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No more bargain dinners

Margin-eating restaurant deals may be on the way out

By Paul Ziobro

NEW YORK (MarketWatch) -- Casual-dining restaurants may be lifting their foot off the promotional pedal.

Recent data out of Knapp-Track, a survey of restaurant sales, suggest that rampant discounts that hurt margins and sales at some chains appear to be easing. While traffic and same-store sales both still remain negative, the divide between the two metrics has narrowed significantly in recent weeks, showing that guests who come in aren't filling up on discounted meals as much as they had been in recent months, Malcolm Knapp, proprietor of the survey of close to 11,000 restaurants, told Dow Jones Newswires.

"There were some extreme promotions where [casual-dining restaurants] were trying everything they could," Knapp said. "That is going to start changing."

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Tempered discounting could help casual-dining companies on the next leg of their recovery, which hinges on improving sales. Cost cuts helped restaurants exceed earnings expectations as demand for eating out fell, but many chains will begin lapping those cost-saving measures, putting more pressure on better sales to grow earnings.

Historically, same-store sales outpaced restaurant traffic, helped by yearly price increases. That was the story until May, when big discounting turned the equation on its head. For the first time since the Knapp-Track survey began in 1991, guest counts came in ahead of same-store sales and have stayed that way through October. Discounting appears to have hit bottom in September, Knapp said.

Chili's Grill & Bar, the flagship chain of Brinker International Inc. (NYSE:EAT) , is one chain that is trying to shift away from discounting by differentiating its menu with new items. Chili's is still running a deal of two entrees plus a shared appetizer and desert for $20 to draw in diners, using it mostly as a vehicle to introduce its new items as opposed to only discounting existing items.

Chains that shied away from discounting during the recession, like Darden Restaurants Inc. (NYSE:DRI) and Texas Roadhouse Inc. (NASDAQ:TXRH) , have less of a hill to climb in getting patrons to pay full prices, said Tom Forte, analyst at Telsey Advisory Group. "They won't have that discounting hangover that other companies could have," he said.

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"It's full speed ahead, regretfully, in the area of discounting," Nelson Marchioli, chief executive of Denny's Corp. (NASDAQ:DENN) , said in an interview. "It's a short-term fix but I see no less of it through 2010."

Denny's, in formulating next year's menu, considers offering flexibility on meals as a part of its value strategy. In one option being considered, the chain may sell its new premium burger, currently offered at about $6.99 with fries and a drink, at $3.99 for just the sandwich, with toppings and sides costing extra.

Such a deal is modeled on success Denny's had with a build-your-own version of its signature "Grand Slam" breakfast, where giving customers more options has made the item five-times more popular than any other entree.

The lower initial price helps get Denny's customers, who, on average, make less than $45,000 a year, into the doors, while the add-ons are a chance to build the bill. However, such price cuts and a new consumer mindset may make it hard to get prices back up to prior levels, which looks to be a ways off.

"I don't think we're going back" to full prices, Marchioli said.