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McDonald's Corp. (MCD)

Q1 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Hello and welcome to McDonald's First Quarter 2021 Investor Conference Call. At the request of McDonald's Corporation, this conference is being recorded. Following today's presentation, there will be a question-and-answer session for investors. [Operator Instructions]

I would now like to turn the conference over to Mr. Mike Cieplak, Investor Relations Officer for McDonald's Corporation. Mr. Cieplak, you may begin.

Mike Cieplak

Vice President & Investor Relations Officer, McDonald's Corp.

Good morning, everyone, and thank you for joining us. With me on the call this morning are: President and Chief Executive Officer, Chris Kempczinski; Chief Financial Officer, Kevin Ozan; and President of McDonald's USA, Joe Erlinger.

I want to remind everyone that the forward-looking statements in our earnings release and 8-K filing also apply to our comments on the call today. Both of those documents are available on our website, as are reconciliations of any non-GAAP financial measures mentioned on today's call with their corresponding GAAP measures.

Following prepared remarks this morning, we will open queue for your questions. I ask that you please limit yourself to one question. And if you have more than one, please ask your most pressing question first and then re-enter the queue. Today's conference call is being webcast and is also being recorded for replay via our website.

And now, I'll turn it over to Chris.

Chris Kempczinski

President, Chief Executive Officer & Director, McDonald's Corp.

Thanks, Mike, and good morning, everyone. It was a year ago this week that we had our first earnings call of the COVID-19 pandemic. We had just begun to experience the closings, openings and constantly changing regulations that would come to define the past year.

I said then that in the face of such enormous challenges, I was immensely proud of the entire McDonald's system. Franchisees, crew members, suppliers and company employees banded together and continued to feed and foster communities amidst unprecedented change and disruption.

My pride has only grown since then. Through the pandemic, we've seen the power of the McDonald's system and our franchise model at work. We are one of the world's most global corporation, but also one of the most local, serving tens of millions of customers each day across almost 40,000 local restaurants. That's our secret sauce.

And it's hard to imagine how we would have adapted to the constantly changing circumstances of the past year, if we were not a locally owned, locally managed system, rooted in the communities where we operate. That ability to adapt enabled us to build a system playbook that tapped into our operating prowess and synthesize learnings from individual markets.

We put our customers and people first, and found ways to ensure their safety and security amidst a global health crisis. We leaned into our historical strengths, like our core menu and drive-thru, to continue serving our communities, creating feel-good moments that were more welcome and needed than ever.

At the same time, we kept innovating, in areas like digital and delivery, to offer customers new ways to safely connect with our brand and deepen our ability to meet their personalized needs. And we used our marketing muscle to keep the golden arches shining brightly, reminding people of their enduring trust in our brand and our purpose to feed and foster communities.

Importantly, we did it all with a commitment to transparency. Every step of the way, we gave our stakeholders a clear sense of what we were doing and why we were doing it. That communication was made easier by our refreshed values that captured the essence of the McDonald's system and how we operate. No matter where you are in the world, our McDonald's values serve as the glue that unites us and guides our every decision.

We put our people and customers first. We open our doors to everyone. We do the right thing. We're good neighbors. And we get better together. Five simple statements that capture the essence of the company Ray Kroc founded over 65 years ago. Our renewed focus on these values has kicked off a virtuous cycle, energizing our workforce and attracting new leaders who embody these qualities and are inspired by our purpose. That includes Desiree Ralls-Morrison, who joined the team earlier this week as our new General Counsel.

Turning to our business performance. Despite resurgences in continued operating restrictions in many parts of the world, I'm pleased to share that in the first quarter, global comp sales and revenues have already surpassed Q1 2019 levels. Not surprisingly, we expect McDonald's to deliver strong global comp sales and revenue growth against 2019 levels for the full year, reflecting the strength of our business and the pent-up customer demand we're seeing as markets reopen.

Specifically in Q1, global comp sales for the quarter were up 7.5%, with each of our segments achieved positive comp sales. As we will hear in a moment from our US segment President, Joe Erlinger, that improvement was largely driven by the US with comp sales of 13.6% for the quarter.

In Europe, we continue to face a tough operating environment, which is impacting recovery across some of our top markets in the IOM segment. Kevin will talk about our international performance in a minute.

We remain laser-focused on achieving the sustainable growth plan laid out in Accelerating the Arches. Likewise, our three growth pillars, M, C and D, continue to serve as both a guide and an engine for our path forward. We are maximizing our marketing to stay relevant and find those connection points with customers that will pay off in a big way.

We're also committing to our core menu, making the chicken, burgers and coffee our customers love even more delicious. In a moment, Joe will talk about the successful launch of the new Crispy Chicken Sandwich.

Finally, we're doubling-down on digital, delivery and drive-thru. We're creating a faster, easier, better customer experience however our customers want to interact with us, whether at the counter, through drive-thru window or on the app, dining in the restaurant or having that meal delivered to them. We will offer experiences they love and that we believe will keep them coming back.

Over the past four years, we went from just over 3,000 restaurants offering delivery to now more than 30,000 restaurants for 75% of our global footprint. We're excited about our success with multiple [ph] 3PO (6:35) partners, and we continue to innovate. That includes testing self-delivery models in select markets and identifying ways to improve restaurant operations for delivery so that customer experience will get better and better.

Drive-thru made McDonald's what it is today. The drive-thrus in 25,000 of our restaurants worldwide are a huge part of who we are and why we've been able to continue safely serving millions of customers each day this past year. And since the pandemic began, we've leaned into this competitive advantage by continuing to improve drive-thru service times by putting more emphasis on operations and reducing menu complexity.

We also see digital as an important channel to improve speed and convenience, provide customers with more personalization and offer even better value. We have 40 million active app users in just our top six markets and millions more around the world. Our goal is to make sure that no matter how customers interact with us, they have a seamless and consistently enjoyable experience.

