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Darden Restaurants, Inc. (DRI)

Q3 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Hello, and welcome to the Darden Fiscal Year 2024 Third Quarter Earnings Call. Your lines have been placed on a listen-only mode, until the question-and-answer session. [Operator Instructions] This conference is being recorded. If you have any objections, please disconnect at this time.

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

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 today are Rick Cardenas, Darden's President and CEO; and Raj Vennam, CFO.

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

We are simultaneously broadcasting a presentation during this call, which is posted in the Investor Relations section of our website at darden.com. Today's discussion and presentation include certain non-GAAP measurements, and reconciliations of these measurements are included in the presentation. Looking ahead, we plan to release fiscal 2024 fourth quarter earnings on Thursday, June 20th, before the market opens, followed by a conference call.

During today's call, any reference to pre-COVID when discussing third quarter performance is a comparison to the third quarter of fiscal 2020. Additionally, all references to industry results during today's call refer to Black Box Intelligence's Casual Dining benchmark, excluding Darden, specifically Olive Garden, LongHorn Steakhouse, and Cheddar's Scratch Kitchen.

During our fiscal third quarter, industry same-restaurant sales decreased 4.2%, and industry same-restaurant guest counts decreased 6.5%. This morning, Rick will share some brief remarks on the quarter, and Raj will provide details on our financial results and an update to our fiscal 2024 financial outlook.

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

Ricardo Cardenas

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

Thank you, Kevin. Good morning, everyone. I'm proud of our results this quarter. Each one of our segments grew total sales and profit in an operating environment that was tougher than we anticipated. We continued to outperform the industry benchmarks for same-restaurant sales and traffic. Total sales were $3 billion, an increase of 6.8%, and adjusted diluted net earnings per share were $2.62, which was in line with our expectations. We opened 16 restaurants during this quarter. Fiscal year-to-date, we have opened 43 restaurants in 22 states, 7 of which were reopenings.

The quarter started well with strong holiday performance in December, but unfavorable winter weather negatively impacted January traffic, and while February results improved, we experienced some underlying softness we had not seen in the months leading up to January. The lower-income consumer does appear to be pulling back and the mix of guests, based on income, is now in line with pre-COVID. I am proud that even as industry traffic trends weakened, we were able to gain share.

We continue to focus on controlling what we can control, leveraging and strengthening our four competitive advantages of significant scale, extensive data and insights, rigorous strategic planning and our results-oriented culture, and executing our back-to-basics operating philosophy anchored in food, service, and atmosphere. Our restaurant teams continue to perform at their best, especially during our busiest times. In December, The Capital Grille set their all-time total monthly sales record. In February, Eddie V's set their all-time total weekly sales record and Olive Garden established a new sales record for Valentine's Day.

Our internal guest satisfaction metrics reflect our team's focus on being brilliant with the basics. All of our brands remained at or near all-time highs for overall guest satisfaction during the quarter. Additionally, within the casual dining, polished casual, and fine dining segments of Technomic's industry tracking tool, the Darden brand was ranked number one for overall experience. The brands were LongHorn Steakhouse, Seasons 52, and Ruth's Chris Steak House.

Our team's ability to execute at a high level is driven by strong leadership and team member engagement across our brands. We work hard to ensure our results-oriented culture is a competitive advantage for us, and our industry-leading retention rates confirm it is in an area of strength. During the quarter, we completed our biannual engagement survey, and the results showed that our overall level of engagement is at an all-time high. Also during the quarter, three of our brands were recognized as industry leaders in Black Box Intelligence: LongHorn, The Capital Grille and Seasons 52, each received the Employer of Choice Award.

Now, let me provide a quick update on Ruth's Chris. We are in the final stage of integration and remain on track to complete the major changes by the end of the fiscal year. We successfully completed the migration on to our HR platform at the end of December, and all restaurants have now successfully transitioned to our distribution network. Currently, we are halfway through converting the restaurants over to our point-of-sale system, and we are on track to complete that work by the end of May.

This is the most challenging part of integration, and I'm really proud of the focus the Ruth's Chris team continues to have on delivering exceptional guest experiences. This can be seen in the fact that Ruth's Chris was named America's Favorite Chain Restaurant in Technomic's annual survey that was released during the quarter. The survey measures perceptions of service and hospitality, unit appearance and ambience, food and beverage, convenience, and value.

In addition to Ruth's Chris, Seasons 52, Bahama Breeze, LongHorn, and The Capital Grille were all ranked in the top 10. Overall, I am pleased with our performance this quarter. We continue to manage the business for the long-term by executing against our strategy and controlling what we can control. We also continue to work in pursuit of our shared purpose, to nourish and delight everyone we serve. One of the ways we do this is for our team members and their families is through our Next Course Scholarship program.

Earlier this month, the Darden Foundation awarded more than 100 post-secondary education scholarships worth $3,000 each to children of Darden team members. Education is one of the greatest equalizers in our country, and I'm thrilled that we can create a lasting impact on the lives of our team members' families through this program. Finally, I want to thank our 190,000 team members for everything you do to create exceptional experiences for our guests. You are the reason brands continue to be recognized as great places to work and top dining destinations.

Now, I will turn it over to Raj.

Rajesh Vennam

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

Thank you, Rick, and good morning, everyone. Third quarter earnings were in line with our expectations, although, our sales were softer than we anticipated. We were pleased with December's strong holiday performance as the month's same-restaurant sales were in line with our second quarter results. However, winter weather in January negatively impacted traffic results by approximately 100 basis points for the quarter.

As we moved into February, sales trends improved, but were below our expectations, exposing some underlying consumer weakness. Despite the unexpected variability in our sales trends, our teams did a great job managing their businesses. In the third quarter, we generated $3 billion of total sales, 6.8% higher than last year, driven by the acquisition of Ruth's Chris Steak House and 55 net new restaurants, which was partially offset by negative same-restaurant sales of 1%.

