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McDonald's Corp. (MCD)

Q2 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Hello and welcome to McDonald's second quarter 2021 investor conference call. At the request of McDonald's Corporation, the 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 call over to Mr. Mike Cieplak, Investor Relations Officer for McDonald's Corporation. Mr. Cieplak, you may begin.

Mike Cieplak

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

Good morning, everyone, and thank you for joining us. With me on the call today are: President and Chief Executive Officer, Chris Kempczinski; and Chief Financial Officer, Kevin Ozan.

As a reminder, 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, along with their corresponding GAAP measures.

Following prepared remarks this morning, we will take your questions. Please limit yourself to one question, and then reenter the queue for any additional questions. 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. At the heart of McDonald's is the experience we offer. And for 65 years, we've created iconic experiences for billions of people around the world. Along the way, we've always focused on following our customers' needs, finding the most convenient and engaging ways for them to enjoy McDonald's.

At our founding, the restaurant experience was relatively simple. Customers would walk up to the front counter, place their orders and get hot, delicious, fresh food served to them quickly. In the early 1970s, McDonald's pioneered the drive-thru as a new service channel for customers. And in the last few years, we've added even more service channels with delivery, curbside pick-up, kiosks and table service.

At the heart of each of these innovations was our global mobile app, which has evolved our customer experience from the physical world to the digital world. As this evolution continues, our digital offerings will become even more important to serving, interacting with and delighting our customers around the world. And the insights generated from these platforms will help us further improve their experience. Our marketing power and scale will continue to be critical throughout this journey, turning the various customer touch points into a holistic and compelling brand experience.

But our aspirations are even higher, and to reach those goals, we needs to create a more frictionless customer experience across all our service channels. Our customers should be able to move seamlessly between the in-store, takeaway and delivery service channels, so that we offer even more convenience and better personalization.

That's why we were excited to announce earlier this week the creation of a team that has oversight for the end-to-end customer experience under the leadership of our first Chief Customer Officer in McDonald's history, Manu Steijaert. Manu will oversee everything from the physical restaurants that we design and build, to the digital experiences that we embed along each step of the customer journey. As we finish the global rollout of EOTF, Manu and his team will now be focused on what's next to drive a new layer of sustained growth for our system that leverages the foundations that we've built.

For the past 18 months, our digital customer engagement global marketing, data analytics and restaurant solutions teams have worked to standardize our infrastructure and align the system against some common frameworks. These efforts ultimately paved the way for MyMcDonald's Rewards, our first global digital offering that we are now deploying across our largest markets. MyMcDonald's Rewards is just the first example of how we will lead as a digital innovator by leveraging our scale and engaging with our customers in a truly integrated way.

Manu is the ideal choice to integrate these teams and take their work to the next level, with an intense focus on driving incomparable customer-centric innovation. He's been an important part of the McDonald's System for more than 20 years at every level. Manu knows these teams well and has an incredibly deep understanding of the needs of our customers, one rooted in his early experience as a crew member in his parent's McDonald's franchise in his native Belgium.

We believe that connecting these teams will enable us to deliver the seamless omni-channel experience that our customers want and only McDonald's can provide, transforming the way customers connect with, interact with and experience our brand.

Further strengthening of ways to working to better serve our customers is one of many ways we're working to accelerate the arches today. This complements the work underway to accelerate the arches with investments in customer-centric creative marketing that only McDonald's can offer so fully.

That marketing made a measurable impact in the second quarter with the global debut of our incredibly successful Famous Orders marketing platform. I'll have more to say about that a bit later.

We're accelerating the arches by committing to our core menu. We're tapping into customer demand for the familiar, and making the chicken, burgers and coffee our customers love even more delicious. We're borrowing from what has worked well in other markets, like the growing success of the McSpicy Chicken Sandwich. McSpicy launched in China over 20 years ago, and customers can now enjoy this great-tasting sandwich in multiple markets around the world. Late last year, we launched McSpicy in Australia as part of their new chicken sandwich lineup, and earlier this month, it debuted in the UK to great fanfare.

We also continue to leverage our familiar favorites and create new ones to make our menu even more craveable. In the US, the momentum from the successful launch of our Crispy Chicken Sandwich continued into the second quarter, as we supported the platform with culturally relevant advertising, just one more way that our beloved core menu continues to drive growth while anchoring a customer experience that is second to none.

We also know that the customer experience today reaches beyond the physical walls of our restaurants. And that's why we're accelerating the arches to better serve our digitally connected customers.

To give you a sense of the growing digital connection we have to our customers, we have the most downloaded QSR app in the United States. And earlier this month, we were proud to launch our new loyalty program, MyMcDonald's Rewards in the US.

