analyst, Goldman Sachs & Co. LLC

Jake Rowland Bartlett
Analyst, Truist Securities, Inc.

Jeffrey A. Bernstein
Analyst, Barclays Capital, Inc.

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

Brett Levy
Analyst, MKM Partners LLC

Eric Gonzalez
Analyst, KeyBanc Capital Markets, Inc.

Brian Bittner
Analyst, Oppenheimer & Co., Inc.

Lauren Silberman
Analyst, Credit Suisse Securities (USA) LLC

Dennis Geiger
Analyst, UBS Securities LLC

Nicole Miller Regan
Analyst, Piper Sandler & Co.

Jeffery Daniel Farmer
Analyst, Gordon Haskett Research Advisors

Brian H. Mullan
Analyst, Deutsche Bank Securities, Inc.

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

David Palmer
Analyst, Evercore ISI

Andrew Barish
Analyst, Jefferies LLC

John Ivankoe
Analyst, JPMorgan Securities LLC

Jon Tower
Analyst, Wells Fargo Securities LLC

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

Andrew Strelzik
Analyst, BMO Capital Markets Corp.

Christopher Carril
Analyst, RBC Capital Markets LLC

MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the Darden Fiscal Year 2022 First 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 Restaurants, Inc.

Thank you, Kevin. 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 will include certain non-GAAP measurements and reconciliations of these measurements are included in the presentation. Any reference to pre-COVID when discussing first quarter performance is a comparison to the first quarter of fiscal 2020. This is because last year's results are not meaningful due to the pandemic's impact on the business and the limited capacity environment that we operated in during the first quarter of fiscal 2021.

We plan to release fiscal 2022 second quarter earnings on Friday, December 17, before the market opens, followed by a conference call.

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

Now I'll turn the call over to Gene.

Eugene I. Lee, Jr.

Chairman & Chief Executive Officer, Darden Restaurants, Inc.

Thank you, Kevin, and good morning, everyone. As you saw from our release this morning, we had a very good quarter. Our teams continue to operate effectively in a challenging environment, and I'm proud of their focus and ability to deliver another quarter of strong sales and profitability.

All of our segments delivered record first quarter profit. Our ability to drive profitable sales growth is a testament to the strength of our business model and our continued adherence to the strategy we implemented six years ago.

Our brands remain laser-focused on executing our Back to Basics operating philosophy anchored in food, service and atmosphere, while at the Darden level, we concentrate on strengthening and leveraging our four competitive advantages of significant scale, extensive data and insights, rigorous strategic planning and our results-oriented culture.

Our first quarter sales trends started strong, as momentum carried over from the fourth quarter, and they further strengthened and peaked in July. However, in August, sales slowed due to the impact of the Delta variant, but remain positive relative to pre-COVID levels. For the first quarter, sales per operating week were up 4.8% relative to pre-COVID. And through the first three weeks in September, sales per operating week were up approximately 7% relative to pre-COVID.

Regardless of the operating environment, our unwavering commitment to our strategy ensures we'll stay focused on what we do best, providing exceptional guest experiences. Throughout this unique period, our operators have shown tremendous flexibility while remaining locked in on the fundamentals of running great restaurants.

At the same time, our focus helps us continue to find ways to make our competitive advantages work even harder for us. One of the ways we do this is by leveraging our ability to open value-creating new restaurants. We opened seven new restaurants during the quarter, all of which are exceeding our expectations. And we remain on track to open approximately 35 to 40 new restaurants this fiscal year.

Our long-term framework calls for 2% to 3% sales growth from new restaurants. Given our stronger unit economics, our development team is working hard to build out a pipeline of locations for fiscal 2023 and beyond that would put us at or above the higher end of our framework.

Before I turn it over to Rick, I want to thank our team members in our restaurants and our support center. As I visit our restaurants and talk with our teams, I'm constantly reminded why our people are our greatest competitive advantage. Their passion for being of service to our guests and each other fuels our success. Rick?

Ricardo Cardenas

President & Chief Operating Officer, Darden Restaurants, Inc.

Thank you, Gene, and good morning, everyone. Our success this quarter was driven by the work we have done to simplify our processes and our menus to drive execution at the highest level. We also paused any new initiatives in order to further eliminate distractions for our restaurant team and allow them to focus on what it takes to run 14 great shifts a week.

In addition, To Go sales continue to benefit from the ongoing evolution of our digital platform. This platform makes it simpler for our guests to visit, order, pay and pick up, all while making it easier for our teams to execute at the highest level, both in the dining room and off-premise. This served our teams well as To Go sales remained high through the quarter.

For the quarter, off-premise sales accounted for 27% of total sales at Olive Garden and 15% of total sales at LongHorn Steakhouse. Digital transactions accounted for 60% of all off-premise sales during the quarter, and guest satisfaction metrics for off-premise experiences remained strong.

As we navigate short-term external pressures, our focus is simple. We must continue to win when it comes to our people and product.

From a people perspective, the employment environment is challenging. That's why our top priority during the quarter was staffing our restaurants. Our operators and HR teams have done a great job sourcing talent. We recently launched a new talent acquisition system that helps increase our pool of candidates by allowing applicants to apply and schedule an interview in five minutes or less.

Additionally, our brands are successfully utilizing their digital platforms, including social media, to promote our employment proposition and drive applications. As a result, we are netting more than 1,000 new team members per week, and our team member count is approximately 90% of our pre-COVID levels.

The biggest operational challenge we've been dealing with is the temporary exclusion of team members identified through contact tracing. Given our commitment to health and safety, we are diligent about exclusions, but they create sudden staffing disruptions for our operators. Despite being appropriately staffed in the majority of our restaurants, these exclusions reduced the number of available team members with little notice for our operators to prepare. This volatility can negatively impact sales in these restaurants for the duration of the exclusion period.

Getting and staying staffed also requires a strong focus on training. As we continue to hire, it is critical that we have the right training in place to ensure we continue to execute at a high level. That's why our operations leaders are validating the quality of our training during their restaurant visits, ensuring new team members receive the appropriate amount of training and successfully complete the required assessments.

Our team members are the heart and soul of our business, and we are constantly focused on our employment proposition. The investments we have made and continue to make in our people are helping us retain and attract top talent, and I'm confident in our ability to address our staffing needs.

When it comes to product, our significant scale, including our dedicated distribution capabilities, enables us to manage through the challenges affecting the global supply chain and maintain continuity for our restaurants. Our supply chain team continues to work hard to ensure we successfully manage through any spot outages we encounter, and our restaurants have the key products they need to serve our guests.

During the quarter, we had to secure more product than usual on the spot market because our brands exceeded sales expectations and some of our suppliers experienced capacity challenges. Raj will share more details in a moment, but these higher sales volumes as well as freight costs have contributed to higher-than-expected inflation.

Our scale advantage provides the opportunity for us to price below our competition and inflation, which is a strategy we have executed successfully. Our competitive advantage of extensive data and insights allows us to be surgical in our pricing approach, positioning us well to deal with these higher costs and maintain our value leadership.

The rich insights we gather from our analytics help us find the right opportunities to price in ways that minimize impact to traffic over time. We still expect pricing to be well below the rate of inflation for the year, further strengthening our value proposition.

Ensuring our restaurants are appropriately staffed and our supply chain continues to avoid significant disruptions will be the most important factors of our continued success in the short-term.

To wrap up, I also want to recognize our outstanding team. I'm inspired by the dedication and winning spirit that our leaders and team members, both in our restaurants and in our support center continue to demonstrate. Thanks to each of you for all that you do to continue to create exceptional 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 first quarter were $2.3 billion, 51% higher than last year, driven by 47.5% same-restaurant sales growth and the addition of 34 net new restaurants. Diluted net earnings per share from continuing operations were $1.76. We returned approximately $330 million to our shareholders this quarter, paying $144 million in dividends and repurchasing $186 million in shares.

