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Darden Restaurants, Inc. (DRI)

Q2 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the Darden Fiscal Year 2018 Second Quarter Earnings Call. Your lines have been placed on listen-only until the question-and-answer session. [Operator Instructions] This 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 Director, Corporate Analysis & Investor Relations, Darden Restaurants, Inc.

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

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

We are simultaneously broadcasting a presentation during this call, which is posted in the Investor Relations section of our website at www.darden.com. Today's discussion and presentation include certain non-GAAP measurements and reconciliations of these measurements are included in the presentation. We plan to release fiscal 2018 third quarter earnings on March 22 before the market opens, followed by a conference call.

This morning, Gene will share some brief remarks about our quarterly performance and business highlights, and Rick will provide an update on our financial results and outlook for the year. During today's call and for the remainder of this fiscal year, all references to Darden's same-restaurant sales only include Darden's legacy brands since Cheddar's Scratch Kitchen restaurants are new to Darden.

Now I'll turn the call over to Gene.

Eugene I. Lee

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

Thanks, Kevin, and good morning, everyone. Let me start by saying I'm very pleased with our performance during the quarter. Our teams did a great job managing through some difficult circumstances recovering from the hurricanes. Total sales from continuing operations were $1.88 billion, an increase of 14.6%; same-restaurant sales grew 3.1%; and adjusted net earnings per share were $0.73, an increase of 14.1% from last year's diluted net earnings per share.

Given our consistent positive results, I am more convinced than ever that our success has been driven by the strategy we implemented three years ago. Our intense focus on improving the food, service, and atmosphere in our restaurants, combined with relevant integrated marketing, remains a winning strategy for our brands. The long-term investments we have made and will continue to make in these areas are paying off, and we will work hard every day to better execute in these critical areas.

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This back-to-basics operating philosophy is coupled with Darden's four competitive advantages: one, leveraging our significant scale to create a cost advantage; two, using extensive data and insights to improve operating fundamentals and to better understand our guest and communicate with them more effectively; ensuring our brands systematically go through a rigorous strategic planning process; and four, cultivating our results-oriented people culture to enable growth. Together, our operating philosophy and competitive advantages give me confidence in our ability to continue to deliver our long-term framework over time.

Turning to Olive Garden, same-restaurant sales grew 3%, outperforming the industry benchmarks excluding Darden by 400 basis points. This was Olive Garden's 13th consecutive quarter of same-restaurant sales growth driven by our focus on simplification and flawless execution, which continues to result in high guest satisfaction scores – our promotional strategies and core menu working together to create everyday value and drive increased frequency for our most loyal guests and our strong ToGo performance which grew 12%.

During the quarter we ran our two most popular value promotions: Buy One Take One, which appeals to our guest need for convenience; and Never Ending Pasta Bowl which highlights our brand pillar of never-ending abundance. Both promotions leveraged brand equities and were supported by strong integrated marketing campaigns highlighted by Olive Garden's most anticipated event of the year, the Pasta Pass. This year, in addition to making 22,000 Pasta Passes available, we introduced the first of its kind Pasta Passport, which included all the benefits of the Pasta Pass plus a trip of a lifetime to Italy.

Once again, all Pasta Passes were claimed online immediately. The volume of social media and PR buzz surrounding this event illustrates the strong emotional connection our fans have with the Olive Garden.

LongHorn Steakhouse had a strong quarter as the investments we've been making for the last two years are significantly improving consumer perceptions and motivating guest to visit more frequently. Same-restaurant sales grew 3.8% outperforming the industry benchmarks excluding Darden by 480 basis points. This was LongHorn's 19th consecutive quarter of same-restaurant sales growth.

The emphasis LongHorn's leadership has placed on simplification like reducing their menu items by nearly 30% has led to higher levels of execution. At the same time, they continue to enhance the quality of the guest experience with strategic investments in food, service, and atmosphere.

As I mentioned last quarter, same-restaurant sales in LongHorn's new markets continue to grow at a higher rate than in the established markets. Consumers in these new markets are discovering what makes LongHorn special while at the same time fully realizing the value proposition that inherently exist in the brand. This performance trend is not new to LongHorn. We have seen it play out over the past 20 years as I have been associated with the brand.

Now I'll update you on the Cheddar's integration. The Cheddar's team is doing a great job managing the complexity of this integration which also includes integrating their two largest franchisees, which were recently acquired. Merging three different operating systems into the Darden network isn't easy but it's going exactly as planned. We are at an important point in the integration progress as we transition from planning to execution.

Integration-related activity is peaking as we transition distribution networks including our mainline distributor, produce suppliers, and smallware suppliers, convert point-of-sale systems in 10 restaurants per week which also includes two weeks of training per restaurant prior to the conversion, fully transition Cheddar's payroll system onto the Darden payroll platform, and finally, we just completed open enrollment and Cheddar's team members will be transitioning to Darden benefits at the beginning of the calendar year.

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It is our intent to integrate Cheddar's and the two acquired franchise systems as fast as possible in order to position their brand to take advantage of the scale, synergies and other benefits of the Darden infrastructure. We realize that this is having a short-term negative impact on sales momentum, but we believe the long-term benefit will far outweigh the short-term impact. Rick will provide an update on synergies in his remarks in just a moment.

I want to thank the integration team for their outstanding work on this project. They have developed a comprehensive plan and are executing that plan at a high level. The more we learn about Cheddar's, the more excited we become about the long-term growth prospects. They are the undisputed value leader in casual dining with a large, loyal guest base and average approximately 6,300 guests per week per restaurant.

Let me close by saying the holidays are the busiest time of the year for our restaurant teams as they help our guest celebrate with coworkers, family and friends. On behalf of our management team and the board of directors, I want to thank our 175,000 team members for all you do to create memorable guest experiences during this special time of the year.

We remain focused on getting better every day, and I look forward to making even more progress in the year ahead. And now I'll turn it over to Rick.

Ricardo Cardenas

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

Thanks, Gene, and good morning, everyone. We had another strong quarter with total sales growth of 14.6% driven by 11.5% growth from the addition of 153 Cheddar's and 28 other new restaurants and same-restaurant sales growth of 3.1%.

Second quarter adjusted diluted net earnings per share from continuing operations were $0.73, an increase of 14.1% from last year's earnings per share. We paid $78 million in dividends and repurchased $89 million in shares. In total, we returned approximately $167 million of capital to our shareholders this quarter and $346 million fiscal year-to-date.

Turning to this quarter's P&L, restaurant level EBITDA margin was 20 basis points higher than last year as cost savings and leverage from same-restaurant sales growth more than offset overall inflation pressure and the addition of Cheddar's, which I'll refer to as brand mix. Adjusted EBIT margin was flat as G&A expense as a percent of sales was 20 basis points higher than last year due to an unfavorable outcome in a legal matter this quarter. Excluding this matter, G&A would've been favorable by 10 basis points. This unfavorability in G&A was completely offset in income taxes due to the resolution of certain prior-year matters. So for the quarter, our adjusted EBIT margin increased 10 basis points versus last year.