One key lever in reaching our digital ambition is loyalty. In addition to France and a few other markets, which already have loyalty, we are currently piloting our new loyalty program, MyMcDonald's Rewards, in the US and Germany, with plan to deploy later this year. What inspires me the most about our digital transformation is that we constantly have the opportunity and ability to become even relevant in our customers' everyday routines.

The power of our growth pillars come to life, not in isolation but in combination. The success of our Famous Orders program is a great example of how the three pillars, our M, C and D, are deeply interconnected, reinforcing and bolstering one another. And last week's announcement that we're partnering with Supergroup BTS from South Korea, to offer fans in nearly 50 countries their favorite McDonald's order shines a powerful light on a simple truth: in every country where we operate, from every walk of life and at almost every stage of life, you have your go-to McDonald's order.

This is much more than your traditional promotional partnership. For one, it will harness the scale of McDonald's and the relevance of authentic fans like BTS. I think it's fair to say that few other brands have the cultural relevance and global appeal to pull off this kind of partnership. That's the power of brand McDonald's.

Famous Orders takes that universal insight of everyone's unique go-to McDonald's order, celebrates our fans' love of the core menu and brings it to life through digital activations. The BTS ARMY will soon experience the M, the C and the D of our plan in a way that authentically taps into their love of these two global icons.

And it doesn't stop there. Whether it's through successful traffic-generating promotions like digital calendars in Australia or Germany, building on the strength of core equities with line extensions like Katsu Curry Chicken McNuggets and Grand Big Mac in the UK, or piloting the MyMcDonald's Reward loyalty program, we continue to deepen our connection with customers and create a consistent and enjoyable experience.

Let's turn it over to Joe to tell us what that experience is looking like in the US. Joe?

Joseph M. Erlinger

President, McDonald's USA, McDonald's Corp.

Thanks, Chris. Our US business ended 2020 in a position of strength and that carried into the first quarter, delivering a 13.6% comp sales increase, with double-digit positive comps across all dayparts. We exited Q1 with historically high average daily sales volumes and the record high operating cash flow our franchisees experienced in 2020 continued in Q1. While we have seen some benefit from consumers receiving government stimulus checks during the first quarter, our results are truly a testament to the hard work happening each day in our restaurants.

I've recently been in our restaurants in Maine and Massachusetts, and you can feel the energy and excitement. Our franchisees and, importantly, their restaurant teams, are focused on keeping our crew and customers safe. In addition, they are delivering gold standard execution, especially around chicken and the 3Ds, and this has led to higher customer satisfaction scores. I want to give a special thank you to our Owner/Operators and restaurant teams for all they've done during extremely challenging times.

Our growth plans in the US are rooted in the Accelerating the Arches strategy and focused on the MCD framework. As for our results, the quarterly performance is a product of the accumulation of what we've done over the past 12 months and not because of any one action we took during a quarter or a four-week marketing window. The values and brand-based decisions we've made, along with simplifying our menus, strengthening our digital business and recommitting to our core, are having a multiplier effect. I've seen this recipe for success in several markets during my time overseas, and I'm confident that the right pieces are in place for our US business to sustain results.

Let me pull back the lens and give you some examples. Driving customer visits begins with committing to the core menu. Early in the pandemic, the US business removed dozens of menu items. As a result of this focus, our drive-thrus got faster, margins grew and customer satisfaction improved. Put simply, our restaurants became easier to run and more profitable.

Reducing complexity set the stage for the right investments in the core beginning last fall with Spicy Chicken McNuggets, which we brought back for a limited time in February. They drove customer excitement and comp sales growth during the quarter. Then in late February, we introduced our Crispy Chicken Sandwich line of three delicious new sandwiches, the beginning of our multiyear chicken journey.

While the category is very competitive, we are so far exceeding our projections. We are selling substantially more chicken sandwiches compared to our previous chicken sandwich line and seeing strong unit movement, especially after 4:00 PM.

Our success is a demonstration of McDonald's at its best, with all three legs of the stool working together. First, we developed the platform and built the supply chain. We then aligned the system around the opportunity. And finally, we created engaging and exciting marketing, PR and social media plans nationally and across our 10 field offices.

Today, we're learning from each other and working to transfer the success we're seeing in our top restaurants to all restaurants. We expect to refresh and sustain this platform and do so in a very culturally relevant way throughout the rest of 2021.

At the same time, we doubled-down on the 3Ds: digital, delivery and drive-thru. With COVID as the catalyst for a consumer behavior shift, we experienced an absolute surge in off-premise dining. We drove our digital sales mix and app usage. In the first quarter, we had nearly $1.5 billion in digital sales, which includes app, kiosk and delivery. And we now have over 20 million active app users with loyalty yet to come.

We grew delivery to an all-time high in dollars and sales mix. And we continued to reduce overall experience times, especially impressive given the increased volume of business we've experienced through the drive-thru.

Chris mentioned the Famous Orders platform earlier. Nothing had a greater impact on our digital business than the introduction of this program last year. We've retained many of the digital customers acquired during those

Famous Order promotions. And the US business is very excited about the upcoming BTS meal, which continues to maximize our digital investments without adding any restaurant complexity. And with that foundation, we are well positioned heading into our loyalty program launch later this summer.

When we built MyMcDonald's Rewards, our goal was to create a platform that elevated our brand, excited our customers and engaged our crew. And we did just that. In our two test and learn markets, Phoenix and New England, we're encouraged by the initial results. User adoption, as measured by guests ordering through the app, are up significantly since the test began. Frequency has increased. In fact, our loyalty customers are far more likely to return in the next 30 days compared to non-loyalty customers. And customer satisfaction is up.

Customers love the personalized experience of being greeted by their first name. We've received overwhelmingly positive feedback from restaurant crew, not only on the program itself, but the ways in which we've trained them; for example, using digital simulations. Of course, as in any test, we've captured many learnings around training, operations and deployment, that will help us maximize the impact when we launch this nationally.