We had strong performance this quarter despite increased inflationary pressures, with EBITDA of $370 million and EBITDA margin of 16%, 250 basis points higher than pre-COVID. Our sales results were better than expected, requiring us to go out and purchase more products on the spot market. In particular, proteins, as our LongHorn and Fine Dining segments, had the largest sales outperformance versus our expectations. The market for proteins this quarter was very strong with spot premiums as high as 30% above our contracted rates. This resulted in higher average cost per pound for our proteins, contributing to total commodities inflation for the quarter of approximately 5.5%.

Given the heightened attention on inflation, I want to clarify that we use a conventional approach to calculating the rate of inflation. We're only measuring change in average price, holding product mix and usage constant. We follow the same approach for calculating wage inflation rate, in which we keep the hours and job mix constant and only look at change in wage.

While we expect higher rates of inflation to persist for the remainder of the year versus what we initially planned, we believe our scale and recent enhancements to our business model enable us to deliver significant margin expansion while still adhering to our strategy of pricing below inflation.

Now, looking at the P&L for the first quarter of 2022, we're providing a comparison against pre-COVID results in the first quarter of 2020, which we believe is a more comparable to normal business operations and with how we've been talking about our margin expansion.

For the first quarter, food and beverage expenses were 150 basis points higher, driven by investments in both food quality and pricing significantly below inflation. Restaurant labor was 110 basis points lower, driven primarily by hourly labor improvement due to efficiencies gained from operational simplifications and was partially offset by elevated wage pressures. Restaurant expenses were also 110 basis points lower due to sales leverage. Marketing spend was $45 million lower, resulting in 220 basis points of favorability.

As a result, restaurant-level EBITDA margin for Darden was 20.9%, 290 basis points better than pre-COVID levels. G&A expense was 30 basis points higher, driven primarily by approximately $10 million of stock compensation expenses related to the immediate expensing of equity awards for retirement-eligible employees. Additionally, we had approximately $5 million of expense related to mark-to-market on our deferred compensation. As a reminder, due to the way we hedge this expense, it's largely offset on the tax line. These impacts were partially offset by savings from corporate restructuring implemented in fiscal 2021.

Our effective tax rate for the quarter was 12.6%, which benefited from the deferred compensation hedge, I just mentioned. Excluding this benefit, our effective tax rate would have been closer to the top end of our guidance range for the year.

Turning to our segment performance, first quarter sales at Olive Garden were flat to pre-COVID, while segment profit margin increased 220 basis points. This was strong performance, despite elevated inflation and two-year check growth of only 2.4%. LongHorn had the best sales performance across our segments with sales increasing by 26% versus pre-COVID, while growing segment profit margin by 250 basis points.

Sales at our Fine Dining segment increased 24% versus pre-COVID, in what's traditionally their slowest quarter from a seasonal perspective. Segment profit margin grew by 490 basis points, driven by strong sales leverage and operational efficiencies, which more than offset double-digit commodity inflation.

Our Other segment grew sales by nearly 5% and segment profit margin by 360 basis points. We continue to be excited about the long-term prospects of this segment, as it's driving the strongest underlying business model improvement of all our segments.

Finally, turning to our financial outlook for fiscal 2022, based on our performance this quarter and expected performance for the remainder of the year, we increased our outlook for the full year. We now expect total sales of $9.4 billion to $9.6 billion, representing growth of 7% to 9% from pre-COVID levels, same-restaurant sales growth of 27% to 30%, and 35 to 40 new restaurants.

Capital spending of $375 million to $425 million, total inflation of approximately 4% with commodities inflation of 4.5% and total restaurant labor inflation of 5.5%, which includes hourly wage inflation of about 7%.

EBITDA of $1.54 billion to $1.6 billion, an annual effective tax rate of 13% to 14%, and approximately 131 million diluted average shares outstanding for the year, all resulting in diluted net earnings per share between $7.25 and $7.60. This outlook implies EBITDA margin growth versus pre-COVID in line with our previous outlook, as higher sales are helping offset elevated inflation.

Before we open it up for questions, I want to remind you about a calendar shift next quarter. Thanksgiving falls in our fiscal second quarter this year, whereas it was in the fiscal third quarter pre-COVID. This will be a net negative to second quarter from a sales perspective.

Now, we'll take your questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Thank you. And our first question today comes from John Glass of Morgan Stanley.

John Glass
Analyst, Morgan Stanley & Co. LLC

Q

Thanks. Good morning. Gene or whoever, could you please first just talk about the impact of the reduction of couponing at Olive Garden? I think that probably has adversely impacted sales. It obviously has a huge positive impact on margin. But can you just sort of quantify what you think the foregone sales were for that? So, as we think about that brand versus peers, we have the right context.

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

A

Yeah. Let me take a stab at this a little broader, John, and just the coupons because I am not sure we can get right to the number that you're looking for. I mean, I think the coupon number probably was about 1% of sales. And so trying to say, okay, what's that driving guest count? I think that's a little bit harder to get at.

When I look at that line in the P&L, it was about 1%. Let me just put Olive Garden's performance in context for everybody. Obviously, I'm thrilled with their performance. We only have 2.5% check in the business over the last two years. That's compared to a little over 5% for the industry. I mean, that's a strategic choice that we continue to make, and we think it's the right choice. If you just assume that the marketing was breakeven and you've got to add another 10 points to the sales. And so basically, they're flat – flattish, and you take out that marketing, that's a big number.

The other thing, and then Rick alluded to this in his script, I mean, we're still struggling from a staffing standpoint, primarily because of the exclusions. And if you think about that, that's limiting our sales. And the way I think about it, it's just another way of capacity limitation.

If you just think about it, on average, I guess, we have one or two sections closed in most of our restaurants, most nights. So, we're losing six to eight tables. So, there's – especially in Olive Garden, that's putting a cap on what we can do for sales.

So, when I think about the overall and I sum up Olive Garden's performance, I just think that we're doing unbelievable. We've got a 23.2% restaurant level earnings percentage. Our profit grew $25 million over pre-COVID. This is an impressive business. And we're reevaluating over time how we're going to take this business to market when we think about couponing, we think about overall promotional activity and full marketing.

John Glass
Analyst, Morgan Stanley & Co. LLC

Q

Thank you for that. And if I can just ask one follow-up. Raj, on your commodity comments, it sounds like you would still expect maybe better commodity inflation later in the year. Do you have better visibility than you did before? I mean, what would prevent you from having to go to the spot market more often if sales continue to go? How much visibility do you have on that inflation for the full year now versus last quarter?

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

A

Sure, John. Let me start by saying we have – you saw we increased our forecast for sales. So, that gives us a little bit of, I guess, less need to have to go back into the market than what we're already anticipating. So some of that increased sales impact is baked into our estimate. As we look at Q2 and Q3, we have more visibility clearly into – a lot more into Q2 and some decent visibility into Q3. Q4 is one that's probably we'll have to figure out where things shake out. But we did have higher inflation last year in Q4.

But all-in-all, the way we're thinking about it is, Q1, we had about 5.5%. We have about 80% contracted for Q2 based on the updated volume. And then for Q3, I think we have around 60% contracted out. So we feel pretty good about that.

Could there be some movement? Absolutely. But I think that's where we showed you, I think, in the first quarter, how we have the ability to manage through that. I mean, I think, the fact I mentioned about the business model improvements as well as other levers we have at our disposal to help us manage through that fairly well.

Operator: Our next question comes from Andrew Charles of Cowen.