Looking more closely at the details, food and beverage costs were favorable by 20 basis points as pricing of approximately 1.5% and cost savings more than offset commodity cost inflation of just under 1% and our continued investments in food quality. Restaurant labor was unfavorable by 30 basis points compared to last year due to Cheddar's brand mix. Restaurant labor in our legacy Darden brands was in line with last year due to continued productivity gains and sales leverage despite inflation of about 4%.

We opened more restaurants this quarter than the same period last year, which increased our pre-opening expenses. As a result, restaurant expense as a percent of sales was unfavorable 10 basis points versus last year. Marketing expense was favorable by 40 basis points due to sales leverage and favorable brand mix from Cheddar's.

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Finally, G&A expense was unfavorable by 20 basis points due to the legal outcome I mentioned previously. Olive Garden, LongHorn and Fine Dining segment, all grew sales in the quarter driven primarily by strong same-restaurant sales. Segment profit margin increased in each of these segments by leveraging the same-restaurant sales growth and managing costs effectively, while still investing in a great guest experience.

Looking at the Other business segment, sales grew 71.7% mainly due to the addition of Cheddar's, as well as same-restaurant sales growth at Yard House and Bahama Breeze. Similar to last quarter, segment profit margin was 200 basis points lower than last year due to the brand mix impact of adding Cheddar's and from moving consumer packaged goods out of this segment, primarily to Olive Garden.

Turning to the Cheddar's synergy update, we continue to expect total run rate synergies of between $22 million and $27 million. Based on the speed of integration and the great job our teams are doing to realize these synergies, we expect to achieve them a little faster than we originally anticipated. We now project to realize just under $10 million in synergies in the current fiscal year and achieve our targeted run rate no later than the middle of fiscal 2019 instead of the end of fiscal 2019.

And finally, this morning, we increased our full year fiscal 2018 outlook. We now anticipate same-restaurant sales growth of approximately 2%; new restaurant growth of approximately 40, and total sales growth of approximately 13%. Each of these are at the high-end of our original annual outlook.

Our full-year adjusted diluted net earnings per share from continuing operations are now anticipated to be between $4.45 and $4.53. This is an increase from our previous outlook of $4.38 to $4.50. We are anticipating an effective tax rate of approximately 25% and a diluted average share count of approximately 126 million shares outstanding for the year.

Please note, this outlook does not contemplate any potential impacts from the pending tax legislation. Based on the information we know today, we anticipate that the tax legislation will have a benefit to us in terms of our effective tax rate going forward.

Also, in the quarter the bill is enacted, we are required to revalue our deferred taxes. Since the bill has not received final approval, there are still many details we must analyze. And we will reserve comment on the specific impacts to our tax rate overall. Given the complexity of the pending legislation, we will not be providing any other detail in the Q&A session.

Again, neither the expected reduction to our effective tax rate nor the one-time deferred tax adjustments are included in the outlook we updated today. We plan to update our fiscal 2018 outlook in early January to reflect the impact of tax legislation.

In closing, I want to wish you all a great holiday season and hope you will celebrate with family and friends in one of our restaurants. And with that, we'll take your questions.

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QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the question-and-answer session of today's conference. [Operator Instructions] Our first question comes from Brett Levy from Deutsche Bank. Your line is now open.

Brett Levy
Analyst, Deutsche Bank Securities, Inc.

Q

Good morning, and thank you. Can you share a little bit color on what you're seeing across the competitive landscape? Obviously, you're still generating significant market share gains, but the rate of growth seems to have slowed a little. Where are you seeing pockets of – I'd hesitate to use the word weakness? And also just one quick question on tax. I know you said you won't say much, but are you under the impression that there will be no change to tip credit, how it impacts casual diners? Thank you.

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

A

Brett, as Rick said, we are making no further comments on the pending tax legislation. We will update our guidance in January once the bill is passed. So for everybody out there that wants to ask us a question on it, we're not going to answer them.

As far as the consumer landscape, I think you're referring to that our gap to that may have – or gap to the benchmarks may have shrunk a little bit, and we've been pretty clear. And we said, we prefer to operate in an environment with a stronger industry. And if our gap shrinks a little bit, that's okay with us.

As I said in my prepared remarks, I think we had a great quarter considering everything that transpired. We saw strength in all our businesses. We started in a pretty big hole in September. I think it feels pretty good out there. I would say, when I look at the benchmarks, I'm seeing about 3% growth in what the consumer is paying. So I don't feel as though the environment is all that promotional right now. They could be getting that in a couple different ways, whether getting it through price or mix. But I feel like it's fairly positive out there right now, and I just feel good. I think the consumer is using the whole menu. They're not all that reactive to what people are doing from an incentive standpoint. So it feels good.

Brett Levy
Analyst, Deutsche Bank Securities, Inc.

Q

And just one follow-up. Your guidance raise on both the top line and the comp, is that implying just what we've achieved so far in the first half of the year? Or is there something that you are seeing in the second half that's given you greater confidence? Thank you.

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

A

Hey, Brett. It's Rick. The guidance implies what we know for the first half of the year, and just some estimates that the economy or the industry is not going to get much better. We don't assume that it's going to get better until it gets better. So the guidance we have given is prudent based on where we are today.

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Brett Levy
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you.

Operator: Our next question comes from David Palmer from RBC Capital Markets. Your line is now open.

David Palmer
Analyst, RBC Capital Markets LLC

Q

Thanks. Good morning. Just I'm thinking ahead to calendar 2018. I'm struggling a bit to create an outlook for what the casual dining industry same-store sales would look like for that year. And, obviously, given the fact that you have an empire that slices across various concepts and you can see how the consumer is behaving across the menu, this is an easier comparison quarter for the industry than what we'll have perhaps coming up. Do you feel like this is a sustainable improvement that's going on lately? And is there any tea leaves that you can see in terms of behavior that gives you confidence that there is an improvement going on even before tax reform? Thanks.

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

A

Good morning, David. When I look over the landscape, the brands that are well-positioned, that have strong value equations are continuing to take share. This is approximately $100 billion category that has been growing approximately 2%. And for those that are well-positioned, I feel like they're going to continue to do well. If your value proposition's a little off and your offering is not resonating with the consumer, it could be a struggle. I think focusing on the overall industry benchmarks is somewhat dangerous because there's been such deviation in the performance of the people that are doing well compared to the people who aren't.

So I can't comment and give you guidance on what we think calendar 2018 might look like. We've given you what we think our guidance is for the back half of our fiscal year. We always get a little nervous in December, January, February and March because weather is out of our control. We can't control that. And if we have a bad winter, that could put pressure short-term on our same-restaurant sales. We don't think that has any impact on the overall momentum of the business. So, as I said earlier to Brett's question, we feel pretty good about how the consumer is reacting to our brands right now.

