US Casual-Dining Companies Explore Smaller-Format Restaurants

By Annie Gasparro, Of DOW JONES NEWSWIRES

NEW YORK -(Dow Jones)- Casual-dining companies, such as Cheesecake Factory Inc. (CAKE) and Texas Roadhouse Inc. (TXRH), are experimenting with smaller restaurant prototypes as a way to improve margins coming out of the recession.

Cheesecake Factory is working on a new 8,000-square-foot model, which it expects to generate similar cash flow margins as its typical 10,000-square-foot locations. The cash investment required for the smaller-format restaurants is reduced by more than 20%, allowing the restaurant to reach peak margin levels with lower sales. With the new model, Cheesecake Factory said it can exceed 20% return on investment with sales volumes of just over $8 million.

The smaller prototype also provides more site-selection flexibility, said Chief Executive David Overton, during a conference call. "We don't require only new mall development or expansion of malls to build new restaurants," he said. " This is a big advantage."

Smaller spaces require less capital investment, increase efficiency, and make chains more adaptable to existing retail space, at a time when new sites are hard to come by and restaurant traffic still hasn't returned to pre-recession levels.

Texas Roadhouse is testing a 10% smaller version, which opened last month.

"The smaller prototype certainly reduces development costs, but it also allows us to open in some smaller markets that may not be able to support a full-size restaurant," a spokesman said.

Often, these smaller markets can be more profitable because they offer cheaper real estate and less competition in the steakhouse category.

"Also, designing and working on the new prototype helped us to identify some inefficiencies in the kitchen, which we will incorporate in all new units [big or small] going forward," the spokesman added.

Bill Fahy, senior restaurant analyst at Moody's, said that, because restaurant companies reduced costs so drastically in the downturn, it will be tougher to downsize now. "There's always ways to cut costs," he said. "The biggest challenge is cutting costs without impacting the customer experience."

The restaurant companies said they can cut square footage in non-revenue- producing areas such as kitchens and waiting areas to allow for a similar amount of seating as in larger models, creating better margins.

WD Partners, a Columbus-based restaurant design and development firm, estimated that reducing a restaurant's size to 7,250 square feet from 8,100 square feet through engineering improvements could save $153,000 per unit in development costs alone.

Dennis Lombardi, WD Partners' executive vice president of food-service strategies, said reductions in the back of the restaurant, or "house," if done right, "won't just avoid a negative impact on customers, but can actually improve the customer experience." Adding tables to waiting areas shortens wait times, and decreasing kitchen size reduces the fatigue factor for employees, he noted.

Darden Restaurants Inc. (DRI), which owns Olive Garden, Red Lobster and Longhorn Steakhouse, is exploring a similar strategy with a multi-brand restaurant opening March 7 in Florida. The combination Olive Garden/Red Lobster includes a joint kitchen and two separate dining rooms that are each about half

"It allows us to go in to new markets, which normally wouldn't have the traffic to support one of our full-size restaurants," a spokesman said.

P.F. Chang's China Bistro Inc. (PFCB) recently hired a new vice president of real estate for its Pei Wei chain and is evaluating alternatives to the chain's typical 3,200-square-feet design. With fewer malls and shopping centers in development, the company said it hopes to increase potential sites for Pei Wei. But Co-Chief Executive Rick Federico warned, "We don't want to jump in with both feet, before we get a couple of those in the ground, and risk compromising the guest experience."

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