Andrew Charles
Analyst, Cowen & Co. LLC

Q

Great. Rick, I appreciate the commentary on the labor and staffing challenges. What have you seen over the last two weeks since that $300 a week supplemental unemployment insurance expired? Has this been as large of a tailwind as you previously anticipated? And perhaps you can speak to what you're seeing in states that curtailed benefits earlier this summer as a leading indicator. And then I have a follow-up. Thanks.

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

A

Hey, Andrew, thanks for the question. I would say is we've done a lot of things to help increase applicant flow. And one of those that I talked about was the new system we put in place. We haven't really seen a dramatic change in staffing flow from when we put that new system in place to when the unemployment benefit started to eliminate. So we think we've been getting staffing flow even before that happened.

We have, as we said, staffing challenges. And the challenges are a little bit more in certain parts of the country, but not necessarily driven by unemployment benefits. It's just driven by when they've opened up versus not when they've opened up. We're not so worried about getting great applicants because we are getting them right now.

Andrew Charles
Analyst, Cowen & Co. LLC

Q

Yeah. And then my follow-up question is that you've called out prior to the pandemic that Olive Garden could reach 20% of sales off-premise. And obviously, with the rebound in the dine-in business, you're seeing that off-premise mix come down a bit. Still sticky. You're now accounting for about 27% of the brand sales. Do you think this is a fair mix of sales that you can sustainably see going forward? Or is it likely to further come down as staffing challenges ultimately ease and you can fulfill more on-premise dining?

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

A

Hey, Andrew, I still think that the off-premise mix will come down at Olive Garden and at LongHorn as the dining rooms continue to fill, and people feel more comfortable going out to eat in a restaurant. We were starting to see that some when COVID was winding down before the Delta variant spiked. We were starting to see our percent of sales go down. And then when the Delta variant spike came back, we started to see that percent go back up.

So we don't believe that 27% is where we'll be in the immediate long-term after COVID is over. We still think somewhere in the 20s, but that all depends. I mean, we've made a lot of great investments in our technology. We've made it easier for our team members to handle all of the orders. We've made it easier for our guests to order, to pay, to do the things that I mentioned in the earnings – in the call.

And so we do believe that our To Go as a percent of sales is going to be greater than it was – than we ever thought it would before COVID. That's because we're getting a lot of people that have come to Olive Garden, into LongHorn that hadn't done that and hadn't done To Go before. So – and they're getting a great experience.

Andrew Charles
Analyst, Cowen & Co. LLC
Q

Very helpful. Thank you.

Operator: [Operator Instructions] The next question today comes from Jared Garber of Goldman Sachs.

Jared Garber
Analyst, Goldman Sachs & Co. LLC
Q

Thanks for taking the question. Obviously, the LongHorn trends remain very robust, and I think it was really encouraging to see the Fine Dining segment turn positive this quarter. Can you talk about what you're seeing in terms of pent-up demand and consumer trade-up? It seems like the steak category remains really strong, maybe even relative to some of the other brands. And I wonder if some of that trade-up is sort of not benefiting Olive Garden as much despite some of the reduced promo activities in that brand?

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

Yeah. I think that might be over-thinking it just a little bit. I mean, the steakhouse category has been strengthening, even pre-COVID, strengthened through COVID. I think that LongHorn, as we've discussed, has benefited somewhat from a geographical footprint that has been – when you think their footprint, heavy Georgia, heavy Florida, I also think that we've made a lot of investments in LongHorn over the last five or six years. And I think they've come through.

I would also say that operating these smaller footprints has been a little bit easier through COVID. We need a lot less employees to run a LongHorn. I think we're fully – basically fully staffed in that business. And so I think it's all come together and running real well.

As far as Fine Dining goes, I mean, we're thrilled to see the sales volumes we did this summer in Fine Dining. I will tell you that there's still a heavy drag on Fine Dining in the major cities. We're still down 40% in our three Manhattan locations, a little bit less than that in the other major cities, but we're seeing a big uptick in suburbia in Fine Dining, which has been fantastic. And so that business has been robust.

I never thought in my wildest dreams, I'd see the kind of absolute numbers that we saw this summer in Fine Dining, which has been fantastic. So I think there's some celebratory out there. I think people who aren't traveling for business as much as they used to, are using Fine Dining restaurants maybe a little bit more on the weekend, which has been great to see.

And I think the only other thing that I would say on Fine Dining is Sundays become a legitimate sales day in Fine Dining, which was really pre-COVID kind of a throwaway day unless you're in a convention city and a convention start on Sunday. But Sunday is a real legitimate day now, which operationally has taken some adjustments for us to get used to.

Jared Garber
Analyst, Goldman Sachs & Co. LLC

Q

Thanks. Appreciate the color there. And I just wanted to follow-up on the unit growth commentary that you made earlier, Gene. I think it was really encouraging to hear you'll likely be ahead of that at the top end or ahead of that 2% to 3% range in 2023. Can you talk a little bit about the adjustments or the impacts you've seen in the Other segment and maybe some of the opportunities coming out of the pandemic in that segment for the restaurants within there?

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

A

Yeah. I think the biggest impact has been when we transformed those business models, and we've talked about the transformation we've made at Cheddar's. Also, Bahama Breeze had a significant transformation there. We're doing some good work in Yard House. We're making some more investments in the food. We've got that business model in a good place. So we think there's good outsized, hopefully, good growth in that business.

So we have a lot more confidence in investing on new capital into these segments. I mean, Seasons is another business that's really made significant improvement, so we're confident to reinvest in that business.

So, as the real estate becomes available, we have more options. We're confident in more options to use that real estate. So if we go into a market where we already have a great Olive Garden, a great LongHorn, we have a property or a brand that we can put on top of that great piece of real estate and confident that we're going to get a really good return from that. And so, it's given our real estate and development team a little bit more flexibility now that we have this confidence in these businesses that we can grow them.

Jared Garber
Analyst, Goldman Sachs & Co. LLC

Q

Thanks so much for the color. Appreciate it.

Operator: The next question comes from Jake Bartlett of Truist Securities.

Jake Rowland Bartlett
Analyst, Truist Securities, Inc.

Q

Great. Thanks for taking the question. My question is on the limited menu in Olive Garden. And I'm just wondering whether there – do you have any concern that, that's impacting the recovery, the pace of the recovery at Olive Garden, whether that's impacting sales? I know it's been great for margins. In the context of that question, I think there's been commentary from some distributors that independents are re-expanding their menus. Is there a concern that, as others kind of re-expand the menus that you guys might be missing on sales? And then I have a follow-up.

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

A

Jake, I think that the limited menu is not impacting Olive Garden at all, and I'll go back to the context I provided in the beginning. If you just use the breakeven on the advertising, we'd be up double digits in this business. And we don't do advertising to break even. Again, the recovery in Olive Garden, I think, has been stronger than most. And I define recovery based on how much profit we make. And I keep looking at that profitability number, and I'm really pleased. So I don't think the limited menu is having any impact on our ability to drive top line in that business. I'd go back to some of the things I outlined in the beginning.

As far as independents adding menu items, [ph] more power to it (00:29:54). If they think that's what's going to drive their business, let them make those decisions. We're very comfortable where we are with our menus at this point in time.

Jake Rowland Bartlett
Analyst, Truist Securities, Inc.

Q

Great. I appreciate that. And following up on that, your selling expense has been about 1% of sales for the last three quarters now. Is that the right level we should think about for the rest of the year? And maybe just share any thoughts you have on longer term significant change from historical? So where should we be thinking more than near in the long-term in terms of marketing as a percentage of sales?