We outperformed the industry again this quarter with same-restaurant sales that were 320 basis points better than the industry and same-restaurant guest counts that were 270 basis points better. And on a two-year basis, we have outperformed on same-restaurant sales by 770 basis points and by 970 basis points on same-restaurant guest counts.

Our focus on managing the business and controlling costs resulted in adjusted diluted net earnings per share from continuing operations of $2.62 in the quarter, an increase of 12% from last year's reported earnings per share. We generated $512 million of adjusted EBITDA and returned approximately $190 million of capital to our shareholders through $157 million in dividends and $33 million of share repurchases.

Now, looking at our adjusted margin analysis compared to last year. Food and beverage expenses were 90 basis points better, driven by pricing leverage. Total commodities inflation of approximately 1.5% was below our total pricing of approximately 3.5%. Restaurant labor was 10 basis points unfavorable to last year, due to total labor inflation of approximately 4.5%, partially offset by pricing and productivity improvements at our brands.

Restaurant expenses were 10 basis points higher as sales deleverage was partially offset by strong cost management by our teams. Marketing expenses were 10 basis points higher than last year, consistent with our expectations. All of this resulted in restaurant level EBITDA of 20.6%, 70 basis points better than last year.

G&A as a percent of sales was 40 basis points lower than last year, and total expense was slightly favorable to our previous guidance related to lower incentive compensation and ongoing synergies from the integration of Ruth's Chris. Interest expense increased 50 basis points versus last year, due to the financing expenses related to the Ruth's Chris acquisition. And for the quarter, adjusted earnings from continuing operations was 10.6% of sales, 30 basis points better than last year.

Looking at our segments. Olive Garden increased total sales by 0.7%, driven by new restaurant growth, partially offset by negative same-restaurant sales of 1.8%. Olive Garden same-restaurant sales outperformed the industry benchmark by 240 basis points and their traffic outperformed the industry by 270 basis points. Despite the negative same-restaurant sales, Olive Garden segment profit margin of 22.5% was flat to last year.

At LongHorn, total sales increased 5.1%, driven by new restaurant growth and same-restaurant sales growth of 2.3%. LongHorn same-restaurant sales outperformed the industry by 650 basis points. Segment profit margin of 18.7% was 130 basis points above last year, driven by pricing leverage and improved labor productivity.

Total sales at Fine Dining segment increased with the addition of Ruth's Chris company-owned restaurants. Same-restaurant sales at both Capital Grille and Eddie V's were negative, as the Fine Dining category continued to be challenged year-over-year. Fine Dining segment profit margin was flat year-over-year at 21.8%.

The Other Business segment sales increased with the addition of Ruth's Chris franchised and managed location revenue, but was partially offset by combined negative same-restaurant sales of 2.6% for the brands in the Other segment. However, this was still 160 basis points above the industry benchmark. Segment profit margin of 14.9% was 90 basis points better than last year, driven by the additional royalty revenues and higher overall pricing related to inflation.

Turning to our financial outlook for fiscal 2024. We have updated our guidance to reflect our year-to-date results and expectations for the fourth quarter. We now expect total sales of approximately $11.4 billion, same-restaurant sales growth of 1.5% to 2%, 50 to 55 new restaurants, capital spending of approximately $600 million, total inflation of approximately 3%, including commodities inflation of approximately 1.5%, an annual effective tax rate of 12% to 12.5%, and approximately 121 million diluted average shares outstanding for the year.

This results in an increase to our adjusted diluted net earnings per share outlook of $8.80 to $8.90, which excludes approximately $55 million of pre-tax transaction and integration-related costs. For the fourth quarter specifically, our annual outlook implies sales of $2.95 billion to $2.99 billion, same-restaurant sales between negative 0.5% and positive 1%, and adjusted diluted net earnings per share between $2.58 and $2.68.

Now, looking forward into fiscal 2025. We plan on opening between 45 and 50 new restaurants, and spending between $250 million and $300 million of capital for those new restaurants. Additionally, we anticipate approximately $300 million of capital spending related to ongoing restaurant maintenance, refresh, and technology. And finally, we anticipated effective tax rate of approximately 13% for fiscal 2025. And now, I'd like to close by saying that we continue to be very proud of how our teams are managing their businesses to deliver strong results in this dynamic environment.

With that, we'll open the call for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. We'll now be conducting a question-and-answer session. [Operator Instructions] Our first question today is coming from Eric Gonzalez from KeyBanc Capital Markets. Your line is now live.

Eric Gonzalez
Analyst, KeyBanc Capital Markets, Inc.

Q

Hey. Thanks for taking the question. Maybe if you could unpack the comments about the low-income consumer pulling back and maybe specifically talking about what behaviors you're seeing that lead you to that conclusion. And how the brands are differing from Olive Garden to Cheddar's to maybe some of the higher-end brands, how that low-income consumer is changing their usage of those brands? Thanks.

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

A

Hey, Eric. We're clearly seeing consumer behavior shifts. Our data shows – our data shows we're essentially back to our normal pre-COVID mix across all income groups. But specifically to your question, for the third quarter, transactions from households with incomes above $150,000 were higher than last year. Transactions from incomes below $75,000 were much lower than last year, and at every brand, transactions fell from incomes below $50,000. Similar to Q2, this shift was most pronounced in our Fine Dining segment.

Eric Gonzalez
Analyst, KeyBanc Capital Markets, Inc.

Q

Great. And then, just a follow-up. If you could just talk about, from a margin perspective, this year has been pretty strong. I'm wondering if you could maybe tease out how much of that margin improvement is related to commodities versus what you've achieved from a productivity perspective. And as you look to next year, do you see that being a year of additional productivity gains or is some of that pulled forward into this year?