The loyalty of our McDonald's brands has been unmatched for 65 years. And with these new digital connections, we're able to do an even better job of rewarding them for it. We already have over 22 million active MyMcDonald's users in the US, with over 12 million enrolled in our new loyalty program, MyMcDonald's Rewards. And that's before national advertising for loyalty, which began earlier this week.

Loyalty is a good example of how our core menu and personalized marketing come together through digital channels to build a stronger relationship with our customers. Our digital systemwide sales across our top six markets were nearly $8 billion in the first half of 2021, a 70% increase versus last year. And that's why we're moving aggressively to bring MyMcDonald's Rewards to our top six markets. We currently have loyalty programs in place in France and the US. Germany and Canada plan to launch MyMcDonald's Rewards before the end of this year, followed by the UK and Australia in 2022.

We're just as excited about our drive-thrus, through which much of our business has come from this year, and about delivery. Over 80% of our restaurants across 100 markets globally now offer delivery. We're excited about our success with multiple 3PL partners. And as I said last quarter, we continue to innovate.

Overall, our recent successes show that our M, C and D growth pillars working in concert can deliver unmatchable experiences for our customers and drive growth unlike anything else in customer retail.

Of course, our work to accelerate the arches is built on the foundation of the very core of McDonald's' success: running great restaurants. As we open our dining rooms, return to regular hours and get back to full staffing, we know that world-class execution will be more important than ever.

While the Delta variant has brought more stops and starts to the COVID story around the world, people are venturing out and establishing new routines. That includes a return to in-person dining. Today, about 70% of our dining rooms in the US are open. By Labor Day, barring resurgences, it will be nearly 100%. Internationally, the majority of our restaurants are now operating all channels including dine-in, but many continue to operate with limited hours or restricted capacity.

We're working hard to get back to normal. When our customers are ready to come back to dining in our restaurants, we will be more than ready and eager to welcome them. Not only are we more resilient today than we were heading into the pandemic, as Kevin will tell you, we are building from a position of strength.

Kevin?

Kevin M. Ozan

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

Thanks, Chris. I'm pleased to share that global comp sales were up 40% in the second quarter or 7% on a two-year basis. Our performance is continued demonstration of the broad-based strength and resiliency of our business. We have surpassed 2019 sales levels for the second consecutive quarter and now at an accelerated rate.

Turning to the segment performance for the quarter, we grew comp sales across all segments versus 2019 levels, as business recovery progresses at varying degrees around the world. In the US, our momentum continued, with

Q2 comp sales up 26% or 15% on a two-year basis, our strongest quarterly two-year growth in over 15 years. And we saw double-digit positive comps across all dayparts on a two-year basis, while at the same time franchisees continue to achieve record high operating cash flow.

Our performance in the US is the result of an accumulation of decisions that we've made over the last 18 months. This includes bold marketing initiatives, investing in the core menu and strengthening our digital offerings, with an underlying focus on running great restaurants.

As customers in the US began to venture out more during the second quarter, we continued to see strong average check growth, driven by larger order sizes and menu price increases. That's been bolstered by growth in delivery and digital platforms as well as robust menu and marketing programs. This includes an advertising re-hit of our Crispy Chicken Sandwich, which continues to perform at an elevated level, and the success of our BTS Meal. Both initiatives attracted customers and drove incremental sales in the quarter.

In our International Operated Markets segment, which has been historically strong, recovery is taking hold. Comp sales were up 75% in the quarter or nearly 3% on a two-year basis, as we lapped the peak in 2020 restaurant closures. Remember, in some cases, full country operations were shut down in Q2 last year due to the pandemic.

Although we're continuing to monitor recent resurgences of COVID in countries around the world, Western Europe began to reopen during the quarter, allowing us to bring back indoor dining, still with some restrictions in place. IOM segment comp sales began exceeding 2019 levels in May.

Strong performance continued in Australia. The market benefited from continued growth in delivery and successful marketing and core menu news, including the BTS Famous Orders and 50th birthday Big Mac promotion. While Australia produced strong results for the quarter, outbreaks of the COVID-19 Delta variant throughout the country have led to recent lockdowns and reduced customer mobility.

Momentum accelerated in both the UK and Canada in Q2. In the UK, the national lockdown ended, and the market reopened dining rooms in mid-May. The market saw record digital engagement, with a significant portion of sales coming through digital channels, where customers placed delivery orders and used self-order kiosks as dining rooms reopened. Canada benefited from strong marketing activity, featuring our core menu, including the BTS Famous Orders meal.