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

A

Well, I think for the short-term, I don't think you'll see us change our marketing strategies at all or, I guess, our tactics at all at this point in time. I think longer term, I think I'm going to go back to what I talked about last call was, we're still waiting to determine where is the equilibrium of this business. What's going to be on-premise? What's going to be off-premise? What's the competitive set look like? This additional kind of ramp-up in COVID, I think, is stressing out more restaurants, so maybe there's going to be some more closures. We don't know.

And so we're just searching for equilibrium. And once we get to that equilibrium, we'll develop a strategy and implement tactics that we think will best position our brands to be able to grow profitably into the future. But at this point for us to talk about that and kind of say where we think that's going to end up, that's just a huge mistake because we just don't know what environment we're going to be operating in.

Jake Rowland Bartlett
Analyst, Truist Securities, Inc.

Q

Thank you, very much. Appreciate it.

Operator: Our next question comes from Jeffrey Bernstein of Barclays.

Jeffrey A. Bernstein
Analyst, Barclays Capital, Inc.

Q

Great. Thank you very much. Two questions. One, Gene, I think you mentioned in your prepared remarks, specific to August, that trend slowed versus June and July, but still up versus pre-COVID. Just wondering how much of that you maybe attribute to the staffing shortage versus maybe the spike from a Delta variant perspective, just trying to gauge the impact from each. And I think you said September was up 7% per operating week versus the first quarter, up only 4.8%. So I'm just wondering what your assumption is for the rest of fiscal 2Q relative to that September comment. And then one follow-up.

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

Good try, Jeff. I'm not going to comment on forward looking on sales. I will say in our commentary about the trends is that as COVID started to pick up, especially in the Southeast and Florida was hard hit where we have a huge footprint, you had the impact of the Delta variant, and you also had back-to-school in a lot of these territories at that time. So we're having a hard time teasing out what was seasonality, what was the impact of the variant. And that's one of the reasons why we – we're not going to get in the habit of giving quarter-to-date sales at this call, but we felt that there was enough change in the sales environment that we wanted to be explicit that our sales have come back a little bit in September after falling a little bit in August.

We think some of that has to do with COVID, some of that has to do – maybe there's a little bit less seasonality in the business. There's so many different variables impacting us week-to-week, month-to-month right now. It's very difficult to tease out. And so we're just being as transparent as we possibly can. You know where we're at quarter-to-date, and I'm not going to comment on what – we've given you guidance for the rest of the year, and that's what we think we're going to be able to do.

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

Understood. And then just a follow-up more broadly on inflation. Just wondering how you think about the restaurant industry and maybe even retail more broadly. It just seems like inflation is elevated. All industries seem to be raising prices and not getting much pushback from the consumer. I'm just wondering maybe in your view, how does this end, whether for the industry or just for Darden, when you think about inflation versus pricing in the context of trying to drive traffic. Thank you.

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

Jeff, it's a very good question, right? So I think – first of all, I think we could all agree that lower income consumer is going to be disproportionately impacted by increases in inflation. And that consumer is a big part of our guest make-up for our casual brands. So we're incredibly focused on the longer-term pushback, not so much short-term.

People say, well, we're pushing this off on the guest, no one's pushing back. Eventually, there's going to be pushback. And so we're making a strategic choice, especially in Olive Garden and I'll say for Cheddar's, is that we're being very cautious with pricing, and we want to make sure this big group of consumers that we service feel as though they can still come to our restaurants and get an extremely great value for what they have to pay.

And so I think that those who manage through this prudently, those who can really take a longer look, will get through this okay. I think those who pass through a lot of price that aren't really managing their costs effectively, I think we've got to really think about how we manage our costs going forward. Because at some point, your average consumer could get priced out of casual dining, if it costs too much. And I think myself and the entire team is really, really concerned about that. And that's why we've made the strategic choice that we've made with pricing. And so I think we're thinking about how we position ourselves to excel in an inflationary environment.

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

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

Hi. Good morning. Gene, a question on Olive Garden and the performance there. And I appreciate all the factors that you mentioned on that that may have weighed on the sales for that brand. But I was just curious to get your thoughts on whether you think that was particularly acute in the quarter you just reported and some of those factors could ease as the year goes on? Or how are you thinking about that? Are you assuming those factors continue for the rest of the year or not?

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

A

Yeah. I think the one thing I would add that I did not mention in the comparables for this first quarter was two years ago, we were running buy one take one, which is a significant traffic driving promotion. And we believe it does have some profitability tied to it. So that was weighing on the comparable performance in Q1.

David, I really don't know, I mean, I think that we're looking at Olive Garden more on a bottom line perspective than just the top line at this point in time. It makes no sense at all for any business today to be advertised and driving sales in the restaurants that you aren't assured that you are 100% fully staffed and can provide a great dining experience.

And until we get to that and we feel certain that we have that every single day without having to deal with exclusions, we're not going to get out there and try to push people into these restaurants. It just makes no sense to me. And so when I look at what we're doing in Olive Garden and I continue to just be thrilled and continue to exceed my expectations. And it seems as though, we continue to disappoint the sell-side expectations on this.

But this is a very, very difficult operating environment. And I think that some of those things, if COVID – if you can tell me what's going to happen with COVID moving forward, then I can tell you that some of this stuff will ease. But when COVID is still prevalent in our communities, we're not going to know what the full potential or what I refer to as equilibrium is for a while.

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

Q

Understood. And on the staffing levels, I just wanted to clarify. I think you might have said that you're running at about 90% of pre-COVID levels, if I heard that right. What is the targeted level? How does that compare to what you would ideally like to be? Because I think you had some efficiency gains that might lead to, I guess, lower levels than you had pre-COVID optimally. But I guess, where are you relative to optimal level?

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

A

Hey, David, this is Rick. I did say 90% of pre-COVID staffing levels. Assuming the volume that we have today, right, so volume will drive how much staffing you need, so think about that, we probably need somewhere in the single-digit number of team members in our restaurants.

We have some restaurants that need a little bit more because of the location they're in. But as I said, most of our restaurants are fairly well staffed. And so as the volumes start to increase, we continue to hire. And so it really depends on where the volumes end up. But we don't believe that we would need the same number of people that we did before COVID at the same volume levels with these new venues. Yeah.

And the other thing that's happening now is we've got team members that are coming into the industry that may not be able to work the same number of hours. So, it really all depends on the hours that people can work and the days they can work. So, staffing levels in number of people versus where we were pre-COVID probably isn't the best indicator, but it's a pretty good one. And again, as I said, we've increased our productivity. So, all equal, same number of hours for a person, same number of guest count for someone, we would need fewer people.

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

Q

Great. Thank you very much.

Operator: Our next question today comes from Brett Levy of MKM Partners.

Brett Levy
Analyst, MKM Partners LLC

Q

Great. Thanks for taking my question. I guess, if we could just go both big picture and then more specific to you guys. If you could just parse out a little bit more on the competitive landscape, maybe a little bit more on the regionality and what you're seeing out there as well as if you're willing to share the market share data of how much share you gained in the quarter?

And then also, specifically for you, you've had great successes on the margins, both through your planning, but just also through your execution. Where do you see margins really hitting a ceiling? And I guess, we can either do that for Darden consolidated or at LongHorn and Olive Garden specifically. Thanks, guys.

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

A

Yeah. Good morning, Brett. I think let me just comment on maybe some regionality more so than get into the competitive situation. I think that we've been very pleased with how California has come back. I spent some time in California this quarter. It was a lot different than what I thought it was going to be. So, I think that our sales have come back there since the middle of July, very strong. So, we're very pleased with what's happening out there. We felt some pressure in Georgia and Florida over the last six to eight weeks with the Delta variant.