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

A

Hey, Eric. This is Raj. So, from a margin perspective, if you look at where – what we talked about at the beginning of the year, we – this was one of the years where we had pricing a little bit above inflation going into the fiscal year. But as the year progressed, inflation came down better – inflation came in better than we expected for both commodities and labor. And then, that combined with our team's strong cost management that improved productivity on the labor front. We also improved our waste. We had some favorability on the mix in terms of how the trading happened between the items. So, all of these were contributors to our margin improvement versus our plan.

Now, as we look at next year, we'll share more details in June, but the way we look at, as we – we're going through the planning process right now, but we'll always use our long-term framework as a guidepost to inform how we think about plan. So, we'll share more details in June and – but we have – if you look back over the last four years, we were underpriced a lot.

Operator: Thank you. Our next question is coming from Brian Bittner from Oppenheimer. Your line is now live.

Brian Bittner
Analyst, Oppenheimer & Co., Inc.

Q

Thank you. Good morning. I wanted to follow up on the lower-income consumer and your comments about this cohort pulling back, because it was a pretty pronounced commentary there. And I know you talked to Eric's question about what you're seeing, but I think this is reflected in your 4Q same-store sales outlook. But do you anticipate this dynamic that you're seeing with the low-end consumer to be powerful enough to impact industry sales throughout the rest of the calendar year? And if so, how are you thinking about updating your strategy to deal with this?

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

A

Hey, Brian. Yeah. We can't determine whether it's going to be impacting the rest of the year. What we can say – what I can say is that impact to the low-end consumer was a year-over-year phenomenon and now we're back to our pre-COVID mix. And so, if you think about where we were before COVID, what percent of our guests were below $50,000, what percent of our guests were below $75,000, et cetera, across all of our segments, all of our brands, it's almost exactly the same as it was before COVID. So, at least that makes us feel like we know how to operate in this environment.

The other thing is, if you look at Black Box, according to Black Box, every segment in the industry, from QSR and up, was negative in same-restaurant traffic in our third quarter, every one of them. So, that's also a year-over-year phenomenon. And so, we'll continue to monitor what we see with the guest and what we see on that lower-end consumer, but we're pleased that it's back to our normal pre-COVID levels. And in respect to marketing, as we've talked about often, we're focused on profitable sales growth, and our brands, all of our segments improved sales and profits for the quarter year-over-year.

And we, even with the increase in competitive activity, we expected – we exceeded, I'm sorry, industry traffic by 270 basis points on top of the 700-basis-point gap we had in Q3 last year, so almost 1,000 points, so 970-point gap in two years. So, we're going to stick to our strategy of everyday value to our guests and continue to use our filters to evaluate any marketing activity. If that means that we're going to spend a little bit more in a quarter or a little bit less in a quarter, that's what we'll do, but we're going to focus on our strategy and stick to it as long as we can. Thanks.

Brian Bittner
Analyst, Oppenheimer & Co., Inc.

Q

And just as my follow-up, as it relates to the third quarter specifically, your ability to manage the margins was very impressive, despite where the comps shook out. Can you just talk a little more specifically, about how you nimbly manage that labor and other operating expense line?

And just Raj, as we look to 4Q, I think you had previously said you expect to underprice inflation by about 150 to 200 basis points in the fourth quarter, is that still kind of the range you want us thinking about pricing versus inflation for 4Q? Thanks.

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

A

Hey, Brian. I'll start with how we manage labor and productivity, and then I'll let Raj answer the question on the pricing. So, if you think about what we've been doing over the years, we've been improving our technology on guest count forecasting by using machine learning and AI tools to help the brands write better schedules and manage their business better. And we're able to react quicker to impacts that we see in our restaurants, but we're also continuing to find ways to improve productivity. And one of the ways and the benefit that we had this quarter is continued improvement in turnover. And so, we've had less training expense for new team members, and we've got better retention, so the team members know how to do their job better.

In the turnover ranks, where we are today across Darden, our turnover went down by about 20 basis points – 20 percentage points versus last year and almost 30 percentage points better than the industry. And now our turnover is much closer to pre-COVID levels, except for Yard House and Cheddar's, which actually we believe are at a level – lower than they've ever had in their history. So, those things help with labor and food costs and other parts of the P&L. And I'll let Raj answer the other part about inflation.

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

Yeah. Brian, for Q4, we're still expecting that gap to be in the 100 to 150 basis points. So, overall inflation is expected to be in the mid-3s for us, and the pricing is probably going to be in the 2% to 2.5%. So, we still expect to underprice inflation by – in that range of 100 to 150 basis points in Q4.

Operator: Thank you. Next question is coming from Dennis Geiger from UBS. Your line is now live.

Dennis Geiger
Analyst, UBS Securities LLC
Q

Great. Thanks, guys. Wondering if you could speak to what you're seeing from a customer average check standpoint, anything with respect to alcohol or other mix contributions that you saw in the quarter or that have changed relative to prior quarters.

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

Yeah. We're actually for the check – for the third quarter, we actually saw the mix moderate from the levels we saw in terms of what we saw in Q2. So, if you look at our casual brands, the negative mix was around 40 basis points. In Q2, it was closer to 60 basis points. And then, from the Fine Dining, we saw a huge improvement. I think, Fine Dining, in the second quarter was north of 200 basis points negative mix. We're now seeing in the low 100 basis points negative mix. So, that's almost half. So, we are seeing some improvement in terms of check mix, and part of that could be a wrap, but also the holidays were pretty strong. And so, that – on that front, we're actually seeing a positive momentum, I guess, quarter-to-quarter.