In France and Germany, comp sales were still below 2019 levels for the quarter. While some restrictions are still in place, indoor dining reopened for both markets in June, and we've seen steady improvement since then.

As we look ahead to Q3, we expect comps to surpass pre-pandemic levels across all of our big five international markets. The past year has shown us that when markets reopen, customer demand for McDonald's returns quickly.

Comp sales in the International Developmental Licensed segment were up 32% for the quarter, or relatively flat on a two-year basis. Performance was largely driven by positive results in Brazil, Japan and China.

Japan maintained momentum in Q2, with comps up nearly 10%, achieving an impressive 23 consecutive quarters of comp sales growth. The market's performance was driven by strong menu and marketing promotions, delivery growth and our ability to continue serving customers their favorites, safely and conveniently throughout state-of-emergency waves across the country.

In China, comps were strong for the quarter, but have yet to return to 2019 levels due to COVID resurgences in Southern China, resulting in operating restrictions. The market continues to build its digital member base with a successful MyMcDonald's app launch and focused delivery expansion in the breakfast and evening dayparts. In addition, China surpassed the 4,000 restaurant mark in June and is now on pace to open over 500 new restaurants this year.

Given our slightly quicker recovery and continued momentum around the world, we now expect full year systemwide sales growth in the mid to high teens in constant currencies. However, there is still some uncertainty as we continue to see pandemic-related stops and starts in markets around the world, especially now with the Delta variant.

Now, I'll turn it back to Chris.

Chris Kempczinski

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

Thanks, Kevin. As we look ahead to the rest of 2021, we're finding ways to capitalize on our strengths. As we've seen, the growth pillars of Accelerating the Arches are deeply interconnected, reinforcing and bolstering one another. It is at the intersection of our M, C, Ds that we continue to deepen our connection with customers and create a consistent and enjoyable experience, proving that the whole is greater than the sum of its parts.

Which brings us back to our Famous Orders platform. When it launched in the US last year, our goal was to create an ambitious marketing campaign, one that would leverage our customers' favorite core menu items, speak to a new generation in authentic ways and increase digital engagement without adding any restaurant complexity, all while positioning us for the longer term.

The Famous Orders platform was based on a simple idea: what unites all our customers, including famous celebrities, is everyone has their go-to McDonald's order. The Travis Scott, then J Balvin Famous Orders broke records in the US. This quarter, the BTS Famous Order took that ambition global, connecting our marketing, core menu and digital strategies in 50 markets. And it was our first Famous Order with custom packaging and app exclusive content. It has been, to borrow a BTS lyric, dynamite.

We saw significant lifts in McNuggets sales and record-breaking levels of social engagement. McDonald's customers and BTS fans all over the globe downloaded our app, ordered Chicken McNuggets with delicious Sweet Chili and Cajun Dipping Sauces and posted about it on social media, leading McDonald's to trend number two on Twitter globally and number one in the US.

And then the BTS ARMY took it a step further and memorialized the partnership, creating shoes, accessories and framed memorabilia from our packaging. They were so appreciative of the meal that the BTS ARMY went out of their way to prepare snacks for our crew and managers in Malaysia, the Philippines and Vietnam to support them on launch day. The Famous Order platform is the M, C and D in action.

Both Famous Orders and MyMcDonald's Rewards are also reminders of the unrivaled convening power of McDonald's. And this is just the beginning of the digital customer journey at McDonald's. As we create more personal and seamless McDonald's experiences and make it easier for our crew to connect with our customers, we're giving customers multiple reasons to continue to come back to McDonald's. By using digital, we'll also leverage our advantages in value and convenience, daypart and menu breadth and our biggest advantage, our size and scale.

Now, for more on the financial performance in Q2, I'll pass it back to Kevin.

Kevin M. Ozan

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

Thanks, Chris. Adjusted earnings per share in Q2 was $2.37, which excludes a gain on the further sale of some of our ownership in McDonald's Japan and a one-time income tax benefit in the UK. And year-to-date adjusted operating margin was 43%, reflecting improved sales performance across all segments and higher other operating income compared to last year. Total restaurant margin dollars grew $1.3 billion in constant currencies with improvement in both franchised and company-operated restaurant margins, mostly driven by higher comp sales as a result of COVID-19 impact last year.

Company-operated margins in the US were strong, as we continue to see top line growth driven by higher average check. In the IOM segment, company-operated margins improved significantly in Q2, as sales have recovered to pre-pandemic levels.