Texas didn't have much impact, and Texas seems to have a mind of its own. The Northeast has never really come back from where it was. It's still performing okay, but hasn't really rebounded. And then we've got pockets today where you can just look at the heat map for COVID, you know that you're going to have some sales problems. So, you've got some Tennessee, Kentucky, West Virginia issues today. But overall, I mean, I would say there's not a tremendous amount of difference in regionality.

As far as margins go, the way I would think about that is we'll eventually get back to a framework where we think we can get to 10% to 30% once we figure out where equilibrium is. And I don't think any of us should sit here today and say what's the ceiling or where these businesses run long-term. We do think that we've made some really great strategic choices over the last couple of years. We've transformed our business models. We've learned a lot. We've learned a real lot through this on how to be more efficient. And I don't think you'll see us give that up. And as long as we can continue to drive the top line, there's no reason why we can't hang on to these margins.

Brett Levy
Analyst, MKM Partners LLC

Q

Thank you.

Operator: Our next question comes from Eric Gonzalez of KeyBanc Capital Markets.

Eric Gonzalez
Analyst, KeyBanc Capital Markets, Inc.

Q

Hey, thanks for the question. I just want to go back to the comment about the quarter-to-date trends. And I don't want to beat a dead horse here, but I was just wondering if you can maybe talk about the different – performance of the different brands. Did you see acceleration broadly across all your major brands? Or was it just maybe specific to one or two of them?

And then my real question here is on the off-premise business. Recognizing that you don't want to overwhelm the staff by drawing in traffic with advertising, I was wondering if maybe there's an opportunity to push harder on that off-premise strategy with marketing promotions given that channel likely requires less labor. Thanks.

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

A

Yeah. No comments on quarter-to-date. We gave you a number which I don't like to do and I'm not going to talk about it anymore. As far as off-prem goes and trying to drive that, it's very, very difficult to drive that business specifically without discounting. And we don't want to discount. And there's – part of the labor problems and dealing with the exceptions impacts off-premise, too. It takes less labor, but you still need a cook, you still need all these people to produce the food. And so when we think about this, we're trying to create great guest experiences, whether it's on-prem or off-prem.

And as Rick outlined in his prepared remarks, dealing with these exclusions, I mean, it's not like we get a lot of notice that we've got seven people that are excluded from the restaurant, and all of a sudden you're seven people short for the night. You got to adapt and try to overcome those challenges. And so, I think that where we're at right now, we are doing some things off-premise without discounting. And on the weekends, we have to throttle the off-premise business.

In other words, we've got to control how many orders we do every 15 minutes. And each brand has a different way of throttling. Each restaurant can throttle differently. But on average, I'll give you an idea is that we only take four orders to go every 15 minutes, and there are a lot more orders than that. And I think that's something that we know we have excess demand, but we've got to be able to service the [ph] dine-in (00:45:25) and service the off-prem.

Eric Gonzalez
Analyst, KeyBanc Capital Markets, Inc.

Q

From a margin perspective, the exclusion pay, are you able to maybe talk about what that might be just from an expense perspective, recognizing that the sales have an impact, but maybe there's an expense there from paying labor that's not present.

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

A

It's not big enough. It's not meaningful impact on the P&L.

Eric Gonzalez
Analyst, KeyBanc Capital Markets, Inc.

Q

Thanks.

Operator: Our next question comes from Brian Bittner of Oppenheimer & Company.

Brian Bittner
Analyst, Oppenheimer & Co., Inc.

Q

Thanks. Good morning, guys. Just going back to the staffing issues you talked about at Olive Garden that clearly are restricting the sales capacity. When you look at LongHorn, are they dealing with the same or similar issues from a staffing perspective? Obviously, it doesn't look like it when you look through the lens of just looking at the numbers. So if they are dealing with those staffing issues, can you just talk about why and the primary difference going on there between the two brands?

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

A

Hey, Brian, it's Rick. A couple of things about LongHorn, one is they have a smaller total team than Olive Garden does, right? So – and they actually were in parts of the country early in the pandemic that opened up a lot faster. So, their staffing challenges aren't nearly where Olive Garden would be. And actually, right now, they have more team members than they did pre-COVID, but they're doing a lot more volume. So their staffing challenges are really the same thing on exclusions.

And if you think about the exclusions, a lot of it impacts the kitchen. And so as long as they've got enough people working in the kitchen that they have an exclusion, they can continue to drive sales through that. It's not as big an issue for them. So if you think about a LongHorn, probably 60% of the total team members of a restaurant than an Olive Garden does. And so when you have exclusions, it's not as big of an impact for LongHorn.

Brian Bittner
Analyst, Oppenheimer & Co., Inc.

Q

Okay. Great. Thanks, Rick. And just with Olive Garden, aside from the staffing issues, how do you want us thinking about your ability to proactively drive the business in the future with more marketing and more promos? Meaning, are you just so pleased with this new profitability profile of Olive Garden that you really want this to kind of be the new base case strategy moving forward and how the brand operates? Or do you want us analysts thinking that you have these unused weapons that you could potentially deploy if you want?

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

A

No, I think this is – Brian, this is the way to think about – this is the base business. And what we're going to try to do is once we figure out where equilibrium is, we will develop a strategy and implement tactics to be able to drive the business profitably. What [ph] we don't want (00:48:18) to do is put back in another $100 million of marketing and only get $400 million in sales. And then you go back to some of the comments I made earlier is that we want to make sure that we're focused on value.

We think that with this inflation going through, there's going to be – longer term, there is going to be – the winners are going to be the ones who provide exceptional value to the consumer. And we're trying to position Olive Garden to be that brand. It's historically done well in downturns. And if we have a downturn, we want to position it to do really well.

I think we'll promote again. Don't get me wrong. We will promote again. We just think we will do it differently. And we think a lot more about the opportunity cost around the value of that table when we're extremely busy and how not to have guests sitting at that table paying less than full price. Even though it's a value proposition, we don't – if we want to be value and focus on value, we don't want to be discounting off a value platform. And I think that's really important. And so we've got to figure that out once we get there. We've got contingency plans right now. We think we know what we want to do. But we need to see what the competitive environment is, and we need to see what the economic backdrop is.

Brian Bittner
Analyst, Oppenheimer & Co., Inc.

Q

Great. Thank you, Gene.

Operator: Our next question comes from Lauren Silberman of Credit Suisse.

Lauren Silberman
Analyst, Credit Suisse Securities (USA) LLC

Q

Thank you. So just looking at trends across the brands on a two-year basis, comp accelerated from the fourth quarter in May for all the segments except for Olive Garden. And I appreciate all the commentary on the differences on an absolute basis. But from a sequential perspective, are the dynamics the same? I'm just trying to understand why there's no change there.

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

A

Hi, Lauren, let's make sure we understand the question. Can you repeat the question?

Lauren Silberman
Analyst, Credit Suisse Securities (USA) LLC

Q

Sure. So just looking at a two-year basis, comps for the quarter accelerated from the fourth quarter for LongHorn, Fine Dining and the Other business, reasonably flat for Olive Garden. So I understand all the commentary on an absolute basis on two-year comps across the brands. But just from a sequential perspective from the fourth quarter to the first quarter, if there's anything to call out regarding sort of the factors on the acceleration for the other brands versus reasonably flat for Olive Garden?

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

A

Yeah. I'll just make a couple of quick things. I mean, when you think about like the Other business, we got all – mostly Yard House back in the quarter. And Fine Dining, we got a lot more full capacity back in the second quarter. LongHorn is just the – the steakhouse segment has just done extremely well. So I think that's really the big change.

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

A

Yeah. And I think the other thing is, really the starting point is not apples-to-apples. That's what we keep trying to come back to, is Olive Garden had a lot of – we talked about the promotion in Q1. We had a lot of market – the best – one of their best promotions and we had a lot of marketing dollars in there.