Dennis Geiger
Analyst, UBS Securities LLC
Q

Great. Thanks, Raj. Just one other quick one. Just as it relates to off-premise, anything to call out there in the quarter, what you're seeing, how your strategy has been effective despite some of the consumer pressures out there on the off-premise side of things? Thanks, guys.

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

Yeah. From an off-premise perspective, our sales as a percent of sales was slightly below last year, but not a lot. This is typically a high season for Olive Garden off-premise. So, Q3 was closer to 26%. Last year was also in that range. We were probably 40, 50 basis points lower, but not a lot. And LongHorn was around 13%, which was also about 40 or 30 basis points lower. But overall, I think it goes back to the execution. Our focus has been staying – on just ensuring that we execute at the highest levels for off-premise, and that's helped contribute to maintaining the stability.

Operator: Thank you. Our next question today is coming from Jon Tower from Citigroup. Your line is now live.

Jon Tower
Analyst, Citigroup Global Markets, Inc. Q

Great. Thanks. I appreciate that. I guess, the first one is – and I understand you guys want to stay true to the operating philosophy. But how do you keep your brands top-of-mind and visible in front of consumers when the industry is getting more aggressive with getting in front of them by spending a lot more dollars than they have in the past several years on marketing?

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

Hey, Jon. If you think about the amount we spend, even with the spending that we had this quarter, Olive Garden in most of the weeks were in the top three in share of voice. And so, we're still in front of our consumer. We have other ways to get in front of the consumer with our eClub and with other digital spend. But at the end of the day, the best way to get people to come into our restaurants is to have guests recommend us to others. And so, that's what we're continuing to focus on.

We will continue to use marketing with our filters to talk about our core equities and to continue to drive results in the long-term. And we do have great everyday value, and what – as we think about what we want to do in the future, I don't want to get into the details, but we have levers to pull, and if we pull them, you'll know after we pull them.

Jon Tower
Analyst, Citigroup Global Markets, Inc. Q

Okay. I appreciate that. And then, just on the 2025 outlook for the unit growth, I was surprised it was lower than at least this year from a gross opening or planned opening perspective. Can you speak to why as of right now, you're expecting kind of 45 to 50 versus what we've been seeing in the past several years?

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

Yeah. Jon, you said it, the new restaurant projection we have for next year, it is within our long-term framework, but it's lower than we'd like it to be. We're going to keep working on getting to the high end of that framework over time, but it will take a little bit of time.

I would say construction costs were quite a bit higher than pre-COVID levels, and we have walked away from some deals, because of the construction costs and they've come back to us after we walked away. And so, we're willing to slow it down a little bit to get a better result in the long-term and – but the good news is, at least the construction cost has stabilized.

The other thing is, it's still taking longer to get construction starts than it was four years ago. It's also taking longer to get to completion than it was in the past. And so, if you think about the time it will take to build a restaurant, it's longer than it was, a lot of that's driven by developers, utilities hook-ups in time for permitting and also time for getting certificates of occupancy.

So, if you think about the time that we have openings, we've got a lot of our openings next year towards the end, which could slip. And that's what we – we just wanted to make sure that we get the number – that we tell you a number that we're going to hit, but we want to get closer to that high end over the long-term. And the other thing is I want everybody to remember, we do include M&A as part of those new restaurants, and we didn't talk about that, but Ruth's Chris, we added 77 restaurants this year. So, it gave us a little bit of a relief valve to not be so aggressive if we didn't need to be aggressive.

Operator: Thank you. Our next question today is coming from David Tarantino from Baird. Your line is now live.

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

Hi. Good morning. Rick, I wanted to come back to the question of how you would manage the business, if the environment were to get worse from here. And in particular, you mentioned you had some levers to pull on. I know you don't want to share details around that, but I was wondering if you could just comment on whether anything would change if things got worse. And then, specifically on the pricing question, just wondering your pricing philosophy in the current environment and whether you will continue to be conservative, relative to your inflation levels.

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

Yeah. David, as we think about the levers we can pull, we have – as we've talked over the years, we brought our marketing down. We've actually focused more on our core equities. And every year, we might take marketing up a little bit, but we're not going to strategic – we're not going to change our strategy. We're not going to become a discount kind of heavily promotional brand. We worked really hard through COVID and before to get to what we think is a better, stable, stronger business for us for the long-term, and we would be willing to deal with short-term pressures to not change our strategy to get to the long-term.

Now, again, we have some tactics that we can do, which would still stick to our strategy, but we're not going to – we don't plan on getting to be a promotional deep-discounting brand. Again, Olive Garden, which had less marketing in Q3 than it did in Q2, while they had less marketing than last year and in the second quarter, our competitors had more, Olive Garden still gained share. And that's what our focus is, is to share gain, sales and profit growth over the time.

We're going to continue to focus on execution, our food, our service, and our atmosphere to increase frequency with our core guests. And we love our core guests. We think they're great for us, and we'll continue to build over time. We're just not going to fight gravity on what's going on in the environment. We're going to stick to what we want to do.

And then, on the pricing side, our strategy is to continue to price below inflation overtime, and we've taken a lot less pricing than the competitive set. We've taken a lot less pricing than CPI, a lot less pricing than full-service, limited-service over the last four years. So, it gives us some room to continue to price, if we need to, but our plan is still over the long-term to price below inflation.

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

Great. Make sense. Thank you.

Operator: Thank you. Next question today is coming from Jeffrey Bernstein from Barclays. Your line is now live.

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

Great. Thank you. My first question, Rick, you mentioned the operating environment tougher than anticipated. Just wondering how would you size-up how much of that is the broader macro versus maybe whether you'd say there were any internal missteps. I mean, I'm assuming, your data is showing that the broader industry pullback was not just Darden in February, that you're seeing – the broader industry see the very same directional trend in February, is that fair to say? Any thoughts there would be great.