As I close, I want to reiterate that there is not one single reason for our success. The accumulation of our decisions, grounded in our values, returned the US business to a place of brand relevancy for our customers and meaning for our people and has provided us a strong foundation towards sustained business growth.

And now, I'll turn it over to Kevin to talk about our international performance and our financial results.

Kevin M. Ozan

Chief Financial Officer & Executive Vice President, McDonald's Corp.

Thanks, Joe. As Chris mentioned earlier, global comp sales and revenues for the quarter surpassed Q1 2019 pre-pandemic levels, largely driven by the US. For the quarter, global comp sales increased 7.5% with growth across all segments, and comps were up significantly in March, as we started to lap the impact of COVID-19.

In the IOM segment, comp sales were up 60 basis points in Q1. With widespread resurgences and ongoing government restrictions across Europe, including dining room closures and reduced operating hours, the segment has not fully recovered to pre-COVID levels.

As a result of the restrictions, we saw varied performance across the markets. Strong results continued in Australia, as customer mobility has mostly recovered and the country remains nearly COVID-free. The market benefited from sales of their new chicken line, along with successful LTL line extensions on core burgers. And average check has continued to hold up, with sustained growth in delivery and drive-thru sales and a shift into more core and premium menu items.

Comp sales were positive for the UK and Canada for the quarter and surpassed 2019 pre-pandemic levels. Despite UK's national stay-at-home order for nearly all of Q1 and Canada's recent surge in COVID infections, both markets have successfully leveraged the competitive advantages of our 3Ds to grow sales.

And in France and Germany, comps were negative for the quarter, as dining rooms were closed and curfews were in place. Government restrictions are expected to ease somewhat in Q2, but we don't expect these markets to recover to pre-COVID sales levels until later in the year.

Comp sales in the IDL segment were up 6.4% for the quarter, with growth across nearly all geographies. Performance was largely driven by positive results in China and Japan. In China, comps were up significantly for the quarter, as we comped over COVID impacts from February and March last year.

By leveraging their large digital members base, China ran compelling digital offers, contributing their results for the quarter as they continue on the path to recovery. In addition, China opened 150 new restaurants in Q1, keeping on pace to open nearly 500 new restaurants this year. Japan maintained momentum in Q1, with comps up 9%, and that's on top of over 5% growth last year, as a strong balance of core, value and family-related promotions resonated with customers.

Looking ahead to Q2, we expect the US to continue to outpace 2019, with two-year comp sales growth relatively in line with Q1. In the IOM segment, we expect the two-year growth rate to improve over Q1, but the segment will likely continue to lag 2019 until the second half of the year.

Given our strong start to the year, we now expect full year systemwide sales growth in the mid-teens in constant currencies. But we continue to see pandemic-related stops and starts in markets around the world, impacting customer behavior and our business. So there's still some uncertainty.

Turning to earnings. Adjusted earnings per share in Q1 was $1.92, up 27% in constant currencies. And adjusted operating margin was 41.9%, reflecting improved sales performance, higher other operating income and lower G&A costs compared to last year. Total restaurant margin dollars increased 10% in constant currencies, with improvement in both franchised and company-operated restaurant margins.

Franchise margin dollars grew by over $170 million in constant currencies, mostly from the strong sales performance in the US. And company-operated margins in the US were strong, as we continue to see top line growth driven from higher average check. As I mentioned last quarter, we expect US margins to moderate somewhat as check growth tempers and we reopen dining rooms.

In the IOM segment, company-operated margins improved in Q1. With the ongoing impact of COVID on the segment, we don't expect to get back to full year pre-COVID margin levels this year. This is a result of near-term sales and cost pressures, but there's nothing structural to prevent us from returning to pre-COVID margins longer term.

Turning to G&A. Chris and Joe both talked about the contributions from digital on our results, and we continue to invest in this important area to fuel growth. For the quarter, G&A was down 6% in constant currencies, due to some one-time costs we incurred in the first quarter last year.

As a result of our strong start to the year, we're now expecting higher incentive-based compensation. So for the full year, we expect G&A to be about 2.4% of systemwide sales. Because this increase to incentive-based comp just relates to current year performance, it will only impact this year's G&A.

Our effective tax rate was 21.3% for the quarter. And we're still projecting a full year rate in the range of 21% to 23%, with some fluctuation across the quarters. And finally, foreign currency translation benefited Q1 results by $0.06 per share. Based on current exchange rates, we expect FX to benefit EPS by about $0.10 for Q2, with an estimated full year tailwind of $0.24 to $0.26. As usual, this is directional guidance only, as rates will likely change as we move through the year.

I'm pleased with our global recovery to-date, even as we face resurgences and restricted operations around the world. And I'm confident that our Accelerating the Arches strategy will continue to drive growth in the business.

Now, I'll turn it back to Chris.

Chris Kempczinski

President, Chief Executive Officer & Director, McDonald's Corp.

Thanks, Kevin. I want to close by saying, once again, how proud I am of everything our system has accomplished and continues to do amidst such difficult circumstances. If last year was about defining who we are, what we stand for and where we're going, this year is about execution and how we're going to get there.

Every year, we check in with our staff to get their feedback on the work that's happening. In our latest survey results received last week, almost 90% of employees expressed strong confidence in our business. And just as importantly, they agreed that we were abiding by each of our core values. And just a few weeks ago, we held our Annual Leadership Summit, virtually bringing together our top 50 field and corporate leaders. Across each of our markets and amongst this leadership group, there was strong alignment against our Accelerating the Arches strategy and universal recognition that our continued success depends on great execution.

Back in November at our Investor Day, I said that distinctions between the corporate brand and the consumer brand are blurring. They're now two sides of the same coin and you can't build an inclusive family-focused global consumer brand like McDonald's, unless the corporation's actions give evidence to those attributes.