David Palmer
Analyst, RBC Capital Markets LLC

Q

Thank you.

Operator: Our next question comes from John Glass from Morgan Stanley. Your line is now open.

John Glass
Analyst, Morgan Stanley & Co. LLC

Q

Thanks very much. Rick, maybe first, can you just maybe split the guidance to your previous expectations? You've raised sales expectations for both units and for comps, and you raised earnings, but it would seem like tax and share count were responsible for that. But you're also observing some hurricane impact. So, are those the right puts and takes? Or how do you – is there anything else that moves, for example, in G&A or something that's not explained by that?

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

A

Yes, John, a couple of things. One, as I said earlier, we did have a little bit of a legal settlement that we had this quarter – not a settlement but an outcome that we had this quarter that we didn't anticipate. As we talk about the G&A – I'm sorry, G&A, cost of sales, and food and beverage, we're still saying that our cost inflation in total is going to be about 2% when you include labor. But every tenth that that moves is about $0.03 a share. So we're still seeing approximately 2%. It's just closer to the – right at the 2% than maybe a little lower than the 2%.

And also, we're going to continue to invest in our consumer and invest in value. So, as we've said before, if we do get some incremental revenues, we may have some of that that we hold back and invest in our consumer for the long-term. So, that's why we still believe that the high-end of our range at $4.53 is the right place to be even though we did increase our sales and we did have a little bit of benefit in tax, which was offset in legal.

John Glass
Analyst, Morgan Stanley & Co. LLC

Q

And you, last quarter, talked about being conservative in pricing in the middle of the 1% to 2% range. You've been a little bit higher than that at Olive Garden, maybe at, but maybe slightly above it although lower in LongHorn. So, can you maybe just update what your thoughts on pricing are? If the industry is better, do you feel like that gives you a little more license to be a little higher in that range? Or do you still want to maintain that lower than competitors' value proposition?

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

A

Yes, a couple of things. One is o0ur long-term framework and algorithm has always had – and our strategy of leveraging Darden's cost advantage, we've always said that we want to price below our competition, which generally prices at inflation. Even if inflation goes up and competitors start to price, we believe that somewhere in that middle of – between the 1% and 2% is the right place to be. And Olive Garden, you mentioned it, I think it was at 1.7% this quarter, LongHorn was below 1% this quarter. Even though our commodity cost inflation was 1%, Olive Garden had much more inflation than LongHorn because of dairy. So, as we think about Olive Garden over the year, it's also a timing thing. We still think Olive Garden will be about 1.5% for the year and LongHorn will be below that.

John Glass
Analyst, Morgan Stanley & Co. LLC

Q

Okay. Thank you.

Operator: Our next question comes from Nicole Miller from Piper Jaffray. Your line is now open.

Nicole M. Miller Regan
Analyst, Piper Jaffray & Co.

Q

Thank you. Good morning. First question, could the industry be benefiting from off-premise sale and could that be a permanent benefit as we enter the calendar year? And then specific on that point to Darden, when you look at what you're doing in test, how do you look at the price point breaks and what should be outsourced and insourced? For example, if you get over $100 or maybe it's $200 or $300, is that something you're still insourcing? And when you outsource I think there's a lot of delivery tests – a lot of marketplaces you are testing. So, how are you deciding who to go to, and when? Thanks.

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

A

Okay. A lot in there, Nicole. Let me start with the off-price sales. I take that back to where we identified a couple of years ago that consumer needs state of convenience. The consumer is still looking for convenience. We've got some brands that really can satisfy that, especially Olive Garden. We've done a great job with that. I think that that's probably a more permanent part of our equation today. I don't see that need state going away, I see that need state increasing, and I think we'll continue to come up with innovative ways to meet that need.

As far as – we start thinking about delivery and as we've said before, we've got multiple tests going on in the marketplace. We're trying to learn. We believe that someone is going to rise up and create some scale in the space, and we'll watch those third-party deliverers. We're also watching competitors that are doing it themselves. We have a small test we're doing ourselves, and we'll watch this whole space kind of develop, and we'll decide how we're going to participate in that.

We are still very attracted to the large party delivery catering in Olive Garden where our average order is over $300. That makes a lot more sense for us to market and pursue than running around delivering $10 entrées at this point in time. So, for us, it's a wait-and-see. We're very engaged in the process with all the third-party delivery companies and we're very engaged with our own activity around that. So, to us, let's see how this thing develops.

Nicole M. Miller Regan
Analyst, Piper Jaffray & Co.

Q

And just a quick follow-up on a separate topic. I believe I saw Olive Garden recently showed up as one of Glassdoor's ranked best employers. And what I want to understand, is that a function of the return to basic strategies or tactics that you have in place now? Or is there even more to come? Thanks.

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

A

Well, I think that we have a filter that we run every decision through. And the first question we ask is how does our team member win if we make a decision? The second is how does our guest win if we make a decision? And we believe one of our four competitive advantages is our culture. Even as the employee market has tightened, our retention rates have not moved at all, they've actually improved a little bit. We'll continue to invest in our team members.

We believe we have great training programs. 50% of our management comes from our team member ranks which we believe we're offering growth opportunities to our team members and I think we're doing the right thing. We're now out trying to manage to win these awards. We're just doing the right thing for our team members every single day, and then if we get an award, that's great. But I think you can see it in our results. We're doing a good job taking care of our guests, and when we take care of our guests, we win.

Nicole M. Miller Regan
Analyst, Piper Jaffray & Co.

Q

Thank you.

Operator: Our next question comes from Will Slabaugh from Stephens. Your line is now open.

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Will Slabaugh
Analyst, Stephens, Inc.

Q

Yes. Thanks, guys. I want to ask you about Cheddar's, I know there are a lot of moving pieces there as you integrate the business. But could you talk a bit about its positioning? With such a value bin to the concept, probably a little bit more than the rest of your concepts, does that leave it more vulnerable to improved quality and/or better value messaging from QSR or fast casual? Or do you think we're simply just seeing the pure dislocation with the integration that you mentioned earlier?

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

A

No, I don't think – I think the exact opposite. I think that this is a way for people to trade into casual dining and have an experience for under a $14 check average with made-from-scratch food that is at a higher quality than most comparable operations they're competing against. And we look at the data in the research, we're just really impressed with the loyalty. We've been out doing what we call dine-arounds where our team goes out and dines with guests and we continue to learn more and more about the admiration they have for our brand and the accessibility the brand provides for people who probably couldn't go out to eat in a full service casual dining environment except if they can go to Cheddar's and make it work inside their budget. This is a very strong brand.

When I think about – I know there's a little bit of concern about where the comps are. This doesn't surprise us at all. It happened at Yard House, it happened at LongHorn. I believe the only – LongHorn has only ever had one negative full year of same-restaurant sales decline and that was during the integration in its thirty-something-year history.

