Nation's Restaurant News

Reasons to buy Red Lobster, TGI Friday's, Ruby Tuesday

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Mon, 2014-01-27 13:20

Nation's Restaurant News asked three long-time industry observers to weigh in on the burgeoning casual-dining sell-offs.

Traditional casual dining is at a pivotal point in its history, with three venerable brands up for sale and a consumer base that has yet to feel the benefits of the crawling economic recovery.

In the past three months, Red Lobster, Ruby Tuesday and TGI Friday's have all been put into play, promising that the segment's landscape is set to morph.

Nation's Restaurant News asked three long-time industry observers to weigh in on the burgeoning sell-offs, including each brand's individual situation and the benefits to potential buyers.

"As you look at the three, the story is different in each case," said Craig T. Weichmann, founder of the Dallas-based Weichmann & Associations investment advisory firm. "They are all in the same check-average range, plus or minus a few dollars, but the positioning and the health of the assets is different."

Their operating environment is similar, however, as they fight to recover from a drawn-out economic downturn and increasing competition from fast-casual players at a time when operational costs are escalating and consumers remain spending shy.

"This segment is characterized by very anemic traffic in the last five years," said Kevin Burke, founder and managing director of Los Angeles-based Trinity Capital. "In fact, it has been negative traffic. It's seen an increase in its cost structure in both labor and commodities. It has not enjoyed the same benefits in media. And it has not done a good job with social media yet."

Meanwhile, casual dining's core customers — those with annual household incomes of $50,000 to $70,000 — have fallen slightly below average on spending on food away from home, said Malcolm Knapp, founder of New York-based industry analytics firm Knapp Track.

"That used to be the rich target," Knapp said. "They just don't have as much money. They want to go [out]. The desire is there. They just don't have the money. That's the story of our times."

Knapp projects sales for the full-service segment to grow 2.6 percent, with real growth, after inflation, of 0.2 percent.

Still, some casual-dining brands are holding their own, observers said, pointing to Greenwood Village, Colo.-based Red Robin Gourmet Burgers Inc.; Kansas City, Mo.-based Applebee's Neighborhood Grill & Bar, a division of DineEquity Inc.; and Dallas-based Chili's Grill & Bar, owned by Brinker International Inc.

“The brands that are really doing the best are defining their differences from the other guys and are doing a more effective job than the other guys in communicating that in social media and traditional advertising,” said Wally Doolin, a veteran casual-dining operator and founder of Dallas-based analytics firm Black Box Intelligence.

Some struggling brands, meanwhile, are too unfocused, said Burke. “Casual dining has been a victim to wandering strategies,” he said. “They just haven’t defined who their customers are and how they are going to be served.”

Here Burke, Knapp and Weichmann dissect the fortunes of Ruby Tuesday, TGI Friday’s and Red Lobster.

Ruby Tuesday

Ruby Tuesday Inc., which reportedly has hired investment bank Goldman Sachs to explore strategic alternatives, on Jan. 8 said the Maryville, Tenn.-based chain was closing 30 of its 779 restaurants. Since November, it has eliminated about 70 mostly corporate positions.

Its net losses widened in the Dec. 3-ended second quarter, to a $34.7 million loss compared with a $4.2 million loss in the prior-year period. Revenue in the quarter fell 7.9 percent, to $276.2 million from $300.1 million in the year-earlier period.

“I own the results, they are what they are, and we're trying to make them better,” said James J. “J.J.” Buettgen, president, chief executive and chairman of the chain that Sandy Beall founded in 1972. Ruby Tuesday also owns the 29-unit Lime Fresh brand.

Beall left the company in 2012, after trying to recast the brand as more upscale with improved food quality and décor. But Buettgen, who succeeded him, has recalibrated to a more affordable menu.

What went wrong?

Burke: They really just lost track of their customer. The comps have been pretty bad for several years now – perhaps mediocre and bad. They completely took leave of their senses as to who their customer is.

...Sandy Beall was once a great leader in this sector, and I think, like Babe Ruth, he probably stayed a couple of years too long. Ruby Tuesday added very high-quality ingredients to the menu, which put pressure on price and margin with prime burger and some expensive seafood items. That is not where the market is going.

Weichmann: Ruby Tuesday went through a lot of lifestyle changes, from the salad bar to moving the menu around. ... You really can’t upscale the menu beyond the condition of the physical assets. You walk in the door and look at the physical assets and expect to spend $X. If they suddenly kick the menu up a few bucks, you are going to go, ‘Hey, this is a disconnect.’ There was sticker shock and negative pushback, and we had a large...loss of customer traffic.

Once that starts, employees start to get worried. We’re in an industry where it’s very easy for a good waiter to jump to another place. So you start to lose your good people because they aren’t getting tips. I’d say the fall of Ruby Tuesday is more of a death cycle, where you have compounding loss year over year of traffic.

What would entice potential buyers?

Burke: Ruby Tuesday has a large store footprint, which can give them economies of scale for supply chain, advertising and product development, but they need to relocate and find their customers.