That's why in February, we set five and 10-year goals for increasing diversity and leadership across our corporation. Research has shown that businesses that prioritize DEI recruit and retain stronger talent, unlock greater innovative potential and bolster financial performance. And we're committed to making measurable progress in disclosing representation data to hold ourselves accountable for results by tying a portion of executive [ph] compensation (24:16) to making progress in this area.

Earlier this month, we also shared global brand standards designed to reinforce a culture of safety and inclusion. We want employees and customers to feel safe and protected. And it's critically important to be clear that violence, harassment and discrimination of any kind is not tolerated.

All 39,000 McDonald's restaurants across the globe, including company-owned and franchised locations, will be required to uphold these standards. We're continuing to put resources and tools in place to help restaurants implement these changes and ensure these standards are met.

Beginning in January 2022, restaurants will be assessed in accordance with the applicable McDonald's market business evaluation processes. We understand that the way we show up in our communities and for stakeholders impacts the way customers see us and their trust in us. We have to make sure our values are the lived experience of everyone who interacts with our brand.

We've seen powerful examples of service and dedication on display across the McDonald's system during the most difficult year we've ever experienced. Around the world, our people have embodied the belief that we must all pitch in and help one another. They take pride in that, and they should.

While we all remain hopeful that this will be a year when life begins to return to some version of normal, we know the operating environment remains volatile. We expect that there will be stops and starts that impact results. But as we see, even during the most difficult moments last year, delicious feel-good moments for McDonald's remain high in demand. We will continue to lean forward and make bold bets on our future. I believe more strongly than ever, as I said in November, that this is the start of something new for McDonald's.

As we continue to accelerate the arches, lead with our values and serve our customers and communities, I look forward to seeing what the McFamily can accomplish in the months ahead. And I look forward to seeing our global system come together in person next April in Orlando for our Global 2022 Worldwide Convention.

And with that, we'll begin Q&A.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions]

Mike Cieplak A
Vice President & Investor Relations Officer, McDonald's Corp.

Okay, our first question is from John Glass with Morgan Stanley.

John Glass Q
Analyst, Morgan Stanley & Co. LLC

Thanks and good morning to you. My question is on the health of the European consumer and how you think about the recovery. So we have a lot of data, obviously, on the US and we see it in the numbers. I'm asking, I guess, if you can tease out between the closures and the restrictions, how you think the consumer is there, particularly in the Continental European markets, what you think you need to do differently on reopening? Is value going to be more important? How do you think – is it as simple as reopening or do you think there's a lag just from a consumer response perspective in those markets as well? Thanks.

Chris Kempczinski A
President, Chief Executive Officer & Director, McDonald's Corp.

Hi, John, it's Chris. Good morning. And I think on the European market, start with, it's difficult to talk about it as sort of one single market. I think you have to break it into kind of each of the big markets there. And it varies. In the case of the UK, we're seeing the UK consumer is quite strong. That business is performing well. Markets that are heavily tourist dependent, however, like Spain, Italy, France, those markets are struggling.

And so I think for us, part of what we believe is that this summer, we do think that many of the European markets are going to start opening up. There's been some commentary about perhaps a vaccine passport that allows for travel within the European market. That, I think, will have a big impact and help on stimulating those markets that maybe have had a little bit more of a headwind.

And then I think for us, the key is about also getting the dining rooms open. Our dining rooms are closed in about 50% of our restaurants in Europe. As you know, dining rooms or dine-in is a big part of our European business. And so getting those open, I think, will be another important step for us in getting momentum back into the European business.

But from a consumer standpoint, in terms of just the outlook, I think it's probably best described as being concerned about and anxious about many of the things that are coming with COVID. But I think also there's pent-up demand that we've seen when we do – when we are able to get a market open or even last year when we had some re-openings that then resulted in closures, not too long thereafter as the second and third wave came about, that there's nothing that gives us any concern that as we reopen, that we're going to see the same pent-up demand come back and get the European business moving forward.

Mike Cieplak
Vice President & Investor Relations Officer, McDonald's Corp.

A

Next question is from David Tarantino with Baird.

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

Q

Hi, good morning. My question is on the US business. And really wanted to get your thoughts on how much you think the stimulus might be helping the trends in the US.

And then secondly, what are you assuming in your guidance, either for the remainder of Q2 or the remainder of the year, as it relates to the health of the consumer and whether the current momentum in the business can carry through for the rest of the year?

Chris Kempczinski
President, Chief Executive Officer & Director, McDonald's Corp.

A

So, why don't I have Joe talk about kind of what we're seeing right now, and then Kevin can touch a little bit on what's in the guidance.

Joseph M. Erlinger
President, McDonald's USA, McDonald's Corp.

A

Okay, thanks, David, and thanks for the question. Relative to the stimulus checks, there is no question that it did benefit our business. But I think, as I shared in my prepared comments, the positivity that we saw in the first quarter was way beyond just the stimulus checks, was that accumulation of all the things that we've done over the last 12 months that's put us in a very strong position. I think you can also argue that the stimulus checks are now wearing off generally, but we're seeing continued momentum in our business. And, as Kevin said, we expect our second quarter two-year stack to be roughly the same as our first quarter stack.

Kevin M. Ozan
Chief Financial Officer & Executive Vice President, McDonald's Corp.

A

I wasn't going to say much more, other than I think going forward, to Joe's point, I think consumers in the US still are fairly healthy. It's certainly helpful for us, obviously, when they've got money in their pockets and stimulus definitely helped in the first quarter. But we are seeing when we do reopen dining rooms, even in the US, that consumers are ready to come back to visit in the dining rooms and have some money to spend. And so, I don't think we have a big concern right now about consumer ability to be able to spend.

Mike Cieplak
Vice President & Investor Relations Officer, McDonald's Corp.

A

Okay. Our next question is from Dennis Geiger with UBS.