The other thing I would add is that we've acquired two large franchise operations inside of Cheddar's that make up approximately 35% of the system. Those restaurants, there's 54 of them, I believe, or approximately 54, are a significant drag on the base Cheddar's restaurants that were the real base of the company-owned operations that we bought. Those restaurants are dragging it down well over a percent as we standardize the menus because the menus were somewhat different and their pricing philosophies were somewhat different. As we standardize the menus, we're getting some negative check that's dragging us down to. These are decisions we have to make for the long-term.

And lastly, as I mentioned in my remarks, integration is hard and we believe, when we look back on a couple of our last acquisitions, we didn't go fast enough. We let integration drag on too long. And so, we made the determination during this one that we're going to push hard and get to the other side quicker, and that's what we're doing. And we actually integrated the two franchise systems first, so they've actually had the most activity because their systems were so weak.

I'll close up by just saying the most important thing for us to do is to get our POS systems in these restaurants so that we can start getting the data that we get to analyze our other businesses to help us make the right strategic choices as we move forward to drive this brand.

Let's not get hung up on short-term quarter-to-quarter comps. This business does 6,300 guests a week, has incredible loyalty and is the undisputed value leader. Once we get to the other side of this, which will be another 6, 9, 12 months, this business will be a good growth driver for Darden.

Will Slabaugh
Analyst, Stephens, Inc.

Q

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Got it. And one quick follow-up if I could on the off-premise question from earlier, did you give what Olive Garden ToGo's growth was in the quarter?

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

A

12%

Will Slabaugh
Analyst, Stephens, Inc.

Q

Great. Thank you.

Operator: Our next question comes from Brian Bittner from Oppenheimer. Your line is now open.

Brian Bittner
Analyst, Oppenheimer & Co., Inc.

Q

Hey, guys. Thanks, and happy holidays to you. As we start to think about 2019 just the synergies from the accretion are significant and they are accretive, what's going to be the strategy with that extra money as you think about it today? Is it something that you're going to let flow through the P&L and be accretive? Or is it something where you're looking to possibly reinvest it back into price or value?

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

A

Yes, I think, Brian, every year we start off with a detailed plan for each of our business. The first thing that we look at is what investments do we need to make into the business either through employee experience and to the guest in order to be able to grow our market share and compete more effectively. We look at our advantages and we've always come back to that, and how do we make scale work for us and that's really, really important. And so we're not really talking about next year, our next fiscal year, but we're constantly looking at how do we make our experience better?

Brian Bittner
Analyst, Oppenheimer & Co., Inc.

Q

Thanks for that, Gene. And just following up with a lot of the other questions, I mean you've always said throughout the last couple years in at least conversations with me for sure, that when the industry trends do pick up that we should all expect your outperformance gap to narrow. But I mean it didn't narrow much. I mean, you're clearly participating in this improvement that the industry sees. So I mean I'm just trying – I just like to kind of hear your thoughts on that because on one side it does appear you're benefiting like the rest of the industry with the Olive Garden brand. But on the other token, I feel like you kind of want us – you kind of expect the gap to narrow versus the industry if trends remain sustainably healthy. So, if you could just maybe talk a little more to that, I'd appreciate it.

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

A

Yes, I mean you're really asking me to look into a crystal ball and try to project what's happening, I mean what's going to happen. We'll continue to – we think our advantages and if we continue to make the right investments, whether that's underpricing and inflation, whether that's improving the food quality, whether that's improving the employee experience. The way we look at it is how do we increase our share of the $100 billion category both

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through same-restaurant sales growth and new restaurant growth. And we look at the value equation for each of our businesses, and we look at Cheddar's and Olive Garden. The price/value relationship is really important. As we move up the continuum, the experience becomes more important.

So I'm not sure that if the overall industry does continue to improve – I'm telling you right now we're working as hard as we possibly can to get as much of that share as possible. And however it plays out, it plays out. We look at the benchmarks, we report them out to you guys. But we're not sure that's always the total opportunity because we look at the top five or six players in the industry and say, if they're doing something that we ought to be able, we ought to try to be able to beat them, not just the benchmark.

Brian Bittner
Analyst, Oppenheimer & Co., Inc.

Q

I appreciate the comments, Gene. Thanks, guys.

Operator: The next question comes from David Tarantino from Baird. Your line is now open.

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

Q

Hi. Good morning. Gene, I have maybe a high-level philosophical question about the tax reform. I know you don't want to give specifics on the impact, but it does look pretty likely that you're going to see a meaningful benefit from that. So how do you think about reinvestments when it comes to the potential benefit you might get from tax reform? You've talked about a lot of reinvestment so far, but are there big opportunities or big chunks of investments you think are out there that you might pursue if you get a big windfall from taxes?

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

A

Well, I think the biggest thing that we constantly think about is the employee experience and how do we ensure that we have the best team members out there to bring our brands alive. Great brand management is much more difficult in the restaurant space than it is in consumer packaged goods, where you just put your brand up on a shelf and you do some advertising. We have employees and team members that bring our brands to life every single day.

So when I think about the investment – if we think about investments in general, they have nothing to do with what's going on with legislation. We think about how do we improve the overall experience. And the competition for team members I think is going to be the most important element moving forward. How do we get great team members to bring our brands to life?

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

Q

I guess, just so I can clarify, if you do get a benefit or windfall from the tax reform, do think there are meaningful offsets to that in this investment cycle? Or can you embed those investments in what you're already doing? I guess I just want to understand kind of philosophically how you would approach that savings?

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

A

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We're not going to talk about anything that has – you tied this to meaningful benefit to tax reform. We're not talking about anything. I'm sorry, David, about tax reform. We'll talk about general investments and how we think about it, and I think I've already answered that question.

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

Q

Okay. Fair enough. Thank you.

Operator: Our next question comes from Peter Saleh from BTIG. Your line is now open.

Peter Saleh
Analyst, BTIG LLC

Q

Great. Thanks. Just wanted to ask, on wage inflation, it sounds like your wage – or labor inflation is running around 4%. You only had some modest de-leverage on the labor line. Can you talk a little bit about the productivity gains that you're seeing? What brands are you seeing in these productivity gains and what kind of gains? Are they going to be ongoing or should we expect those to kind of lessen as we get through the end of the year?

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

A

Yes, Peter, it's Rick. Yes, we're seeing productivity gains across the Darden system. I'm not going to tell you by brand how much productivity we're getting. Although if you think about what we've been doing over the last few years, we continue to simplify our operation; and the brands that are simplifying are getting the most productivity gains, right? And also, as I mentioned earlier, we did have some same-restaurant sales leverage that helped.

And, finally, our turnover really hasn't moved much, right? As you think about turnover, what happens when you have turnover is you have to train a lot more. What we're doing with our training dollars is we're investing in training on getting our team members better at their job to become more productive than just learning their job, which is what happens when you're hiring new folks.