So when you're trying to compare it to the two years ago number, your starting point is off. That's where we would argue that's 10 points lower or more. So if you start with that, Olive Garden accelerated. And that's where there's some volatility when you look at that by brand because of the promotional differences.

Lauren Silberman
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. Very helpful. And then just on loyalty. You previously tested a loyalty program across select restaurants. I think we've seen a lot of brands implementing them or looking to [indiscernible] (00:51:59). Do you have any updated thoughts on the potential for a loyalty program across the system or what you saw in tests as you think about it?

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

A

Hey, Lauren, it's Rick. Yes. Well, we stopped the test of loyalty right when COVID started. We didn't believe it was the right thing to do during the time that we were making sure that we can get our restaurants open and up and running.

We are working right now on everyday value. As we've talked about for Olive Garden, we want to make sure that our value perception continues to improve. It's already great in all of our brands. And so right now, we haven't decided to even test again.

That may happen someday. But what we don't want to do is provide a loyalty program that provides a discount to the highest used consumer. So if we have a loyalty program, we'll work on something that's different.

Now, I will say, we were seeing positive trends in our loyalty program before. But that was a point-based discounted program that, in the long run, we don't think is the right way to do loyalty in the restaurant business.

Operator: And we can move on to Dennis Geiger of UBS.

Dennis Geiger
Analyst, UBS Securities LLC

Q

Great. Thank you. First, Raj, just wanted to see if you could quantify the impact of the Thanksgiving shift on the quarter by chance?

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

A

Yeah. I would say, at a high level, it's probably, think of it as about a 1% impact on a two-year – because we're comparing to pre-COVID, so as you look at it, yeah, think of it as about 1 point impact, yeah, in normal environment.

Dennis Geiger
Analyst, UBS Securities LLC

Q

Thank you very much. Great. And then, just wanted to come back on the technology front, some impressive digital results as it relates to the digital mix of off-premise. So just wanted to get a sense for any additional opportunities that you can share that can support either that off-premise business or even the dine-in business, as it relates to the top line or even some additional margin efficiency opportunities.

I think geofencing is kind of an interesting one that you've highlighted. So, curious if there's anything to share there and how close that might be, or any other opportunities on the tech side? Thank you.

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

A

Hey, Dennis, this is Rick. Just a broad message on technology first, is our goal is to implement technology really that reduces friction across every part of the value chain. And while we respond to growing desire for choice and personalization from our guests, they want choice, they want to be personal – they want personal experiences.

And so, a few things that we did in the first quarter, just to give you an idea, we added Apple Pay and Google Pay to olivegarden.com. We were already able to use PayPal to pay for you To Go order. And now over 25% of our mobile app transactions are paid via PayPal and these other wallets, where it's much more convenient to our guests to pay.

We've updated the Curbside I'm Here experience for our guests when they have To Go. Still not including geofencing, but it's coming as well. And we've just started A/B testing for Olive Garden and online recommendations for items.

I'm not going to talk about what we're doing in future quarters, but we have more improvements. We continue to invest in this digital platform. Our goal for guest-facing is to lead our segment when it comes to relevance and convenience for our guests. And we will continue to do that.

Will we lead the restaurant industry? No, the quick service players are going to probably spend more and do more things in technology, but we're going to learn what they're doing and see what we can bring to our space. But we are going to lead the full-service restaurant space in technology for guest-facing.

Dennis Geiger
Analyst, UBS Securities LLC

Q

It's great. Thank you.

Operator: We can go to Nicole Miller of Piper Sandler.

Nicole Miller Regan
Analyst, Piper Sandler & Co.

Q

Thank you. Good morning. Two quick ones. On off-premise, can you talk about catering as an underlying trend and what you're seeing in catering?

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

A

Yeah, Nicole. We haven't seen a whole lot of pickup back in catering yet. We did see during COVID more catering to homes than to businesses. But since business spending and people still haven't gone back to offices, we haven't seen a huge pickup, but we are seeing some. We are seeing some growth in catering, but it hasn't been dramatic. We'll see what happens during the holiday season this year. But right now, not a huge jump in catering from what happened while COVID is going on.

Nicole Miller Regan
Analyst, Piper Sandler & Co.

Q

And then just a really high-level question around Fine Dining. Your numbers are up like the industry peers, if not better. What is a fair assessment of some of the pluses and minuses of what we might think about for social or corporate gatherings coming up for the holiday season?

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

A

Yeah. I think it's all going to depend on where we are with this variant and what the levels are, especially in some of the bigger markets. I'd sit here today and say, I think it's going to be a robust holiday season. I think it's going to be a robust holiday season for all our restaurants and all our retail. I think that the consumer is still fairly healthy from a financial standpoint. And we'll know more in the next six to eight weeks as we start thinking about – we start seeing the bookings.

One trend that we have seen over the last six to eight weeks is we've seen a lot of cancellations of larger parties or gatherings inside the Fine Dining restaurants as people aren't as comfortable gathering in big groups as they may have been in the mid-summer. But I would expect this to be a robust holiday season if the variant is under control.

Nicole Miller Regan
Analyst, Piper Sandler & Co.

Q

Thank you.

Operator: We can now move on to Jeff Farmer of Gordon Haskett.

Jeffery Daniel Farmer
Analyst, Gordon Haskett Research Advisors

Q

Good morning. Thanks, guys. Just quickly wanted to follow up on some of the menu pricing and value questions that you guys received. I think you pointed to holding menu pricing obviously well below inflation levels, but that has moved higher for you. So, I think menu pricing sit at roughly 1.5% the last quarter. Where do you think menu pricing could go this quarter and over the balance of the year considering that that inflation – total inflation number has ticked up for you?

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

A

Yeah. Hi, Jeff. I'll speak to the year. What's contemplated in our guidance is pricing just under 2%. So, if you think about our total inflation being 4% in the forecast we provided or the outlook we provided, we're assuming pricing just under 2%...

Jeffery Daniel Farmer
Analyst, Gordon Haskett Research Advisors

Q

Okay. And then...

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

A

...for the year.

Jeffery Daniel Farmer
Analyst, Gordon Haskett Research Advisors

Q

That's helpful. And then, different topic. A lot of your peers, casual dining peers have been pretty aggressive in taking these delivery menu pricing premiums, which have improved the margin structure profile for that delivery offering. I'm just curious, has that changed your opinion about potentially pursuing delivery, considering that there's a little bit better margin profile out there for that sales channel?

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

A

No.

Jeffery Daniel Farmer
Analyst, Gordon Haskett Research Advisors

Q

All right. Easy enough. All right. Thank you, guys.

Operator: Our next question comes from Brian Mullan of Deutsche Bank.

Brian H. Mullan
Analyst, Deutsche Bank Securities, Inc.

Q

Hey. Thank you. Just a question on the long-term development opportunity for Olive Garden. You made commentary in recent quarters, a bit less worried about cannibalization you might have been in the past, more optimistic on the number of units. So, this question is, what's your current thinking on the long-term potential here? Is there an actual number you have in mind? Could there be 1,000 restaurants? Could there be more? Just any color on your updated thinking.

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

A

Yeah. I don't think we want to put a number. I will say more than 1,000. We think that there's a pathway to get there. I think it's dangerous to say, I've been in this business doing this for a long time, and every time we run a brand, we put out numbers that we think are potential. If the brand is really strong, we kind of get through those numbers pretty easily.

So, let's just say one of our underlying beliefs is that convenience is going to continue to matter. We're going to need to build restaurants closer to where people live. And we also believe especially in Olive Garden that we can build in more remote areas that have these large, what I would call these like 60-mile trade areas where people travel in and out to get things and dine. And so we're pretty excited about where we can take Olive Garden, especially if we can maintain over 20% off-premise, that opens up some more trade areas.