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

Yeah. Jeff, I think it's a broader market versus any specific missteps we had. Our gap increased from January to February, our traffic and sales gap increased, both of those increased between January and February. And as I said, every category in the industry, from QSR and up, had negative traffic in the quarter. And so, I think there's a little bit of a bigger challenge, at least a year-over-year challenge for our consumer. And we're going to see how that plays out over the next couple of quarters and see if there's anything we need to change, but it won't be dramatic change.

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

Understood. And then, just to follow up on the February, it sounds like you said it improved, but below plan. Did that underlying consumer weakness persist into March? I mean, I know we're talking about short periods, but February is a short period, and now we're pretty far into March. I'm just wondering whether you've seen any change for the better or the worse.

And just curious from your perspective, because you do have, I believe, up to nine brands now. What do you think drove that change in behavior? Is there anything in particular you're seeing? Because it does seem like January was weather, but then it really was just February and potentially into March. So, I'm just wondering what your perspective is in terms of what drove that pullback. Thank you.

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

Yeah. I would say, first of all, our guidance contemplates everything we know about March. So, I don't want to get into March. We have lot of challenges forecasting three weeks in a month, when you've got spring break shifts and those kind of things happen. And so, we're going to continue to watch. I think, I've read a little bit on tax returns being a little bit delayed, but we're not going to read too much into that. We improved our gap between January and February. And so, that's what we feel good about, we're not going to talk about March yet.

Operator: Thank you. Next question is coming from Jeff Farmer from Gordon Haskett. Your line is now live.

Jeffrey D. Farmer
Analyst, Gordon Haskett Research Advisors
Q

Great. Thanks. Just following up on Jeff's question there. So, again, you had made some references to lower-income consumer, but in terms of thinking about just maybe a little bit softer trends than you had expected, how much of that would you put at the feet of the lower-income consumer as opposed to the balance of potential drivers?

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

A

Yeah. I would say that if you think about our results being a little bit softer than we thought, I would put it more at the feet of the lower-end than the higher-end. Our higher-end consumer was up versus last year. So, that would tell you that it was really more on the lower-end consumer. But as I think about what the consumer trends are, I just want to remind everybody, that we believe that operators that can deliver on their brand promise with value, can continue to appeal consumers despite economic challenges, and that's what we're going to continue to focus on doing.

I remain confident that we're well positioned and prepared for whatever we have to deal with. Thanks to the breadth of those nine brands that Jeff talked about, the strategic decision we made to price well-below inflation and CPI over the last four years, and those outstanding team members we have in our restaurants, who are committed to create exceptional guest experiences for our guests. And so, yeah, the lower-end consumer probably drove a little bit more of our miss to what we thought when we talked to you before, but we're going to continue to focus on what we do and take care of every guest that walks in the door the best that we can to have them to come back.

Jeffrey D. Farmer
Analyst, Gordon Haskett Research Advisors

Q

And then, the second question, you just touched on, you gave me a pretty good segue there. But in terms of your more conservative pricing strategy relative to your peers, from what you've seen, has that driven traffic outperformance, market share outperformance? Is that strategy actually pay dividends to these customers, casual dining customers? Appreciate that the Darden brand portfolio is actually a better price value than lot of other concepts from what you've seen.

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

A

Yeah, Jeff. I think if you look at our gap over two years, our gap to the industry, as I said, being almost 1,000 basis points – I'm sorry, yeah, 10% gap over the three years, it's been strong, and that's what we do. We're taking this price below inflation, having a great everyday value, and we think over the long-term that continues to build the value differential we have. We've got value leaders across and that helps build the traffic gap.

Jeffrey D. Farmer
Analyst, Gordon Haskett Research Advisors

Q

All right. Thank you.

Operator: Thank you. Next question today is coming from Andrew Strelzik from BMO Capital Markets. Your line is now live.

Andrew Strelzik
Analyst, BMO Capital Markets Corp.

Q

Hey. Good morning. Thanks for taking the questions. I wanted to ask about industry capacity, particularly given what you're talking about with more challenged kind of traffic backdrop. And I think initially, during COVID, Darden talked about maybe a 10% decline in locations, because of closures. And it feels like from a lot of the public companies we hear from, there's a desire to accelerate unit growth or has been, and not exactly sure what's going on in the independent side. So, I guess, I'm just curious, if you have a sense where capacity is now versus that 10% reduction. Are you seeing it come back in any of your markets or any specific regions, and maybe if you could touch on the independent side as well? Thanks.

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

Andrew, I think we're still in that ballpark of 10-plus-percent, but if you actually look at the last year or so, there have been more closures than openings from the data we've seen. So, net – there's net closings even in the last 9, 12 months data that we're looking at. When you think about the environment today, with all the regulation around where things are, it's very hard for someone to open a new restaurant. The financing costs have gone up. There is less developments happening, that's actually part of the reason we talked about some growth being constrained a little bit in the near-term for us on the unit opening. So, we would say, it's not that different, it has not gotten much better, maybe let's put it that way.

Andrew Strelzik
Analyst, BMO Capital Markets Corp.
Q

Okay. Great. And then, maybe on your unit growth expectations for next year, just curious where we should expect the fewer openings to come from, I guess, does it just match based on the size of the portfolio or any of the brands in particular? Thanks.

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

Yeah. I would say, assume that a two-thirds of the growth is going to be come from Olive Garden and LongHorn combined, and then the rest is – a third is from all the other brands. I don't know that we would say there's a huge difference year-over-year. It's a little bit of a change, but as we look forward, as Rick said, we'll continue to try to get that ramped up further.

Operator: Thank you. Next question is coming from John Ivankoe from JPMorgan. Your line is now live.