Weichmann: My question there is: Can the assets be physically redeployed into other higher use? I'm personally involved in a company where the site was doing $21,000 a week and they're now doing $55,000 to $60,000. Same location. There was nothing wrong with the real estate. They converted it to their concept, and they are off to the races with it.

Knapp: Some companies have to get out of the public arena to fix their problems. Ruby Tuesday is in a turn-around. They brought new people in and they reorganized. They have a lot of things to fix. It takes a while to get the traction. In a tough environment, it's hard to get that traction. The advertising is good. It just takes a while to get people to believe they'll have a good experience.

TGI Friday's

Carlson, the Minneapolis-based parent company of the TGI Friday's casual-dining chain,said in November it was undertaking a corporate review of strategic alternatives, including a possible sale.

Carrolton, Texas-based Friday's operates about 920 restaurants in more than 60 nations and pioneered the so-called "fern bar" segment when the first unit opened in 1965.

Nick Shepherd, Friday's president and chief executive, said in November, "For the past several years, Carlson has invested heavily in the business to refresh the brand, coupled with aggressive actions within the corporate structure to contain costs."

The privately held brand had estimated sales per unit of $3.31 million in its latest fiscal year, a 2.3 percent increase over $3.23 million in its preceding fiscal year, according to the latest Nation's Restaurant News Top 100 report. Friday's is the seventh largest casual-dining restaurant chain in the NRN Top 100, with estimated U.S. systemwide sales of $1.8 billion in 2012.

What would entice potential buyers?

Burke: Friday's probably does a better job than anybody at the bar business. I think that when they lead with that business, they win.

Weichmann: TGI Friday's, back in the '60s and early '70s, had huge business. The name is iconic. There's a huge value just in the branding of the name. A lot of people seem to forget that value.

Over time, we lost that sense of urgency to go to a TGI Friday's. Some areas still have that. That's a brand that has value for the right player to step in. Chili's has battled back with some menu innovation. Applebee's didn't give up. They are fighting back. Look at their commercials and strong menu. You have an iconic name. There are locations that you have to edit out in any portfolio. There is relevance.

Knapp: TGI Friday's is still throwing off more cash. They are not selling it because it's not doing well. They're selling it because it is doing well.

Red Lobster

Under pressure from New York-based hedge fund Barington Capital Group LP, Darden Restaurants Inc. said Dec. 19 it would sell or spin off its Red Lobster chain, which along with Olive Garden has been a drag on profits.

Clarence Otis, Darden's chairman and chief executive, at the time acknowledged that the casual-dining segment had experienced "relatively low levels of consumer demand in each of the past several years" and "additional unexpected softness since June."

Red Lobster, founded in 1968, has 705 restaurants in the United States and Canada and had fiscal 2013 sales of about $2.6 billion. The company said same-store sales for the brand fell 4.5 percent in September, 4.3 percent in October and 4.6 percent in November.

Red Lobster's comparative sales declines contributed to Darden's report of a 41.1-percent decline in profit for the Nov. 24-ended second quarter, to $19.6 million, or 15 cents per share, from $33.6 million, or 26 cents per share, in the prior-year period. Revenue rose 4.6 percent, to $2.05 billion from $1.96 billion in the same period last year.

Another activist investor, New York-based Starboard Value LP has taken a 5.6-percent stake in Darden and joined Barington in calling for changes at the company.

What went wrong?

Knapp: Operations have clearly faltered. The new team really has the strong belief they can make it work using different marketing tactics than were used for Olive Garden. They have a client. They have a good shot. They are getting quite a good reception overseas for Red Lobster. It's a sign of faith that the CFO moved over to Red Lobster. [The company announced in December that Brad Richmond, now chief financial officer for Darden, would become Red Lobster's CFO.] He's obviously done his due diligence and thinks they have a shot.

What would entice potential buyers?

Burke: I think Red Lobster is undoubtedly the best seafood chain for the middle class with the best media. They are an exception to my comments about media not being effective.

Weichmann: You don't see many restaurant brands that are able to reinvent themselves like Red Lobster has done. If you look at the attack on Darden, it's more an activist group trying to get a bump in the stock price. I'm not saying everything Darden has done is right. They went on a buying binge and paid too much for a few of the assets, and that made them vulnerable because the stock wasn't performing as well as it could have performed if the earnings were moving at a faster pace. You had two cash cows that were giving you the internally generated cash flow to rapidly develop the other brands that they had invested in. On paper, it's a brilliant theory. In execution, they may have paid too much for some of those assets and brought too many on in too short a period of time [LongHorn Steakhouse parent Rare Hospitality and then Eddie V's and Yard House].

Clearly, Red Lobster still has legs and life and a dominant position in its niche. It is a brand that is extremely well known. The criticism is more on the corporation itself because it's a slower-growth brand. The activists don't see the cash generation. There still is a lot of relevance in the brand. ... With the right owner, it could be great because of the cash-flow generation.

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