Dennis Geiger
Analyst, UBS Securities LLC

Q

Great. Thanks for the question. Chris and Joe, just another one on the US, where you've got very strong momentum, clearly. And based on the plans that you outlined, it seems like that the momentum continues for the year and beyond. But wondering just if you could help frame your expectations for the coming quarters as the US continues to reopen and you think about other restaurant options reopening, how you think about tailwinds, headwinds. You're getting your own benefits as it relates to that reopening, I assume. How you're thinking about that.

And just kind of building on that, just, Joe, you kind of talked, I think, about the US relative maybe to some other really strong countries internationally. Just wondering if you could draw some parallels there for the potential for kind of multiyear period of outperformance in this US business, maybe the way you have with some of the other really strong countries outside of the US historically.

Joseph M. Erlinger
President, McDonald's USA, McDonald's Corp.

A

Hey, Dennis, thanks for the question. I mean, there's no question that as you think back to the initial onset of the pandemic, there was the surge in off-premise dining. And we were set up incredibly well, given the investments that we've made historically in digital, delivery and drive-thru within the US business to succeed in that environment. And that's exactly, obviously, what we've done. Beyond that, though, obviously, we've made some great investments in chicken, great investments in the core, that have begun to really set us up well for the future. And we continue to have our prowess around value.

As you begin to look forward, we think there's no question that the consumer is going to want to come back into dining rooms. Chris has already mentioned it in Europe, but we think it's the case in the US as well. And so we will continue to open our dining rooms, but we want to do it in a way that really drive sales and make it an event almost as we reopen our dining rooms, because with 90% plus of our business being through the drive-thru, if we can sustain that and return our dining rooms and take-away to the levels that they were pre-pandemic, we've set ourselves up for a very good run here.

In terms of parallels between the US business and other successful markets overseas, it's never one lever, Dennis. It's always a combination of things that are put together in concert, such that you're not dependent upon the next promotion or the next deal that you do. And this is this idea of underlying baseline momentum. And so we're feeling the benefits of that underlying baseline momentum in the US that I saw in many international markets as they set themselves up for multiyear runs. And I think that's where we are.

Mike Cieplak
Vice President & Investor Relations Officer, McDonald's Corp.

A

Okay. Our next question is from Eric Gonzalez with KeyBanc.

Eric Gonzalez
Analyst, KeyBanc Capital Markets, Inc.

Q

Hey, good morning. Thanks for the question. Clearly, the stimulus has provided a nice boost to industry sales in recent weeks. But on the flipside, the labor pool seems to have shrunk. How are your franchisees handling the labor shortages? And what is your expectation for labor inflation this year? And also, do you see this as a temporary step-up that might recede after the supplemental unemployment benefits go away? Or are you looking at this as more of a permanent environment, speaking about the specific staffing issues and the issues restaurant operators are facing today? Thanks.

Chris Kempczinski
President, Chief Executive Officer & Director, McDonald's Corp.

A

Hey, Eric. Well, I think you have accurately characterized what we're seeing in the US right now is definitely a very tight labor market that's putting pressure on both us and our franchisees. I think one of the things that we are thinking about, and I'll have Joe talk about it, is in our company-owned restaurants, how do we think about what is the pay and benefits package need to look like for us, to make sure that we're able to get the people that we need. And then, Joe can also talk about how franchisees are addressing that.

Joseph M. Erlinger
President, McDonald's USA, McDonald's Corp.

A

Yeah. Thanks, Chris and Eric. Thanks for the question. Yeah. About two weeks ago, we actually came together on a system webcast. Because, obviously, across 14,000 restaurants and nearly 2,000 franchisees, while there might be some general struggles, there are also some specific best practices in specific areas where we are succeeding.

And so there were opportunities for our franchisees to talk to their fellow franchisees, about the things that they're doing that are yielding success. And that's always been one of the hallmarks of our system, when we can take a best practice from one restaurant and try to get it to all restaurants. It yields real benefits.

Interestingly, we are faring a bit better in our company-owned restaurants, as Chris mentioned. We have higher crew sizes overall than the average franchisee. We recognize that we need to continue to stay a little bit ahead of things on this topic.

And so, we're working through what some changes in our company-owned restaurants might look like from a wages and compensation perspective. We think the external environment is right to do this. We think the internal environment is also right to do this. And we think it's actually a great business decision for us.

Mike Cieplak
Vice President & Investor Relations Officer, McDonald's Corp.

A

Okay. Our next question is from Andrew Charles with Cowen.

Andrew Charles
Analyst, Cowen and Company

Q

Great. Thank you. Maybe looking back a little bit, the International Operated Markets, you saw four consecutive years of 3% comp growth and positive traffic in 2015 through 2018 after the EOTF remodels hit a tipping point.

And it just kind of feels like the US is kind of at the start of this, that the remodel program is substantially complete. And you've got all this traction over the last year with digital and the early success of the loyalty program that's come this summer.

So, thinking forward, 2022 and beyond. Am I wrong to think the business seems poised to go through this tipping point? And is there something unique about the IOM that would prohibit the US from delivering similar 3%-plus comps in 2022 and beyond? Thanks.

Chris Kempczinski
President, Chief Executive Officer & Director, McDonald's Corp.

A

Thanks, Andrew. Well, certainly, what we embarked on in the US several years ago drew a lot on the learnings that we had seen in our European, our IOM markets.

And a key feature of that was the EOTF program. I think the fact that we've been able to get almost all of our restaurants to be remodeled and have that sort of big reinvestment cycle behind us, that's a huge positive.

I think the fact that we're seeing now 2019 was a record cash flow year for franchisees. 2020 is a record cash flow year for franchisees. And 2021 will be a record cash flow year for franchisees.

I think that ability to have just franchisees with the firepower is something that we've seen in our European markets. And then, you're starting – we're starting to see the brand in the US really improve and move.

And that has been through a lot of the hard work that Joe and the team have done, along with how our franchisees bring the brand to life every day in the restaurant. And I think when you see a stronger improving brand performance, that was the hallmark of our success in Europe. And we're seeing that now, starting to gain some traction in the US.

