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Olive Garden Heads Back Into Kitchen as Activists Circle

By Leslie Patton - May 9, 2014

Jim Nuetzi has a lot on his plate: reinventing a stale pasta menu that can boost sales and help get activist investors off his bosses' back.

Nuetzi is head chef at Olive Garden, [Darden Restaurants Inc. \(DRI\)](#)'s biggest brand. As part of an effort to bring foodie sensibility to a chain that tends to attract an older crowd, he's experimenting with capers, kale and pistachio-crusting truffles -- ingredients more often found at hipper joints.

Darden, a casual-dining company that also owns LongHorn Steakhouse and Bahama Breeze, badly needs to revive Olive Garden to turn around slumping sales and fend off activist investors Starboard Value LP and Barington Capital Group LP. Darden's shareholder critics disagree with a plan by Chief Executive Officer Clarence Otis to spin off the company's ailing Red Lobster chain and are calling for new management.

"Everything else will work itself out if they can get [Olive Garden](#) trending in the right direction," said Peter Saleh, an analyst at Telsey Advisory Group in New York.

The broader casual-dining industry is struggling with still-shaky [consumer confidence](#) and inroads from fast-food restaurants. Last year, sales at full-service restaurants rose just 2.8 percent, compared with a 3.5 percent gain for fast-food places and other limited-service eateries, according to Chicago-based research firm Technomic Inc.

At Darden's three biggest restaurant chains, same-store sales have declined for three straight quarters, and total revenue fell last quarter for the first time in almost four years. The [stock](#), meanwhile, has dropped 8.5 percent this year. It rose 0.7 percent to \$49.73 in New York today.

Real Estate

The answer, according to Starboard and Barington, is shedding the company's real estate holdings and keeping Red Lobster. In March, Barington pushed for Otis's ouster, saying the stock has underperformed since he became CEO in 2004. The hedge fund says the CEO's plan to

separate Red Lobster through a tax-free spinoff or sale may destroy value.

Starboard also opposes Otis's plan and has gathered support for a special meeting to give shareholders the chance to vote against it. It has suggested Darden sell its real estate -- which it says may be worth \$4 billion -- or spin off the properties into a real-estate investment trust.

Darden executives disagree. To make their case, they've met with more than 60 percent of institutional shareholders in the past year, two people familiar with the situation said. The company even brought along directors to help win support, said the people, who asked not to be identified because the information was private.

Testing Flavors

So far, most shareholders have told Darden they care most about retaining the dividend and fixing Olive Garden, which brings in more than 40 percent of revenue. That's where Nuetzi comes in. After years of serving up large portions of basic Italian food, the 800-store chain is no longer afraid to play with more flavorful ingredients, even if they turn off some customers, he said.

"We are purposely using ingredients that would have been considered polarizing," he said in an interview at Olive Garden's test kitchen in its headquarters in Orlando, Florida. "If we don't start introducing polenta, olives and capers, we're going to miss the boat."

Suited in a long-sleeve white chef's coat with black piping and the Olive Garden logo, Nuetzi is talking about the restaurant's new Polenta Shrimp alla Greca. The small plate, a dish of sauteed shrimp on creamy polenta slathered with olives, capers and tomato sauce, is part of the chain's menu overhaul.

Younger Diners

Nuetzi and four other chefs share the 3,000-square-foot (280-square-meters) space that's packed with MagiKitch'n industrial griddles, a wine fridge and a collection of cookbooks. Introduced in February, Olive Garden's revamped bill of fare is designed to attract a younger crowd.

Even as Otis doubles down on Olive Garden, he has been meeting with investors and Goldman Sachs Group Inc. (GS) to evaluate the brands and determine which ones to get rid of. After spending months looking at the financial and tax implications from separating different concepts, Red Lobster emerged as the best candidate because of its limited growth potential.

Red Lobster customers are often elderly and don't go out to socialize very often, said John

Gordon, principal at Pacific Management Consulting Group, an adviser to restaurants. The chain's same-store sales have declined in seven of the past eight quarters.

Longstanding Problems

"All of these things they knew about, or should have known about, and known how to fix them," Gordon said. "There was something wrong in the culture."

Unloading Red Lobster remains the smartest course of action, said Rich Jeffers, a Darden spokesman.

"The plans we've announced, including pursuing parallel paths for the separation of Red Lobster through a sale or spinoff of the business, best positions the company for long-term value creation and are in the best interest of Darden shareholders," he said.

While shareholders may support the idea of a special meeting to decide on Red Lobster, they haven't indicated how they might vote, Jeffers said.

Barrington, based in New York, also has pushed for an independent chairman. Otis, 58, currently serves in that role.

"We do not understand why the board has not appointed an independent chairman and is delaying putting the Red Lobster transaction to a vote as shareholders have requested," Barrington CEO James Mitarotonda said. "It appears that Darden's 'independent directors' are not as independent as we had hoped."

Starboard, also based in New York, didn't immediately respond to a request for comment.

Lighter Alfredo

The Olive Garden chain has more promise than Red Lobster, especially if the latest food experiments pay off. Back in the chain's test kitchens, Nuetzi is fiddling with mushrooms and lower-sodium sauces. While he's already cut the salt by 15 percent in the chain's Abruzzi sauce, a broth used on chicken, he's considering sauteing the chain's chicken parmigiana, instead of frying, to make it healthier.

Nuetzi also is working on a top-secret, lower-calorie Alfredo sauce. He's tinkered with about 20 different versions of the rich cream sauce in the past year, and yet it's still in the "extremely early stages," he said.

The company is right to focus on improving Olive Garden, said Stephen Anderson, an analyst at Miller Tabak & Co. in New York. A turnaround there may help finance an expansion of the

company's more upscale chains, which include Capital Grille and Seasons 52. That's going to be a long-term source of growth for Darden, he said.

"If you have a healthy Olive Garden, it will supply the cash flows you need to grow some of the higher-end concepts," he said.

To contact the reporter on this story: Leslie Patton in Chicago at lpatt05@bloomberg.net

To contact the editors responsible for this story: Nick Turner at nturner7@bloomberg.net Kevin Orland, James Callan

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