So when you think about all of that, we feel really great about the productivity gains we made over the last few years. There are some brands that still have more to go, some brands that have actually been farther along the cycle, so they might have a little less. But they're not stopping looking for productivity in the future. And we did say that we had about 4% wage inflation, which is a pretty high inflation, but we were able to offset that with these productivity gains and with the moderate pricing we took.

Peter Saleh
Analyst, BTIG LLC

Q

Great. And then, just on the ToGo side of the business, I think historically you've had a lot of, I guess, phone-in orders for ToGo. Where do we stand say, I guess, on phone-in versus online orders coming in? Are you seeing more of that growth coming from online orders?

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

A

Yes. We're approximately 30% online now, and it continues to grow. And we do incentivize people to do that because we get a lot of data when we get that via online. And so, that's an important part of the process that just

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helps us simplify the operation, and we'll continue to try to migrate as much of that business over as possible. At the end of the day, we've got a lot of people calling in orders when they're driving home. It's hard to do those online while you're driving. But we'll continue to move people over the best we can.

Peter Saleh
Analyst, BTIG LLC

Q

Great. Thank you very much.

Operator: Our next question comes from Matt DiFrisco from Guggenheim Securities. Your line is now open.

Matthew DiFrisco
Analyst, Guggenheim Securities LLC

Q

Thank you so much. Just had a couple of follow-up questions here. I just want to be clear, did you say then that the negative 2% at Cheddar's was of the full base, including the franchise stores? And it was negative check – more than negative check, so traffic was positive?

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

A

No, no. Let me clarify. The negative 2% is inclusive of the two franchise systems that, what they call the Greer restaurants that were purchased by Cheddar's right before we bought them. And then, we purchased their next largest franchisee, which we referred to as a C&P shortly thereafter. They make up 35% of the overall system. So, in essence, we're doing three integrations at once; and their system has grown dramatically. Now, what I said and maybe I wasn't clear was that the 35% of the restaurants that were franchised and now company-owned are dragging same-restaurant sales down by 100 basis points. And...

Matthew DiFrisco
Analyst, Guggenheim Securities LLC

Q

Were they in 1Q as well?

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

A

Yes – no, C&P wasn't. C&P wasn't. Just the Greer restaurants.

Matthew DiFrisco
Analyst, Guggenheim Securities LLC

Q

Okay. So...

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

A

And we have negative check in the approximately 45 Greer restaurants that we bought, because we had to standardize the menu. So that negative check is part of the drag. And these are great restaurants, great people, but a franchise system that was run a little bit independently off the core company-owned restaurant. So there's going to be some effort and energy to get them up to the operating standards of the company restaurants.

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Matthew DiFrisco
Analyst, Guggenheim Securities LLC

Q

Completely understand. So, it wouldn't be correct to compare the down 1.4% to the down 2% and that you had a little bit of a different composite of the base?

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

A

Yes, that would be correct. You could do that. The C&P restaurants are a drag.

Matthew DiFrisco
Analyst, Guggenheim Securities LLC

Q

And then you mentioned the middle of FY 2019 is now the target ahead of schedule for the integration, correct?

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

A

Yes. It is the middle of 2019.

Matthew DiFrisco
Analyst, Guggenheim Securities LLC

Q

So, does that imply then...

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

A

I'm sorry. Matt, it's for the synergies, not the integration. So, the integration, we expect to have most of the integration work done on the system side by the end of this fiscal year. But we do expect them to have to continue to learn how those systems work, and then take those systems and use the data that we have to help improve the performance in fiscal 2019. So, that's where I think we were saying the integration is going to take 18 months. It's the integration of the systems that's going to take less time than that. It's just the learning and the understanding of the data is going to take a little longer. But we do expect that the synergies, on a run rate basis, we will get by the middle of fiscal 2019 versus the run rate basis we thought we'd be at the end of fiscal 2019. So, sorry, I messed up the question there.

Matthew DiFrisco
Analyst, Guggenheim Securities LLC

Q

No, I misunderstood. So that's great though. So, I guess if everything is moving forward, would it be correct then to assume that potentially you could be looking to re-accelerate growth of the Cheddar's brand, or bring it back to a little bit more meaningful growth perhaps sooner than maybe what you would've thought, say, six months ago?

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

A

Yes, Matt, just because the integration is going a little bit faster, it still takes time to find sites and other things. And when you've got a site pipeline that could be 18 months, it will take us a little longer just to rebuild that pipeline. We do expect to open restaurants in FY 2019, and we'll talk about the number of openings, et cetera, when we give you the fiscal 2019 outlook. But it's just going to take us a little while to build up that pipeline, again using the data that we use to help the find greater sites.

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Matthew DiFrisco
Analyst, Guggenheim Securities LLC

Q

Understood.

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

A

So, I would still expect us to open restaurants at least at the pace that we're opening them today in fiscal 2019, but we'll tell you more about that when we talk about 2019.

Matthew DiFrisco
Analyst, Guggenheim Securities LLC

Q

Understood. And then last question, is there anything that you want to tell us about the hurricanes as far as on the cost structure? Did they impair? Did you have any waste of food in the quarter that should be noted or called out that was meaningful to the margins or disparity in same-store sales as far as recoveries happening a little maybe regionally seeing a little bit of stronger strength in pockets? Or is it pretty much – everything that you report is sort of national trends?

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

A

Yes, Matt. Thanks for that. What happened for the quarter when we originally talked about the quarter we thought would be down 60 basis points in same-restaurant sales and down $0.035 – or $0.03, I'm sorry, in EPS. What it turned out was the restaurants that we had in Florida impacted, and they were closed for quite a while so that impacted us in total by about 50 basis points in closed days, and those are higher volume restaurants than the system average. But then we did get some bounce back in Florida. And so, each brand was impacted differently. But for the company, for Darden, it was slightly negative in comps for the entire quarter. So, it wasn't negative 60 basis points, it was just slightly negative.

On an EPS basis, it turned out to be about $0.02 unfavorable instead of $0.03 because the comp impact wasn't as bad. Now the $0.02 is primarily proactive, things that we did to make sure that the restaurants were boarded up and so, they didn't have as much damage. We did have some food inventory write-off. We had some restaurants that were closed maybe a week, and so that food has to be written off. But we're also very proactive before the hurricanes come to help mitigate any food write-offs. So again, it was about $0.02 for the quarter instead of $0.03. And it was about slightly negative in comps instead of down 0.6.

Matthew DiFrisco
Analyst, Guggenheim Securities LLC

Q

Excellent. Thank you so much.

Operator: The next question comes from Sara Senatore from Bernstein. Your line is now open.

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

Q

Thank you. Just a couple of follow-ups if I could. First on the ToGo, that 12% growth is sort of same as last quarter. I was wondering if that's a signal about kind of what the steady-state pace of growth might be? Or if you have any sense of where you think ToGo mix might max out over time? That's the first question.