So certainly, we're optimistic and hopeful that, what we saw that playbook in Europe will translate over in the US. And we've got a few years of momentum under our belt that gives us confidence in that. Joe, I don't know if you have anything else to add.

Joseph M. Erlinger
President, McDonald's USA, McDonald's Corp.
A

I think you've captured it incredibly well. That certainly was my experience overseas. When you make those right investments, and then you continually tap into them, whether it be the strength of your modern decors or whether it be the digital experience, or whether it be improvements in menu, these things all work in combination together and can set you up for that multiyear run.

Mike Cieplak
Vice President & Investor Relations Officer, McDonald's Corp.
A

Our next question is from David Palmer with Evercore.

David Palmer
Analyst, Evercore ISI
Q

Thanks. A question on loyalty. Could you give us a sense of how much you think loyalty will impact McDonald's globally and in the US? Does France and the US piloting show incrementality to sales and not just the visit intent like you mentioned? I think Joe mentioned that. And what changes to technology or otherwise can help ensure that loyalty can work with the drive-thru? You've made some strides there, but you don't want customers fumbling for scan codes. And it sounds like, from Joe's comments, that you're closer than we thought on customer identification. Thanks.

Joseph M. Erlinger
President, McDonald's USA, McDonald's Corp.
A

Yeah, there's no question that the results out of our tests in New England and Phoenix have been incredibly positive. The operators in those markets love what loyalty is doing. Our customers love what loyalty is doing. And I think our restaurant teams have really taken to it as well.

We're very confident in the business case. And when you think about the impact that this could have on the US business, where 85% plus of the US population actually comes to McDonald's at least one time a year. And so if loyalty can build frequency, given the base that we have of customers in the US, this is just a tremendous unlock for us.

Relative to the operations – operational impact, there – it is having a modest impact in our drive-thrus. We've trained our people really well. The training that's actually happening is really around the customer side. And it's the order-taking time that's slightly up, but we will be seeing benefits in the cash-taking time as a result of this as we become a more digitally penetrated system. I think that the momentum in the system is going to build in the coming months as we set up for our launch later this summer.

Chris Kempczinski
President, Chief Executive Officer & Director, McDonald's Corp.
A

David, I would just add, we wouldn't be doing this globally if we didn't think there was going to be an incremental benefit to loyalty. We're not, at this point, quantifying that. But certainly, our thesis is that there's going to be an incremental benefit that we get out of loyalty.

About the identification at the drive-thru order point, we're not there yet, but I think it's safe to say that we've got a number of ideas on how we're going to be able to make that happen. And that's part of our rollout plan over the next couple years. So I think you can safely expect that we're going to get a solution. It may not be the same solution everywhere, but we'll have solutions in place that allow us to get faster at identifying the customer at the order point. Kevin, were you going to say anything?

Kevin M. Ozan
Chief Financial Officer & Executive Vice President, McDonald's Corp.
A

The only thing I'd add is we have been working on our kind of underlying tech stack around the world over the last couple of years. So one of the things that that facilitates is at the same time we're piloting this loyalty program in the US here, we're also piloting it in Germany also. And we intend to roll out the loyalty program in Germany and Canada by the end of this year also. That's in addition to some countries that already have a loyalty program, like France and China, for example.

Mike Cieplak
Vice President & Investor Relations Officer, McDonald's Corp.
A

Okay. Our next question is from Sara Senatore with Bernstein.

Sara H. Senatore
Analyst, Sanford C. Bernstein & Co. LLC
Q

Thank you. I just ask about the technology investments you mentioned working on the underlying tech stack. I guess the question is kind of two parts. One is, can you give maybe some color on your market share gains in the US, just to validate the view that it's not just the environment that's helping you, it's some of the initiatives you're undertaking? So anything you can say about you versus competitors and different dayparts.

And then without, obviously, disclosing anything competitive, maybe you could talk a little bit more detail about the evidence you're seeing that the investments are paying off, maybe tie those digital initiatives back to the G&A spend, not the incentive comp, of course, this year, but just the sort of elevated G&A spend as a percentage of sales. And certainly the dollars you're spending are substantially bigger than what anybody else in the industry could spend. So just any color you can give that kind of offers credibility to the idea that this is sort of the right amount of investment in allowing you to lead competitors? Thanks.

Chris Kempczinski
President, Chief Executive Officer & Director, McDonald's Corp.
A

Joe, why don't you cover the market share gains and what we're seeing in the US? And then, Kevin, you can talk about just our investment levels there and how we think about that.

Joseph M. Erlinger
President, McDonald's USA, McDonald's Corp.

A

Yeah. Relative to market share, especially on traffic, it's proven very challenging to read exactly what's going on within the industry because you're seeing shifts of all kind. There was, early in the pandemic, the shift away from the breakfast daypart and toward the dinner daypart. You've also seen, obviously, a substantial increase in average check, as you have more people per transaction who are actually eating off of that transaction.

We feel very good about our competitive position and where we are relative to our key competitors. And when we look at our own two-year comp stack and the fact that we're putting up the kind of growth numbers we are versus 2019, we feel good about our position.

And I'll let Kevin talk specifically about some of the tech investments, but when you think about McDonald's USA having digital sales of almost $1.5 billion in the first quarter and the fact that we've got 20 million active app users, I think we feel really good about the way we've set up in the US ourselves to really benefit from these investments and to make these multiyear gains I've talked about.

Kevin M. Ozan
Chief Financial Officer & Executive Vice President, McDonald's Corp.

A

Yeah. I guess the only thing I'd add, we certainly benchmark our tech spend against peers, looking at how much we spend as a percent of revenue, et cetera, and generally are favorable in a lot of those types of metrics. But as Joe talked about and the way we think about it is, you're not going to directly relate every years of tech spend to that year's specific sales. So some of the investments we've made over the last couple years are facilitating us being able to go put in loyalty in the US right now and being able to do it in Germany at the same time and being able to roll it out in several markets kind of simultaneously or in a similar timeframe.