John Ivankoe
Analyst, JPMorgan Securities LLC
Q

Hi. Thank you. I remember in past periods, there were number of things that you've done that aren't necessarily operationally difficult and I don't think overly discounts the brands, things like dinners for two, buy one take one, maybe even highly targeted couponing to certain lower-income consumers to bring them back. Those types of things did prove effective to the Darden of the past. I mean, I wonder if ideas like that are on the table. It's the first part of the question.

And secondly, a lot of the higher-income consumer, obviously, is kind of getting more price-resistant about some of the restaurants that they visit. Is there a way to invite some of the higher-income consumer maybe through different types of promotions back into Olive Garden as well that you haven't been doing in the past couple of years? Thank you.

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

Hey, John. Yeah. That was – the deep discounting, couponing, lot of promotions was kind of a Darden pre-COVID. This is the Darden post-COVID, which is, when we're talking about marketing, being things that elevate brand equity that are easy to execute, and they're not at a deep discount. It doesn't mean that we won't have price points on things over time, but that's kind of more of our everyday low price or around that price. You think about Never Ending Pasta Bowl, we ran that this year at $13.99. It was a great promotion for us, and that was at $13.99. So, we can think about doing those things again next year with Never Ending Pasta Bowl. We already have Buy One, Take One on our menu, basically, with the $6 take homes. So, there's a lot of everyday value already.

In terms of kind of talking to the higher-end consumer, as I mentioned, we actually grew at the higher-end consumer at all of our segments. The $200,000-plus, $150,000-plus was up year-over-year. But I think you could see a little – a few signs of some consumers trading down within our brands. When you think about LongHorn did really well with – as they grew even at a little bit – at the high-end consumer at a little bit lower, the $150,000, $125,000, and they had actually positive check.

And so, we're seeing some of that shift in some ways. And so, we think as long as we execute great and we have great word of mouth, that will get that higher-end consumer maybe to trade to one of our brands from someone else, even if it trades from one of our current brands to one of our brands, that's fine with us, too. But again, long-term, every day, talk about what our core equities are, execute better than the restaurant next door, and we'll win, and we'll deal with short-term challenges.

John Ivankoe
Analyst, JPMorgan Securities LLC

Q

And is the company discussing kind of reintroducing or at least thinking about a more effective way to approach loyalty? I mean, is that something that becomes table stakes in 2024 and 2025 or are we happy with the current approach?

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

A

You know we're happy with the current approach. If you think about loyalty and full-service restaurants, frequency isn't super high, and we've learned that when we did loyalty before. And so, it's a little bit less valuable for our consumer, we believe. Now, there's other ways to get that data. The value of loyalty is the data that you get and we have other ways to grab that data. Doesn't mean that we won't think about loyalty in the future. We're just focusing on what we can do right now to continue to execute better to drive results and not to drive something that's just buying sales, because we'll have to keep buying it next year and the year after that. We don't want to go out and buy sales. We want to go out and earn those sales.

Operator: Thank you. Next question today is coming from Danilo Gargiulo from Bernstein Research. Your line is now live.

Danilo Gargiulo
Analyst, Bernstein

Q

Great. Thank you. So, first of all, it appears the LongHorn weather these challenges of this tough operating environment better than other brands. So, I'm wondering what caused that and what learnings could be applied to the other brands?

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

A

So, Danilo, I think as we talked about in the past, there's lot of things, right. First of all, let's start with the big picture. We've talked about how, in general, steak does a little bit better when beef prices are higher just because of the relative gap between the consumer would rather not take risk on cooking something that's expensive. So, let's start with that big picture. With that said, within the steak category, not everybody is winning. So, if you look at LongHorn, our performance has been driven by our execution. We talk about the simple operations, quality – investments in quality.

So, our team, Todd and the team have done a great job over the last four years, continuing to invest in the food and in service. And so, if you look at overall, you get a better value today than you ever did. So, if you look at their pricing has been a lot lower in the industry versus the industry, and especially for the steakhouse, their pricing has been much lower than the competition. So, the value equation is much better and a great execution. Really, those are the two things.

Danilo Gargiulo
Analyst, Bernstein
Q

Great. Thank you, Raj. And I want to follow up on one of the comments that Rick was just making on, the level of attraction of your customers over the long period of time. And I wonder, if you can provide some updates on your customer trends with regards to the frequency at which they are spending in your brands? And maybe if you can offer also some insight on the size of your eClub members today versus the past, and the total addressable market that you have? So, how many customers you're seeing on a monthly basis at any of your brands?

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

Well, let me start by saying, I think we serve about 1 million guests a day across all of our brands, so – or more than that actually. And so, we get a lot of people coming in. Our frequency hasn't dramatically changed over the last year, and our eClub is roughly between 25 million and 30 million guests, that's active eClub. We have more members, but they're active. And so, we have ways to communicate with that and that's across all of our brands. And so, we're really confident now that we've got our, as I said earlier, on the income demographic back to where we were pre-COVID, we know how to operate in that environment. We're seeing some shifts at the above 65-years-old and we've talked about that before. They're shifting a little bit more to lunch, a little bit earlier to dine, and that's great, but – so those are the only real major shifts we've seen.

Operator: Thank you. Next question is coming from Sara Senatore from Bank of America. Your line is now live.

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

Great. Thank you very much. Just a couple clarifications, please. The first is in terms of the gap in the industry. I know you mentioned that it widened from January to February, but I was curious if – it's also been – have been widening before that from the fiscal 2Q to 3Q. I think, historically, the gap has tended to widen when trends – industry gets tougher, because of that sort of more selective consumer, but I wanted to see if that was the case kind of stepping back.