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And then I wanted to ask about LongHorn and the SKU reduction that you were talking about. I guess I hadn't recognized that it was 30% reduction in menu items. Sometimes we see that at restaurants and it has a negative impact on comps. It doesn't seem like that's been the case. So, maybe you can talk about where those menu items came out? And what do you think the key is to sort of reducing the menu size without impacting traffic? Thanks.

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

A

So, let's start with Olive Garden, a 12% quarter I think is a really strong ToGo quarter. We think about the future, the consumer needs state is going to need to continue to increase for the convenience, for us to continue to grow that. We're doing well over $0.5 million on average inside an Olive Garden box and ToGo. We got restaurants that are doing well over $1 million in ToGo.

So, as we think about going into the future, we need the consumer needs state to continue to grow. We'll continue to innovate. I think one of the biggest things we can do on Olive Garden ToGo is to improve our operations. As the business has improved, Dave and Dan and the team continue to work on coming up with better systems to handle the volume. It's actually an interesting business because they do a lot of pickup like at 11:15, 11:30. And so, they can use the [indiscernible] (49:41) before it fills up to handle the volume. So, I think there's some operational improvements that we can make. We can continue to improve the offering to stay relevant to the guest and continue to remind the guest that it's available.

We have said, we're publicly on the record saying that we think, over time, if the consumer needs state continues to grow that this can be 20% of our business, primarily because the type of food travels so well and we can do it more so than just entrées, that we can do bulk and bulk is where we want to be.

Let me move to LongHorn. We've been making great investments in LongHorn for the last two years. Todd and his team have done a great job of – we've increased the size of the stakes. We've removed complexity in the kitchen, and as we've mentioned, we've taken the SKUs down. A lot of that through – some of that through the menu, some of that through the promotional activity that we've done, reducing the number of new items that we introduce on a quarterly basis. And what we're finding is, we had a lot of stuff on – items on our menu that really were duplicative in the need they were filling for the consumer, and we removed them and it just helps us operate much more efficiently.

I believe all our businesses, all our brands, our menus are too complicated, too complex. We have items that continue to work and do the same thing over and over and over again versus having one great fried appetizer instead of three great fried appetizers. And the more we can simplify the operation, the better the execution gets, the quality increases and the overall value to the consumer is having an impact.

And LongHorn, historically, has been a high food cost/low labor cost operation. And we have simplified that operation to be able to bring the labor cost down and increase the productivity while improving the overall quality of the food product. And even as much as we've reduced it already, I think there is still further reduction to be done in the LongHorn menu to improve, simplify the operation. Those are very small kitchens that have to stay simple in order to be able to cook great steaks in a timely manner.

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

Q

Thank you.

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

Christopher T. O'Cull
Analyst, Stifel Financial Corp.

Q

Thanks. Good morning, guys. Gene, how do you ensure that all the changes that are occurring at Cheddar's do not create a difficult work environment for employees and it could eventually impact the guest experience?

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

A

That's fairly easy. The systems haven't been invested in, in those restaurants. They're working on very old POS systems. And so, big difference in this integration than some of our others were the Cheddar's team is actually pulling from us to get this information in restaurant where some of our past integrations there has been a little pushback because they had good systems and we were just changing the systems to change the systems. Here, our systems are superior. They want the systems as soon as they can get them, and they've just been – they've been great to work with.

We believe overall the benefit package is going to be much stronger for those team members. We think there's a huge upside in Cheddar's in increasing their retention. Right now, their employee retention is about the average of the industry, and we believe that we can take them from 120% team member turnover down to our norm of 70%. That's going to have a huge impact on the overall operation. So, we believe, and all indications are that they like the systems that we're bringing. Ian has done a great job working with his teams and talking about the systems that we're implementing and getting feedback. So I think this is going to really enhance their performance over time.

Christopher T. O'Cull
Analyst, Stifel Financial Corp.

Q

So, you have not seen any changes to the guest satisfaction scores at Cheddar's through this process?

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

A

No.

Christopher T. O'Cull
Analyst, Stifel Financial Corp.

Q

Okay. And then just one last question clarifying the menu changes at LongHorn, you mentioned the reduction in SKUs, but in terms of consumer-facing menu items or what the consumer would experience, what is the percent reduction that you've taken on the menu or through promotional items?

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

A

Yes. It's almost 30%. I mean, we got different tests out there and we got different products in different markets so it's somewhere – it's approximately 25% to 30%.

Christopher T. O'Cull
Analyst, Stifel Financial Corp.

Q

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Okay.

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

We've done a really good job, the management team has done a really good job there of getting back on a pathway of delivering that brand to the consumer differently than how Olive Garden delivers their brand to the consumer, and it has a lot to do with the promotional cadence and new product introductions.

Christopher T. O'Cull
Analyst, Stifel Financial Corp.
Q

And my question was, has that gone through enough purchase cycles so you can see whether there's been a change to frequency of those guest with that menu reduction?

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

Yes. We definitely see an increase in frequency in LongHorn. We measure that every quarter with our tokens.

Christopher T. O'Cull
Analyst, Stifel Financial Corp.
Q

Great. Thanks, guys.

Operator: Next question comes from Jason West from Credit Suisse. Your line is now open.

Jason West
Analyst, Credit Suisse Securities (USA) LLC
Q

Yes. Thanks. Just one, given the upcoming holiday shift, can you guys quantify how that impacted you last year, how you think it may impact the current quarter with the movement and holiday? And any other shifts like that we should be aware of?

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

Yes. Jason, the holiday impact is minimal versus last year, the holiday shift moving Christmas basically from a Sunday to Monday. It's really not going to be much different than it was last year.

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

Let me just add though, there are key days in our fiscal third quarter that cannot be weather-impacted or also have a major impact – could have an impact on the quarter. So, we got New Year's Eve and Valentine's Day which are big, big days in our quarter and a major weather event that covers a large geographic area could have impact.

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

Yes, and last year's holiday shift was about 20 basis points unfavorable so it shouldn't be much different than this year, so pretty much flat for this year.

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Jason West
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. That's helpful. And I know, Gene, it's hard to gauge what's going on with the consumer from month-to-month but we have seen a decent pickup in the industry in the last couple of months. I don't know if you had any thoughts on what's driving that. I know we're lapping some of the election cycle stuff from last year but I don't know if there's anything else that you've seen or do you see in your regional data that a lot of it is driven by the hurricane bounce backs? Or is it a little more broad-based? Thanks.

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

A

The industry is fighting for consumers – the consumer's discretionary dollars. And I've said on this call before, we're not just fighting amongst ourselves, we're fighting for those dollars that are being spent in other places. I do think that overall the industry is being a little more rational. I think there's been some okay innovation and I think we're attracting consumers again. I don't think there's a macro trend out there that says that we're pushing people and I think the industry is doing a better job.

Jason West
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. Thank you.

Operator: The next question comes from Greg Francfort from Bank of America. Your line is now open.