So part of the kind of catch-up that we needed to do over the last couple of years was to get a common tech stack across our globe so that now we're able to move at a quicker pace as we have new things like loyalty and can deploy them in several markets in a relatively shorter timeframe.

Mike Cieplak
Vice President & Investor Relations Officer, McDonald's Corp.

A

Our next question is from Nicole Miller Regan with Piper Sandler.

Nicole Miller Regan
Analyst, Piper Sandler & Co.

Q

Thank you and good morning. Appreciate the color around the franchise partners, especially domestically and what they're doing to put the brand to work. Could you give us an update on the profile, the tenure in the system, number of stores? I haven't asked for a while around first, second, third generation? And I'm just curious how anything in the past year has shaped the natural passing of these legacy systems. And then the second part is on the survey results. I wasn't clear if that was a headquarter kind of survey or a field survey, if you could clarify that. And what was most validating and most surprising? Thank you.

Joseph M. Erlinger
President, McDonald's USA, McDonald's Corp.

A

Thanks, Nicole, for the question. Relative to the franchise profile, it hasn't dramatically changed in the last year or two. Several years back, though, we did begin to make a move towards having fewer and larger franchisees. And that trend roughly continues, but not nearly at the pace that it was happening three to five years ago.

There is a substantial number of second and now third generation franchisees. As I returned to the US business 18 months ago, I really have been struck by the number of second and third-generation franchisees that do now exist within the McDonald's system. Obviously, it's a hallmark of our brand and what we've been in the past. I'll let Chris answer.

Chris Kempczinski
President, Chief Executive Officer & Director, McDonald's Corp.

A

Yeah. On the survey result. So that was a global survey of all company employees. So we had – I forget how many people actually replied, but we had – we were really pleased with the take-up rate on that. And that again was global. I think things that we were most pleased about, the overall optimism that exists around the world for our business outlook was certainly something that was a positive for us. The second is we were – we went in and we had individual questions about our performance against each of the five values that I outlined. We saw very strong performance, both in absolute but also a year-over-year growth in those as well. So I was positive on that.

I think the opportunity for us that I've talked about and that we're working on is doing more to create a culture where people feel comfortable, challenging, debating, speaking up. We have opportunities there. And that's, from a culture standpoint, something that my senior leadership team and I are working on.

Mike Cieplak
Vice President & Investor Relations Officer, McDonald's Corp.

A

Our next question is from Brian Bittner with Oppenheimer.

Brian Bittner
Analyst, Oppenheimer & Co., Inc.

Q

Thank you. Good morning. I want to go back to the IOM segment. I realize that you're still not to pre-COVID sales levels yet. But as markets do successfully wrestle COVID, I think we have enough evidence at this point to believe it's just a matter of when, not if, as it relates to more than a full sales recovery in the IOM segment. And you have 1,700 company-owned units there. So what I would like to understand is how is the company-owned margins in that segment positioned to perform as you inevitably do get to above these 2019 sales levels? I know you just said not to expect it this year as far as a recapture. But perhaps you can share some insights from what you're seeing at the UK or Canada, where the trend is already above 2019.

Kevin M. Ozan
Chief Financial Officer & Executive Vice President, McDonald's Corp.

A

Yeah, Brian, I'll take that question. Yeah, one of the things I think I talked about in my script was that while we are below historic levels, as you said, that is really a result of certain markets not being – not having the sales levels back to pre-COVID, to your point. The markets that are at pre-COVID levels and have been able to continue growing sales, are able to continue growing margins similar to how they were pre-COVID. So to us, it is a, I'll say, matter of time, to a certain extent. We expect, as restrictions ease, as curfews go away, and we're able to reopen dining rooms, those are the biggest things that need to happen specifically in a few of our large markets, like France and Germany, for example. But there isn't anything structural that is preventing us from getting back to our historic levels of company-operated margins in those. And we are experiencing those types of margins in the markets that have already gotten back to those sales levels.

Mike Cieplak
Vice President & Investor Relations Officer, McDonald's Corp.

A

Next question is from Chris Carril with RBC.

Christopher Carril
Analyst, RBC Capital Markets LLC

Q

Hi. Good morning. Thanks for taking the question. So, Joe, you mentioned that US comps were double-digit positive across all dayparts, but I was curious specifically about the morning daypart and how that trended through the quarter. And specifically, what breakfast trends looked like prior to the lap of last year's declines and perhaps what you're seeing more recently. And then looking ahead, how are you thinking about how you can build on breakfast share gains that you've noted recently?

Joseph M. Erlinger
President, McDonald's USA, McDonald's Corp.

A

Sure. Thanks, Chris, for the question. We turned to positive at the breakfast daypart back in the third quarter, I believe. And since then, we've been positive. So it wasn't all a lap of the pandemic negatives at the breakfast daypart.

And, obviously, part of that is because of our historical strength in this daypart. Part of that is because the importance of drive-thru speed, especially at breakfast, is important. And part of that is some of the menu item moves that we've made around offering McCafé Bakery, I think, have also set us up well for the breakfast daypart.

We're acutely focused on this daypart, because we believe that certainly, as some consumer habits return to pre-pandemic ways of life, that the breakfast daypart will continue to come back. And similar to the way that it was a real market share battle pre-pandemic, we think that market share battle will absolutely continue. And we're ready and prepared for that.

Mike Cieplak
Vice President & Investor Relations Officer, McDonald's Corp.

A

Next question is from John Ivankoe with JPMorgan.

John Ivankoe
Analyst, JPMorgan Securities LLC

Q

Hi. Thank you. The comment was made on Australia in terms of maintaining average ticket, even, it sounds like, with traffic coming back. And I was wondering if that could be applied to the US as well.