G&A decreased 1% in constant currencies for the quarter, primarily due to lapping our $160 million incremental marketing investment last year, offset by higher incentive-based compensation and increased spend in restaurant technology. Our adjusted effective tax rate was 21.7% for the quarter, and we're projecting the tax rate for the back half of 2021 in the range of 21% to 23%. And finally, foreign currency translation benefited Q2 results by $0.13 per share. Based on current exchange rates, we expect FX to benefit EPS by about $0.03 to $0.05 for Q3, with an estimated full year tailwind of $0.20 to $0.22. As usual, this is directional guidance only, as rates will likely change as we move through the year.

Now, I'll turn it back to Chris.

Chris Kempczinski

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

Thanks, Kevin. I'm proud of all that we've accomplished during the past 18 months. It's a remarkable testament to the resiliency of the McDonald's System. But as we turn our focus to the incredible opportunities that lie ahead of us, it's also reminded us of where we must go. For 65 years, the one unassailable truth about McDonald's is that we get better together. There's a reason why it's one of our core values.

Continually finding ways to better ourselves and our system is how we keep our business relevant, not just for this generation but the next. How do we get better together today? We get better together by focusing on our people. In this highly competitive market for talent, successful employee recruitment and retention is fundamental to drive growth. That's why, in May, we announced a 10% increase in the average hourly wage at our company-owned restaurants in the US, with the goal to get to a $15 an hour wage by 2024.

We get better together through diversity, equity and inclusion. Today, 23% of our US-based suppliers come from diverse backgrounds, more than double the industry average. We have set a goal to increase purchases of goods and services from diverse-owned suppliers by 10% over the next four years. That will put us in a position where a quarter of our US spend is with diverse-owned suppliers by 2025. And we've committed to doubling our national advertising spend with diverse-owned media here in the United States between 2021 and 2024.

We get better together by serving our customers, but also serving a larger purpose in communities across the world. As part of our ongoing efforts to support communities through the pandemic, we recently partnered with the Biden Administration to make access to information on vaccines easier for the millions of customers who enjoy

McDonald's in the US. Our part in the national We Can Do This campaign continues this month, with McDonald's hot McCafé cups and McDelivery seal stickers, both of which lead customers to vaccines.gov.

In Canada, we're doing something similar around This Is Our Shot. It's a national campaign through which McDonald's will supply information in restaurant and drive-thru orders while supporting a digital campaign to replace vaccine hesitancy with confidence.

Finally, we get better together through our commitment to our planet. In May of 2014, we were one of the first major corporations of our size to publicly commit to a sustainability framework. We promised that we would report on our progress against our 2020 sustainability goals by the fall of this year.

As we prepare to release our impact report, I've never been prouder of the difference we are making in the world. We are working closely with partners across the globe today to source food locally and responsibly, to expand our use of sustainable packaging and to power our restaurants with renewable energy sources. It's the ultimate example of our three-legged stool in action, where owner/operators, suppliers and employees each play a critical role in our efforts to protect the planet.

We're working every day to set ambitious goals and to hold ourselves accountable, to be known not just for what we do as a company, but how we do it. It's part of our broader commitment to transparency and to following clear, science-based guidelines from the experts. We know we still have much work to do, but our internal strategy and the external landscape are converging to create a moment unlike any other.

We are aware of our unique role in the world. We are inspired by all the opportunities that lie ahead. Over the back half of this year, I'm looking forward to getting back into the restaurants around the world and spending more face time with our people. I'm amazed with everything that our system has accomplished over the past 18 months. And we can't wait to write the next great chapter of the McDonald's story together.

With that, we'll begin Q&A.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator instructions]

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

Our first question is from Andrew Charles with Cowen.

Andrew Charles
Analyst, Cowen & Co. LLC
Q

Thank you. Chris, you talked about delivering a more frictionless experience. And just given the pledge to engage guests in new ways and in the backdrop of the challenging industry staffing situation in the US, is this prompting you to accelerate implementation of Apprente AI voice-ordering drive-thru? Was hoping you could provide an update on your ambitions for a lot of the drive-thru technology over both the near and the medium term. Thanks.

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

Yeah, thanks, Andrew. When we announced earlier this week the creation of the Chief Customer Officer job, it was with the idea that as we are introducing more service channels, we have an opportunity to design it in such a way that it feels like these things all happened at the same time as opposed to, in reality, how they happened, which was kind of one came after the other. So Manu's charter is about making this so that the customer feels that this is a completely seamless experience in the restaurant.

I think the point that you're raising about Apprente is related to it, but it's not central to it I think. We announced, maybe it was about a month or two ago, that we were seeing good progress with Apprente. It's in 10 restaurants. But that is going to be a significant effort that takes us a number of years before we're able to deploy that in the US. So I wouldn't read or interpret anything around Manu's announcement as related to accelerating Apprente. There's still a lot of heavy lifting associated with getting Apprente ready for deployment across the US and eventually the globe.