Gregory R. Francfort
Analyst, Bank of America Merrill Lynch

Q

Yes. I had two super quick questions. One is just on the 2% comp guide, is that for the legacy brands or is that ex-Cheddar's or does that include Cheddar's? And then my other one is for Gene, it seems like the high-end category specifically has had a pretty big improvement the last couple of months and I think you definitely saw it in your businesses. What do you think is driving that and what is the reason for the improvement, particularly at the high-end steakhouse and also at Eddie V's?

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

A

Yes, Greg. It's Rick. The 2% comp is for the legacy Darden brands. As Kevin mentioned on the beginning of our call, anytime we talk about comps for this fiscal year, it will exclude the Cheddar's restaurants.

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

A

Yes. Good observation on the high-end category because our high-end brands, with the hurricanes, travel really came to a halt and they were disproportionately impacted and they really came back strong, both Cap Grille [Capital Grille] and Eddie V's. I would also say that Texas has not – stopped being a drag. That business was, for 18 months, we have pretty good presence in our high-end restaurants in Texas and that had really been a constant drag, and that's kind of flipped for us now. And the Texas restaurants are doing better and they're not dragging.

So, on high-end, the consumer – it feels really good out there. The consumers out there, people are celebrating. I think our brands are very well positioned. John Martin is doing an incredible job leading Eddie V's and really

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maximizing those restaurants and put up a great number at 6.8%, very, very excited about that. And we're opening a few restaurants in Eddie V's, which is a really good growth for us.

Gregory R. Francfort
Analyst, Bank of America Merrill Lynch

Q

Thank you. I appreciate it.

Operator: Next question comes from Jeff Farmer from Wells Fargo. Your line is now open.

Jeff D. Farmer
Analyst, Wells Fargo Securities LLC

Q

Thank you. I did hear you guys loud and clear on the reluctance to discuss tax reform, but just having quickly said that, should reform become a reality by the end of this week, by the end of this year? When would you guys expect to be able to share any form of assessment of what reform might mean to your business? And specifically pointing to either ICR in January? Or is this a situation where we might have to wait till late March when you next report to get some more detail as to what tax reform could mean to your P&L and cash flow?

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

A

Hey, Jeff. We expect to analyze the bill when it's signed. We're beginning to analyze it now, but we expect to have the impact of tax reform in early January, ahead of ICR.

Jeff D. Farmer
Analyst, Wells Fargo Securities LLC

Q

Okay. Thank you very much.

Operator: Next question comes from Andy Barish from Jefferies. Your line is now open.

Andrew Marc Barish
Analyst, Jefferies LLC

Q

Hey, guys. You're bumping up pretty close to your $200 million buyback here in the first half. Just any thoughts or further comments on cash to shareholders, free cash usage?

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

A

Yes, Andy. We are, as you said, bumping up close to our high-end of our long-term framework, and it's just that. As we've said, there are years that we could be above it, years that we can be below it. Right now, we have given you our share count for the year, which is 126 million shares. So you could probably see that we don't anticipate buying a whole lot right now. But we did last year go over our $200 million. So as we think about our return of capital, we'll see what other uses we have for that capital and whether we're going to go ahead and buyback shares. But right now, we've given you, I guess, the best indication of what our share count will be for the end of the year – well, actually, for the average for the year.

Andrew Marc Barish
Analyst, Jefferies LLC

Q

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Thanks.

Operator: The next question comes from Karen Holthouse from Goldman Sachs. Your line is now open.

Karen Holthouse
Analyst, Goldman Sachs & Co. LLC

Q

Hi. We've had a couple quarters now of more positive commentary on comp trends in LongHorn outside of core markets. Also, you have pretty strong profit growth there. How should we think about that tying into plans for unit growth, and sort of 2 years or 2.5 years out from a pretty proactive decision to pull back on unit growth? How far you'd want to be in this process and maybe tying in many simplification and whatnot before you would potentially really reaccelerate?

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

A

Hey, Karen. It's Rick. In relation to LongHorn unit growth a couple years out, what we have talked about over the last few years is that our long-term framework for Darden is about 2% to 3% sales from new units, and some of that will come from LongHorn. We're very reluctant to talk about accelerating rapidly any one brand because we know that speed kills, and we opened 40 LongHorns for two years in a row and we're kind of catching up to that right now.

So as we think about LongHorn in the future, I think we've talked this year, it's going to be in the teens, the high teens, number of openings. I wouldn't anticipate that getting way out of line from there. But we'll give you a little bit more about FY 2019 in a few months, or actually by the end of June. But right now, we're looking at pipeline, we're looking at filling in sites in markets that we already have restaurants in. We think that's a really good strategy for LongHorn. And then, continuing to find new markets where we can generate a beachhead and grow from there.

Karen Holthouse
Analyst, Goldman Sachs & Co. LLC

Q

And then, one other question on guidance. If you look at the midpoint of EPS growth and then account for that legal settlement you saw this quarter, it would seem that pre-tax profit growth is decelerating from sort of high teens in the first half towards something that's more mid-teens in the second half despite what I would think would be more of a benefit from Cheddar's synergies into the back half. What are the other drivers of that? Are there individual line items of inflation we should be focused on just to think about that cadence?

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

A

A couple of things. One is, we're wrapping on a really strong last half of last year as you think about growth. And inflation, as we said, for the year is going to be 2%, around 2%, and it's just slightly higher than where we had anticipated. It's still around 2%, but slightly higher around 2% range than before. But we still have, you've done the math, somewhere in the double-digit growth rates in the back half of the year. So while we consider that a deceleration, it's still above our long-term framework growth rate. If you think about earnings after-tax in our long-term framework, we say 7% to 10%, and that would still be above that.

Karen Holthouse
Analyst, Goldman Sachs & Co. LLC

Q

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All right. Great. Thank you.

Operator: Next question comes from Howard Penney from Hedgeye Risk Management. Your line is now open.

Howard W. Penney
Analyst, Hedgeye Risk Management LLC (Research)

Q

Hi. Thank you so much for the question. I have two, if you don't mind. First one, you attributed your success at LongHorn to the smaller menu, increased execution and increased frequency. One of your largest competitors in the casual dining space, Chili's, is also deploying a similar strategy. So I was wondering how you view that competitive dynamic as they go from down 7% to a plus 2% or 3% as a fairly big market share shift in casual dining? Thanks.

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

A

Yes. When we think about LongHorn, we're fine-tuning the menu. As we pull it back, I think it's a little bit difficult than the competitor that you mentioned. We had a lot of menu items that really weren't working that hard for us, and we're introducing a lot of new products on a quarterly or every six-week basis that weren't working hard. And you're very familiar with old LongHorn, Howard. And a great LongHorn experience is a Flo's Filet and a hot baked potato with sour cream and butter, real butter. So as we simplify our operation, we're executing at a high level. We need to get the steaks cooked correctly. We need to get the food out faster, and that's what simplification has done for us. And I'm really not going to comment on our competitors' strategy.