And then, the other question I have is, obviously, you've gotten a lot of questions about the low-income. I wanted to understand how perhaps this normalization will serve as a headwind in the coming quarters. So, for example, you're back at the pre-COVID levels now. Does that continue to be a bit of a headwind for the next three quarters until you lap this quarter? And are you thinking about offsets in the form of better mix. So, perhaps that normalization continues to show up from a traffic perspective, but – by the same token, less of a mix headwind. Thanks.

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

Okay. Let's start with the gap itself. So, if you look at the gap, in January, the gap narrowed a bit, we think primarily because of the geography and the footprint we have that has disproportionately impacted by weather. If you look at the concentration of where the weather was, that was a higher concentration of our restaurants, and we think that's part of the reason the gap was not as strong.

Now, the other part of this gap narrowing this quarter related to the last quarter was the fact that we're wrapping on huge gap from a year ago. We had a very strong performance a year ago. So, that's really how we would kind of frame that. We're not – look, we've been clear that it's very hard to maintain multiple hundreds of basis points of gap forever. We're going to have that narrow over time. But things we've done with our pricing and our value equation have helped us continue to take share and we're happy with that. And as Rick said earlier, in an environment when there was intensity in promotional intensity, more so than ever, we still outperformed and we were able to gain share. So, that's the piece on the industry.

Now, as you look at the income mix, yeah, we – so, this has been an ongoing shift. So, we've talked about in Q2 that we're starting to see a shift a little bit more towards the pre-COVID mix. So, we are – so, as we wrap, as we looked at Q4 now, the Q3 that just ended, we were right essentially where we were before COVID. So, yeah, the next three quarters, there's a little bit of moderation of getting that, but it's not as big as it was this quarter. If you think about – we don't think, I mean, we'll have to see. But based on the data we have, what we are seeing, it should be – it should moderate, but we would expect the next two to three quarters to kind of get back to those levels.

From a mix perspective though, [indiscernible] (00:48:32), we actually think mix is going to get better. We expect mix to continue to moderate. I think, I mentioned already that Q2 to Q3, we saw an improvement. As we get into Q4, we should see that get better, and as we get into next year, we expect this to be not a huge headwind. And we'll see how that plays out, but that's our best thinking at this point.

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

Okay. Thank you very much.

Operator: Thank you. Next question today is coming from Gregory Francfort from Guggenheim Securities. Your line is now live.

Gregory Francfort
Analyst, Guggenheim Securities LLC
Q

Hey, guys. Thanks for the question. A lot of what I wanted to ask was asked, but I wanted to ask you about the commodity outlook and thoughts into the fourth quarter. Maybe what's implied in risks to the upside or downside on that going forward? Thanks.

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

Hi, Greg. Sorry. As far as the – on the commodity side, if you look at where – what we expect, we expect third quarter to be around – the implied guidance would be around 3% for commodities inflation. And part of the reason it's going up relative to where we've been is that everything except for seafood is inflationary as we move into the fourth quarter. Now, not huge, but as you look at beef and produce are more in the mid-single to high-single-digit inflation, and then most other categories are in low-single-digits. So, a little bit of that is just a comparison to last year, a function of the levels last year.

But from a coverage point, we're at 75% covered for Q4, which is consistent with historical average levels, and I think on beef, we're actually 80% covered for Q4. As far as – as we look into 2025, as I said earlier, we're in the middle of planning process for next year. So, we'll be able to share more in the June call, but I think at this point, we are working through some contracts for next year. So, I would hesitate to share a lot at this point.

Gregory Francfort
Analyst, Guggenheim Securities LLC

Q

Thank you for the perspective.

Operator: Thank you. Next question is coming from Patrick Johnson from Stifel. Your line is now live.

Patrick Johnson
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Great. Thanks. Good morning, guys. Rick, I wanted to touch on menu innovation, particularly at Olive Garden and LongHorn. And I'm just curious, if there are any opportunities you see to either introduce permanent menu items that still align with the brand strategy or even if there's potential to create limited time platforms, like Never Ending Pasta Bowl, that aren't necessarily discounted, but could drive incremental interest in visits over time?

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

A

Yeah, Patrick. There's always room for menu innovation. We've got to balance innovation and new items with improving our existing items, and making sure our menu stay compact and simpler than they were before COVID, and there's also always room for kind of limited time, not necessarily promotional offers. So, currently, LongHorn has lamb on their menu and it does really well. It's doing a lot better than it did last year. And with brands like Cheddar's, we use opportunity buys to put some items on the menu, but at really great values. And Olive Garden is continuing to look at ways to improve some of their items and maybe introduce an item, but take off an item.

So, yeah, we still have a lot of work that we do with innovation. But most of our guests come to us for what we have on our menu today and we're not going to alienate the core guest by completely changing those menus around, and we don't plan on getting back to a six or seven-week promotion where an item is great. It does great for six weeks, and then the guest comes back in week 10 and it's not there anymore. And so, we'll continue to innovate, but we'll continue to innovate a lot more on improvements, but we'll introduce new items here and there.

Patrick Johnson
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Great. Thank you, guys.

Operator: Thank you. Next question is coming from Lauren Silberman from Deutsche Bank. Your line is now live.

Lauren Silberman
Analyst, Deutsche Bank Securities, Inc.
Q

Thank you very much. A few follow-ups. Can you just talk about the same-store sales differences that you're seeing across regions? And then, from a marketing perspective, you're now running less than 1.5% of sales this year, well-below pre-COVID at 3% or even north. So, I understand you want to be prudent and protect long-term, but why is this the right level of marketing spend today? How do you assess it, even if it's not deep discounting?

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

Yeah, Lauren. So, from a regional perspective, we continue to see softness in Texas and California. I think Texas, pretty much throughout the year, we had seen weakness and that continues to be the case. Florida was a little weaker, but nothing crazy. But you also had the weather impact that probably disproportionately impacted both Texas and California during Q3. Different types of events, but weather there. So, that's the regional.