In other words, when traffic recovery, I guess at this point is an inevitability, can you maintain that average ticket, which I think has been the primary driver of comps over the past 12 months, is the first question.

And second, and I think related to that, is related to that. What's different about the chicken sandwich this time? Obviously, we've seen over the last 20 years, a number of different core and premium, your chicken sandwiches, strips, what have you, that have kind of come and gone from the McDonald's menu. What gives you the confidence this time that it becomes not only something that you can sustain, that you can grow upon? Thanks.

Chris Kempczinski
President, Chief Executive Officer & Director, McDonald's Corp.

A

Thanks, John. I think on the ticket, we have seen in a number of markets that have been able to kind of weather the pandemic, Australia being one that has done particularly well through that, but Japan, another one, that ticket levels do stay elevated. I think a big function of this becomes to what degree does the channel mix revert back to what we saw pre-pandemic or stay elevated.

So to the degree that you see delivery remain an elevated part of the ticket, to the degree that you see drive-thru continue to outperform, those are going to have a positive impact on ticket and a somewhat negative impact on traffic, just because of the bundled nature of those channels.

So I think it's difficult to say broadly how that's going to play out. But we are seeing overall, that some of the changes that happened with consumers through this pandemic, like doing more delivery, like going through drive-thru, that those we expect are going to be enduring. So I think it's probably fair to say that ticket is going to be a driver for us coming out of the pandemic. Joe, why don't you talk about the chicken sandwich in the US?

Joseph M. Erlinger
President, McDonald's USA, McDonald's Corp.

A

Yeah. I feel very confident about this chicken sandwich. I know, and I absolutely acknowledge, John, that we've had many ins and outs of chicken sandwiches over the years. But I think we did our research. We really grounded ourselves in the consumer on this one in a very significant way. I also think that we've done a good job of tapping more significantly into trends with our spicy offering as part of the chicken line. And I think our increasing focus on multicultural youth also is contributing to our success here.

Whenever you launch a product at McDonald's, you launch and then you have to decay curve. And I feel very confident about this because the decay curve on our chicken sandwich is dramatically different than what we've seen in past years. We're two months past the initial launch of late February. And we still feel really good about the volume and unit movement that we're seeing.

Chris Kempczinski
President, Chief Executive Officer & Director, McDonald's Corp.

A

The only thing I would just add on that, that Joe has talked about in the past and I completely agree is when we think about chicken, it's a holistic strategy. So it's not just going to be predicated on one sandwich. We've got a very strong nuggets platform. We have McChicken. And so one of the things that Joe and the team did, I think, really well in the US is leveraging the other aspects of our chicken portfolio.

We had nuggets that ran in front of, then the Chicken Sandwich launch. And using sort of everything in our arsenal there to drive chicken is going to be one of the things that I think is different this time. I think the other is a very good alignment that Joe and the team have been able to drive with our franchisees on sustained support for this. This is not, sort of, one of those, put a bunch of media weight against it for a quarter and then move on to the next thing. I think there's broad understanding and alignment that this has to be supported over a longer period of time. And so certainly, from my vantage point, those are two things that give me confidence about what we're seeing in the US.

Mike Cieplak
Vice President & Investor Relations Officer, McDonald's Corp.

A

Our next question is from Lauren Silberman with Credit Suisse.

Lauren Silberman
Analyst, Credit Suisse Securities (USA) LLC

Q

Thanks. So just on the global partnership with BTS, your third same sort of collaboration, can you share if and how these partnerships are helping you reach and engage with a new audience and then, just broadly speaking, how your social media strategy has evolved over the last kind of 18 months or so?

Chris Kempczinski
President, Chief Executive Officer & Director, McDonald's Corp.

A

Sure. Well, so I think one of the things that we're delighted to see with our first Famous Order and Travis Scott, was just the huge digital uptake that that drove on the business. Joe might know the exact number of downloads that we saw in the US. But I mean, it was a phenomenal driver of digital engagement for us in the platform. And going forward, I think for us, that's continuing to use Famous Orders as a way to drive digital engagement.

The consumer that is drawn to these sorts of celebrities is inherently a digital-first consumer. And so it's natural that they're going to want to interface and interact with our brand in a digital-first manner. So that going forward is going to be a key part of our strategy.

And on social media, I think you've seen – we have gotten, I think, a little bit more nimble and consumer-centric in our social media approach. It doesn't read anymore like a corporate website that's being populated maybe by the CEO. It's actually being written by people with a sense of humor and that are fun to listen to, which is what our brand is about.

I mean, our brand is meant to be an engaging, fun, youthful brand. And so having voices that are running our social media campaign on a day-to-day basis, I think you're seeing the benefit of that. And I think, for us, it's about making sure, though, that we also do it in a way that feels authentic to McDonald's.

I think some others out there maybe like to veer a little bit more into the snarky territory. We try to be a brand that leads with a really positive message and is one focused on McDonald's and we're seeing great engagement from that. So I appreciate you mentioning that. And I promise I will stay off social media with the corporate website.

Joseph M. Erlinger
President, McDonald's USA, McDonald's Corp.

A

You know, if I could just add one thing on the digital consumer. The US business has never had a significant challenge of attracting a digital consumer. Our challenge has been around retaining them. And I think that we have been much more purposeful in all of our retention and life cycle management efforts actually leading up to the Travis Scott meal initially because we knew that there would be a big surge in interest digitally around McDonald's because of that. And those retention efforts have really borne significant fruit.

And we've utilized those same retention efforts for our holiday promotions as well as for J Balvin and we'll be doing the same as BTS comes here. And then naturally, as we flow into loyalty, we'll naturally have a greater opportunity for retention via MyMcDonald's Rewards.

Mike Cieplak
Vice President & Investor Relations Officer, McDonald's Corp.

Okay. We're at the bottom of the hour. Thank you, Chris, Kevin and Joe, and thank you to everyone that joined our call today. Have a great day.