Howard W. Penney
Analyst, Hedgeye Risk Management LLC (Research)

Q

I just wish you had a LongHorn closer to where I live. And just trying to understand your hesitation towards delivery and the survey work that we've seen on delivery suggests that the biggest opportunity or what consumers are saying they're using delivery for is a replacement for a meal at home. So that would obviously be very incremental to the casual dining industry. So I detected a hesitation. If I'm wrong about that, you can correct me. But is it that you don't know who to go with the delivery or do you want to do it yourself? Or maybe you just don't see the opportunity as being that big? Thank you.

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

A

Well, I think, there's two parts to your answer: we don't know who we're going to partner with yet; and number two, I don't like the current economics of the partnership. And so, we're trying to understand their profit model and we're trying to understand our profit model doing it internally. And once we get a pretty good understanding of both those models and they're well-developed, I think I'll have some leverage in negotiating this with a third-party or doing it ourselves. So I'm not hesitant on the business, the business is a good business. I'm just not going to live with their current economics. I'll do it myself – we'll do it ourselves before we live with their economics.

Howard W. Penney
Analyst, Hedgeye Risk Management LLC (Research)

Q

Got it. Sorry to keep coming over you. So, it's not that you don't see the growth in delivery as taking share from other categories, it's just you don't understand the economics.

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

I understand them, they're not favorable enough for me and I'm not going to give them their discount. There's too much profit in there because they don't have scale yet. And so, we're trying to understand what that model looks like and what it looks like for us from a profitability standpoint, and then we can pinpoint what their profit is and we got to get to a better resolution if they want to do it for us. If not, we'll do it ourselves.

Howard W. Penney
Analyst, Hedgeye Risk Management LLC (Research)
Q

Awesome. Thank you so much.

Operator: The next question comes from Alex Mergard from JPMorgan. Your line is now open.

Alexander J. Mergard
Analyst, JPMorgan Securities LLC
Q

Hi. Thank you for the question. I have a follow-up on how the pipeline is shaping up and I heard your comments on LongHorn. Would you consider exceeding your long-term guidance for 2%, 3% in new restaurant growth? I mean, do you consider that more of a self-imposed cap in order to execute on that growth? Any color there would be helpful.

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

Yes, Alex. The 2% to 3% is the long-term framework we have for a couple of reasons. One is people. We have to make sure we have enough people to open these restaurants and open them strongly and doing a great job with it. We think if we get too high above the 3% across Darden, it puts a strain on the people that we have in knowing the brand. There are some brands that are going to be above the 3% range and some brands are going to be below the 2% range.

But across Darden, we think 2% to 3% is the right investment. And we do know that all of these restaurants on average are creating a significant amount of value. But we also have other ways to return capital and to spend our capital whether it's in dividends or share buyback. So, we want to balance all of our capital spending including new restaurants so we think 2% to 3% is the right amount.

Alexander J. Mergard
Analyst, JPMorgan Securities LLC
Q

All right. I appreciate that. And then one final follow-up and that is on the strength of independent restaurants versus chain restaurants, it's a trend that we've been seeing for some time now. Are you seeing any changes to that dynamic and how it may or may not be impacting your business? Thank you.

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

Yes. I think the independent growth is happening in more the big cities, and we see that and we see that more of a real issue for our upscale brands, in a Yard House and Seasons 52 and Bahama Breeze where they're located more in these upscale suburban areas or urban areas. We're not seeing an influx of casual dining restaurants in suburbia that are privately owned. This is an urban phenomenon and not really impacting LongHorn and Olive Garden.

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Alexander J. Mergard
Analyst, JPMorgan Securities LLC

Q

All right. I appreciate the color. Thank you.

Operator: The next question comes from Andrew Strelzik from BMO. Your line is now open.

Andrew Strelzik
Analyst, BMO Capital Markets (United States)

Q

Hey. Good morning, and thanks for taking the question. I just have one quick one here. The beef outlook that you provided through May is a pretty attractive low-single digit deflation, but we're seeing – in some of the steak cuts, you're seeing some inflation now. So I guess I'm wondering, in terms of the outlook, is that due to the coverage that you have currently? Or is there something that you see in the beef markets or what you're hearing that makes you more optimistic going forward?

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

A

Yes. We're fairly long right now on beef. So, we're covered and our teams made some good decisions along the way.

Andrew Strelzik
Analyst, BMO Capital Markets (United States)

Q

Okay. I guess so when I think about – when I look at the LongHorn margins, you've talked a lot about some of the initiatives and things are going on there, but we did see a nice sequential step-up in the pace of margin expansion. Is it reasonable to assume then that we might start to see that moderate or do you think you reached the point in terms of the initiatives that this is a more sustainable type of margin growth at LongHorn? Thank you.

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

A

Yes, Andrew. We've had a lot of work at LongHorn and simplification to improve labor productivity. And again, they've also had some beef deflation over the last few years to help margins. We still think there's margin improvement for LongHorn going forward. Maybe not to the level that we've seen over the last couple of years because eventually the beef deflation is going to become beef inflation and we're going to continue to invest in quality at LongHorn and we're just not ready to talk more about individual brand margins going forward.

Although, if you look across Darden compared to our competitors, we are the only ones growing margins really over time, over the last few years, or actually the last six months. So we feel good about where our margin is. We don't want to go too high on our margin because we think value is important and not getting too far out of line with what the consumer is willing to pay. But we still have costs that we can go after. We still have productivity gains that we can do to continue to expand our margins across Darden 10 basis points to 40 basis points, which is what's in our long-term framework.

Andrew Strelzik
Analyst, BMO Capital Markets (United States)

Q

Great. Thank you very much.

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Operator: The next question comes from Steve Anderson from Maxim Group. Your line is now open.

Stephen Anderson
Analyst, Maxim Group LLC

Q

Yes. Thank you for taking my question and thanks for taking – most of my questions have been answered already. But just for modeling purposes, I just want to ask when your next 53-week fiscal year will take place?

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

A

Give us a second to find that out. It's probably in a couple of years but it's not next fiscal year, I'm pretty sure. 53-week year, I think it's...

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

A

Kevin can get back to you on that.

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

A

Yes, we'll get back to you on that.

Stephen Anderson
Analyst, Maxim Group LLC

Q

All right. Thank you.

Operator: We show no further questions in queue at this time. [Operator Instructions]

Kevin Kalicak
Senior Director, Corporate Analysis & Investor Relations, Darden Restaurants, Inc.

Thanks, Jean. I think we're ready to conclude the call. I want to remind everyone that we plan to release third quarter results on Thursday, March 22, before the market opens with a conference call to follow. Thanks, everyone, for participating in today's call and have a happy holiday season.

Operator: And that concludes today's conference. Thank you all for your participation. You may disconnect at this time.

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