From a marketing perspective, we've been very clear that, look, we're going to be prudent. We're going to be very deliberate in how we bring back marketing. We've learned a lot in terms of the effectiveness of marketing in different channels, how we deploy it. And we've talked about bringing it back at a level that's more methodical in terms of 10 to 20 basis points increase over time in a way that's margin neutral, all else being equal. So, that's kind of really what – how we're thinking about it, and we have done a lot of work. We continue to do a lot of work on marketing mix analysis and we got our teams of data scientists internally, and work with some external partners to ensure that we're getting that appropriate return, and it's actually being effective the way we want it to be, which is to elevate brand equity and build long-term guest loyalty.

Lauren Silberman
Analyst, Deutsche Bank Securities, Inc.
Q

Thank you. And then, if I can just on the guide, lower sales maintained or increased the lower end of the guide, inflation more favorable. Any other puts and takes in the guide for the year? And then, can you just clarify what you're expecting for the full year on G&A? Thank you.

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

Yeah. Let me start with the G&A. We expect G&A to be pretty similar to what we said last time, $440 million I think is what we said for last – in the last quarter. So, call it, roughly $100 million for Q4.

Look, I think the big things are, we've obviously brought down some sales expectation, but inflation is better. And then, our teams are doing a better job managing our business. So, there is some improvement in productivity, improvement in other waste and other types of inefficiencies. But outside of that, nothing that's not outside of those few items that I've just mentioned.

But if you just step back and look at what we – where we started the year, right. If we look at the beginning of the year, we said earnings guidance was $8.55 to $8.85. And we said, to the extent sales slowdown or we see weakness in sales, we should see inflation come down and our cost management continue to help us get us closer to that. And today, we're talking about earnings guidance of $8.80 to $8.90, now with a lot lower sales, but we got there through other wins. So, again, I don't want to say we said, we told you, but it's just – that is reality. That's what happened.

Lauren Silberman
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you. Appreciate it.

Operator: Thank you. Next question is coming from Peter Saleh from BTIG. Your line is now live.

Peter Saleh
Analyst, BTIG LLC

Q

Hey. Great. Thanks for taking the question. I apologize if I missed this, but I know you guys commented on the traffic softness for the lower-income consumer and maybe by cohort. But can you maybe discuss the behavior of those consumers in terms of their check management. Are you seeing a lot of trade down for the consumers that are coming in within the menu or within brands, are they cutting alcohol or appetizers or desserts, or just anything that suggests that those consumers that are coming in are also managing that check down? Thanks.

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

A

Yeah. Interestingly, from a check management perspective, it's not as much driven by income. The gap is more driven by older consumers, especially 65-plus is managing the check a little bit more, irrespective of their income is what we're seeing, and they are also – I think, Rick mentioned earlier, they're shifting more to lunch. So, we're seeing a couple things. They're getting a little bit less add-ons, but also managing the check. But also, like I said earlier, from Q2 to Q3, it's actually less management of check. Now, with a little bit less traffic, but that's – but what's happening is check management is actually getting better. In terms of negative mix, it's not as big as it was in Q2.

Peter Saleh
Analyst, BTIG LLC

Q

Thank you very much.

Operator: Thank you. Next question is coming from Brian Vaccaro from Raymond James. Your line is now live.

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

Q

Hi. Thanks and good morning. For my question, and sorry if I missed it, but could you share what traffic in the quarter was for Olive Garden and LongHorn? I know that's usually in the Q, but did you or can you share that?

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

A

Yeah. Sure. Olive Garden check was 2% in the quarter. So, basically, traffic would be negative 3.8%. And then, LongHorn traffic was in the mid negative 2s.

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

Q

Okay. Thank you for that. And I guess, you've had this question a couple times, but I'll ask it this way. In an environment where you're seeing softness on the lower-end consumer and maybe there's just a broader backdrop where value seems increasingly important, I guess, it's interesting to see Olive Garden's relative comp outperformance narrow, given the brand's strong everyday value positioning. So, I guess, how do you reconcile that, and is there any evidence that you're starting to see some profitable guests to certain brands, not asking for names, but certain brands that are gaining share or have shifted their tactics in the last year?

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

Yeah, Brian. If you think about Olive Garden. So, as Raj said, Olive Garden exceeded the industry benchmark for same-restaurant traffic by 270 basis points. They spent less in media at a time when many of their competitors ramped up discounts on television. So, they exceeded by 270 basis points with less media and when others were ramping up. Their two-year gap is 830 basis points. So, that's a big share gain over two years. So, I'm really proud of the work that Dan and his team have done to improve the guest experience.

They continue to focus on their key equity of never-ending, craveable, abundant Italian food, specifically focusing on ensuring every guest is offered to refill on their never-ending first course, and that's a huge value. I can't tell you if an Olive Garden guest has shifted over to one of those competitors, but I can tell you that we trade guests all the time. Some of our biggest – Olive Garden's biggest competitors are the ones that are doing some of the discounting today. And so, we're really proud of the 270-basis-point gap on top of the gap they had before. And if we're seeding a profitable guest, I don't think it's a seed forever, it's just because people shift and they move around. And so, we're going to keep focusing on what we can do to keep our guests coming back for one more visit.

Operator: Thank you. We've reached the end of our question-and-answer session. I'd like to turn the floor back over to management for any further or closing comments.

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

Thank you. That concludes our call. I'd like to remind you that we plan to release fourth quarter results on Thursday, June 20th, before the market opens, with the conference call to follow. Thanks again for participating in today's call and have a great day.

Operator: Thank you. That does conclude today's teleconference and webcast. You may disconnect your line at this time and have a wonderful day. We thank you for your participation today.