We just continue to open Olive Gardens and amazed – we continue to be amazed at the volumes we do and then the returns that we're getting. So we definitely think we can get over 1,000 fairly easily.

Brian H. Mullan
Analyst, Deutsche Bank Securities, Inc.

Q

That's it for me. Thanks for that.

Operator: Our next question comes from Chris O'Cull of Stifel.

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

Q

Thanks. Good morning, guys. Gene, I wanted to get your perspective on what you think is driving the industry labor shortage and how the industry can create maybe a stronger employee proposition to attract talent?

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

A

Yeah. First of all, I don't think the labor shortage is just the restaurant industry. I think it's a national problem. I think that we see it with our vendors. We see it in other places. We all have associated maybe with some other companies that we see this challenge every single day.

So I do think that as we think about the restaurant proposition, I think we have to all understand what do restaurant team members want. I mean, they want an opportunity to be able to work in an environment that is well run. They want flexibility. They want growth depending on what they're using the job for. And a lot of restaurant jobs are pass-through. They're kind of let's get from point A to point B. And I think as – we have to continue to find ways to improve that proposition.

I think that one of the things that I'm really most proud of is how many people that come into us as an hourly employee and then were able to get into management. In the last three or four months, we've got almost 500 team members we've taken from our hourly ranks and moved them into management ranks. And I love that growth. I love that opportunity. When I'm in the field, I'd love to meet these people and they're so excited about their future and their potential.

So I think those who have resources – and I think this is where scale is going to matter, too. Those who have resources that can create an employment proposition that's stronger than others will attract people. There's no doubt that, I think that we're in a lot better shape than others with labor at this point in time.

I think it's going to come down to be an individual situation, which company – and, more importantly, it gets down to the restaurant manager, GM, inside each of that box, can they create an environment where people want to work. And that's how we'll attract people. Where we have our best leadership, we do not have people problems.

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

Q

One thing you didn't mention was pay. And I'm just curious, if you think, continuing increasing pay at kind of healthier rates or the rates that we've seen recently, if you think that will address the employment issue at all?

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

A

No, I think you got to have competitive pay. And I think that's only one aspect of the employment proposition. There's been pressure on wage now for a few years, even before COVID. I think there'll be pressure on wage, as we move forward. But I don't think it all comes down to just pay. I don't think the problems for the industry would go away, just because we're going to – we'll have to – if we pay more.

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

Great. Thanks.

Operator: Our next question comes from David Palmer of Evercore ISI.

David Palmer
Analyst, Evercore ISI
Q

Thanks. Good morning. I think the restaurant expense line was down 110 basis points on a two-year basis in the quarter, with comps up 5% over that time. Could you talk about how the company is doing this? And how much of that do you think is sustainable productivity longer term in your view? And then I have a follow-up.

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

Hi David, this is Raj. Hi David. Yeah. So, restaurant expenses per operating week on an absolute basis were slightly below. I think we're about a point below where we were pre-COVID. We have found some efficiencies through the pandemic on some contract services and some R&M. I do think some of the costs will come back in a little bit. But it's still going to be a point of leverage – I mean, a line that we're going to continue to see some improvement versus pre-COVID.

Is it going to stay at the 110, 120 basis points range? Probably not. Again, also it depends on where the sales are. But we are managing – that's one line where we've been able to manage well and keep it fairly flat, or actually slightly below where we were pre-COVID.

David Palmer
Analyst, Evercore ISI
Q

Just a quick follow-up on that part is what are some specific things that are going on there? And then, I just got a separate question on the marketing and promotion side. I'm wondering how you're thinking about marketing and promotion spending, as you see some of these COVID era forces easing, a variety of them. So, more specifically, do you anticipate marketing and promotion spending returning to fiscal 2019 levels in fiscal 2023? Thanks.

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

So, let me answer the last question first. No, we don't expect it to get back to that at this point. But then on the restaurant expense line, like I said, it's really contract services. We continue to look at our vendors and continue to work with them on how to kind of optimize – streamline some of this and that's part of that.

There was a little bit less R&M that has been catching up. And I think by Q1, we're more closer to pre-COVID levels on that line. But there's a little bit more on that line that I think will come back. But beyond that, there's really no specific one item here or there. I mean there's music, there's other stuff that we talk about, but these are – it's in multiple places.

David Palmer
Analyst, Evercore ISI
Q

Thank you.

Operator: Our next question comes from Andy Barish of Jefferies.

Andrew Barish
Analyst, Jefferies LLC

Q

Hey. Good morning, guys. Just a couple of kind of short-term questions, which I'm sure you love. On the September numbers that you talked about, can you just give us a sense of the noise in the quarter so far? I know there was a Labor Day shift, I think, with two years ago, obviously, weather. Just trying to get a sense of what you can tease out given all the other variables.

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

A

Yeah. Hi Andy. So, we actually don't have a Labor Day shift because our fiscal years – we're giving you [ph] fiscal (01:07:30) comps and because of the 53 weeks that we had in fiscal 2019, we actually have apples-to-apples for Labor Day. There was clearly some impact from Hurricane Dorian about two years ago that we had talked about that impacted the first few weeks a little bit. High level, maybe a point or so at the time, I can't recall exactly, but that's what I'd say.

Andrew Barish
Analyst, Jefferies LLC

Q

And then just finally on the margins sequentially. This is usually a quarter where you see a couple of hundred basis points of sequential decline in margins given the volumes are usually the lowest. Is that somewhat predictable this year or just too tough to tell given everything going on out there?

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

A

So, let me answer it without getting to the specifics on that. Q2 is one where we do think because of the low volumes and low margins to begin with, you're probably going to have a little bit more improvement than a typical quarter, but I would say that Q2 is also one quarter where we're probably going to have the highest inflation as we look at where we are sitting, right? So, it's going to be higher than Q1 in terms of inflation.

Andrew Barish
Analyst, Jefferies LLC

Q

Okay, helpful. Thank you.

Operator: And our next question comes from John Ivankoe of JPMorgan.

John Ivankoe
Analyst, JPMorgan Securities LLC

Q

Hi. Thank you. I wanted to get back to labor and staffing in particular. I heard you were adding 1,000 net new employees per week, I think you said, which obviously is a great achievement. Can you talk about the quits rate at Darden, just overall turnover and just as you are kind of hiring 1,000 people net, which obviously is much more than that gross, how you're feeling about some of the real-time operating metrics that you look at in terms of where those are versus standard? And assuming there might be a tick below, how quickly you think you can ramp back up to where you'd like to be?

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

A

Hey, John, this is Rick. On the turnover front, we are actually starting to see our turnover [ph] get – improve (01:09:45) dramatically from where it was kind of during COVID and even coming right out of COVID. We're still well better than the casual dining industry in turnover and especially in the first 90-day turnover, right? And that really is a testament to the training that we're doing to these new team members when they're coming in. Now, turnover is still higher than it was pre-COVID, but it's getting much better, and it's still much better than the industry.

John Ivankoe
Analyst, JPMorgan Securities LLC

Q

And on the operating side?

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

A

Say it again?

John Ivankoe
Analyst, JPMorgan Securities LLC

Q

Sorry. And on the operating side, I mean, considering you are hiring so many new employees, I mean, 1,000 net is obviously much more than that gross. I mean, what that's translating in terms of some of your real-time operating metrics relative to the past? And if there's an opportunity to maybe improve on the margin given how new your overall staff is?

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

A

Yeah, I would say if you think about the percent of our team members that are in the first 90 days, they're not as productive as team members that have been with us for a year. And we do have a higher percentage of team members that are with us for the first 90 days than we were two years ago. So there are some productivity improvements that we can do for those new team members. And we are spending a little bit more in training than we did two years ago because of that.

And so there might be some chance to offset some of those things, but that will just come from inflation down the road. But, yeah, operating – we're operating well all of our operating metrics. If you think about our guest satisfaction metrics, they're still at the same level as they were over the last three or four months, even with these new team members.

John Ivankoe
Analyst, JPMorgan Securities LLC

Q

Thank you.

Operator: Our next question comes from Jon Tower of Wells Fargo.

Jon Tower
Analyst, Wells Fargo Securities LLC

Q

Awesome. Thanks for taking the questions. First, and I apologize if I missed this one. But Raj, did you quantify the headwind that the exclusions had on OG sales during the quarter?

And then second, Rick and Gene, throughout this call, you hit on the benefits of scale and how important that is to your overall business and frankly, how well your business has been doing despite the challenges that the industry has been facing. I would assume that many of your smaller competitors in the category are feeling the pain more acutely than you are. So I'm curious, given the benefits of scale your company could bring to the table, has your appetite for adding brands to the portfolio grown at all over the past six months or so?

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

We did not quantify any impact on sales from the exclusions. That's something that – we can't do that. [ph] No, we have the (01:12:35) methodology to do that.

As far as M&A goes, I mean, we're – at the same place, we're a platform company. Management and the board continue to evaluate options. And when we find an option that we think that makes sense, maybe we'll do some. Right now, I would just pivot to say that we're extreme – as I talked about in my prepared remarks, we're really focused on growing our existing brands. We love how healthy our brands are, vibrant and how good, strong the business models are. We think opening our own restaurants right now is the best way to create value for our shareholders.

Jon Tower
Analyst, Wells Fargo Securities LLC
Q

Got it. Thank you.

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

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

Thanks. Just two quick ones for me. On the quarter to-date, can you confirm that average weekly sales volumes also improved sequentially? Or was the percent increase kind of more driven by lapping easier seasonal comparison, September is usually lower back-to-school? And then Raj, what level of G&A is bedded in your fiscal 2022 guidance? Thank you.

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

Okay. Hi, Brian. For September quarter-to-date, the numbers we're referencing are versus pre-COVID. So as you rightly pointed out, there is a seasonality as you come into September. September is, I think, generally the lowest seasonal month for us and the industry in casual space. But with that said, on the G&A front, like I said, if you take out the $15 million of the unique items that we had this quarter, that would be a good run rate to use as you look forward.

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

Thank you.

Operator: Our next question comes from Andrew Strelzik of BMO.

Andrew Strelzik
Analyst, BMO Capital Markets Corp.

Q

Great. Thanks for taking the question. I just had two quick ones on unit growth and real estate. It feels like similar to yourselves, there's a number of brands that are talking about accelerating unit growth kind of coming out of the pandemic. So I'm just curious for your perspective on the real estate environment in terms of availability price. Are you seeing that kind of competition play out?

And then secondarily, you've given several eloquent answers about why it makes so much sense to put up your own new units. I'm just curious why you think 3-ish percent is kind of the right level at this point? Thanks.

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

A

Yeah. Unit growth, acquiring site is just as hard as it was pre-COVID. I mean, people are out there competing not just restaurants or not just – it's just not restaurants competing for space. I mean, retailers use the spaces that we use. Banks use the spaces that we use. There's a lot of competition out there. It's definitely getting more expensive.

We are seeing construction costs start to moderate. I will tell you that having been an investment grade credit does help with landlords and how we behaved through the crisis and how we paid our rent is not forgotten with these landlords. So I think that we have a very exciting group of brands to put on pieces of property and people are excited as Darden as the tenant.

As far as why is 3% where we believe the right number to be, [ph] it, however, (01:16:05) comes down to people. I think the most important decision we make when running this kind of a business is who's going to be the management team in that restaurant. And we need to make sure we have people that can handle that responsibility. Especially in our smaller brands, it's really tough to really ramp up that growth because you rip through your human resources quickly.

Every time you open a restaurant, you really have two new general managers. You've taken an existing general manager and managing partner from an existing business, putting them in a new business and then you got somebody new in the existing business. So you have two businesses at risk. And for doing this for the amount of years that I've done it, I think that, for Darden, 3% growth rate is really maxing out our human resources and our ability to do this correctly. And it takes a lot to open a restaurant. It takes a real lot to open a restaurant, and we need to do it right. And if you don't open a restaurant right and get it right in that first six months, they tend to be a problem for up to three years. And that's why we're pretty conservative on how we think about this.

Andrew Strelzik
Analyst, BMO Capital Markets Corp.

Q

Great. Very helpful. Thank you very much.

Operator: We can go to Chris Carril of RBC Capital Markets.

Christopher Carril
Analyst, RBC Capital Markets LLC

Q

Hi. Good morning, guys. Thanks for the question. So you offered some commentary around guest-facing technology, but curious to hear your thoughts on investing in technology that helps on the labor side. I believe you mentioned tech related to aiding in-restaurant operations, but maybe anything else that's related to hiring or related to scheduling? Any additional detail on tech focused on labor and staffing would be helpful. Thanks.

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

A

Hey, Chris, this is Rick. In the restaurant-facing things that aren't guest-facing, our primary goal is to improve productivity and simplify processes. We believe we have a world-class scheduling system, and that does a great job taking the general manager's forecast and scheduling a great schedule. What isn't world-class, and it is the user interface for the manager to make it easier for them.

So we continue to do things to make it easier for managers to do things faster, so they can get with guests and they can train their team members and be with guests more. We have some things for our team members and what we've done with To Go in the kitchen. And we are looking at machine learning and AI to do better forecasting. So there's a lot of things that we're working on, especially in the kitchen, making it easier to order and receive product, do inventory and those kind of things.

On the service side, we are testing a few things that may make it easier for them. But what we don't want to do is have technology override the experience for the guests. So, we'll continue to make these investments in our technology, in our kitchen technology, in our To Go technology to help improve productivity.

Christopher Carril
Analyst, RBC Capital Markets LLC

Q

Great. That's helpful. Thank you. And then just quickly, just following back up on the topic of reduced industry supply from competitor closures, just curious, if you have any observations you can share from markets where perhaps you saw more competitor closures versus markets where there were less closures, right? Just really just trying to get a sense of to what extent there's been any – or to what extent there has been a benefit from industry closures. Thanks.

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

A

Yeah. I would say there's two ways to think about it. Number one, in your Tier 1 trade areas, you're not going to see a lot of closures, right? So even in a below average restaurant can make it in a Tier 1 environment, unless the rent is too onerous. So, you're seeing more of the closures in your secondary and tertiary sites, especially from independents in the casual space and some chain restaurants.

Now, in some of the Tier 1 sites, you are seeing some independent closure on Fine Dining. I believe that those will be the first to come back. Those are built out as restaurants. They'll get recapitalized very quickly, [indiscernible] (01:20:23) chef and other owners. So I do think those will come back. But I would summarize this by saying, you're not seeing it in your Tier 1. You're seeing it more in your tertiary area is where you're seeing a lot of closures.

Christopher Carril
Analyst, RBC Capital Markets LLC

Q

Got it. Okay. Thanks for all the detail today.

Operator: That concludes today's question-and-answer session. Mr. Kalicak, at this time, I will turn the conference back to you for any additional or closing remarks.

Kevin Kalicak

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

Thanks, Kevin. That concludes our call. I'd like to remind everyone that we plan to release second quarter results on Friday, December 17, before the market opens with a conference call to follow. Thanks, and have a great day.

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