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

Our next question is from Eric Gonzalez with KeyBanc.

Eric Gonzalez
Analyst, KeyBanc Capital Markets, Inc.
Q

Hey, thanks and good morning. My question's on labor. I was just wondering if you could comment on staffing levels now versus maybe earlier in the quarter and whether you've seen a material improvement across the system, particularly in some of those states that have ended the government benefits early. And then, maybe if you can comment on the strategies the franchisees have used to successfully attract talent and how the recent labor shortage might have impacted drive-thru speed and whether that's become a drag on sales. Thanks.

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

Yeah, thanks, Eric. It's certainly still a challenging staffing environment, not just in the US. We're also seeing in Europe where staffing is challenging, in part because of some of the limitations of movement of people across borders. But if you focus on the US, while it is a challenge, it's getting better. I don't want to declare by any means that it's easy, but we're certainly seeing some improvement. We're seeing applications have increased pretty significantly. Applications in states that have ended early the federal stimulus, those have tended to do even better. So I do think that there is evidence that as the federal stimulus rolls off, that you'll see an improvement in the application rate.

And I think you're seeing wages go up as well. I mean, we have made our announcement. I think broadly, we're seeing wages going up about 5% or so in our US restaurants. And that is also helping improve the situation. I would just point out, for us, in our McOpCo restaurants, after we made our announcement back in April, we're getting close to full staffing levels or what we would deem to be kind of our full staffing levels in our McOpCo restaurants. So it is possible. The situation is improving.

I think the tools and some of the ideas that you're seeing our franchisees out there deploying, whether it's things like free childcare, sign-on bonuses, et cetera, that's the power of the McDonald's System at work and the power of our sort of local franchisees innovating and coming up with ways to ensure that they can staff the restaurants.

In the short term right now, there has been a negative impact on staffing and service times. As you may remember, we've improved service times over the last few years by about 30 seconds. More recently, we've seen service times decrease about 3 seconds, so we don't love that. But a big part of it is certainly associated with the staffing challenges in the restaurant, but also the demand that we're seeing in the restaurants. So I'm constructive and positive on the staffing outlook in the back half. I think we're going to continue to make progress, but it certainly is a challenge.

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

A

Next question is from Dennis Geiger with UBS.

Dennis Geiger
Analyst, UBS Securities LLC

Q

Great. Thanks for the question. Chris, you've got strong momentum in the US and what sounds like a solid strategy and plans to enable continued growth over both the near and the longer term. But as more difficult compares approach, how are you thinking about maintaining that underlying momentum going forward? And maybe if you could kind of help us frame up sort of existing and perhaps emerging drivers that help you to support further gains over the coming quarters in the US. Thanks.

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

A

Sure. So I think the strategy that we've laid out, the Accelerating the Arches strategy, had three growth pillars that for us were going to be multiyear drivers of this. It was going to be: the M, which was marketing; the C, which was core menu; and the three Ds of digital, delivery and drive-thru. So I don't think you're going to see a deviation from those three pillars as being what drives sort of the next layers of growth.

I do expect what you will see is that you will see us continuing to find ways within those to move the business forward. So starting with the M, Famous Orders has been a nice idea for us. My challenge to our marketing team here at McDonald's is, what's the next great idea? And we think there's certainly more we can do with Famous

Orders, but we've got to keep coming up with new ideas from a marketing standpoint. So I think that's going to be something that's on us to deliver.

With core menu, we are rolling out in a number of markets. We've been rolling out a new way to cook our 10:1 Patties. That is delivering hotter and fresher burgers. We're seeing nice lifts in Canada and Australia when we've done that. We call it rapid turnover. We're going to deploy that to the rest of the market as well. I think that's another thing for us. And we're seeing in chicken, certainly we've had a lot of success with the chicken sandwich in the US so far. McSpicy, as I referenced in my opening remarks, that's something that we're taking out, so moving there.

And then lastly, we're in the early, early stages on digital. And I'm incredibly encouraged by what I'm seeing so far with the loyalty rollout. We're seeing very good customer adoption. For us to be at 12 million loyalty users before we've even turned on the advertising is, I think, a great start there and just a testament to customers' sort of pent-up demand for this type of offering for us.

So there's not any one thing that I would point to. The strategy is still very much intact, and we're going to execute. And you're just going to see us continue to come out with ideas within that, that are going to continue the momentum.

Kevin, I don't know if you want to giving any kind of outlook about sort of how we think about Q3 and beyond?

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

A

Well, just as we think about Q3, I guess both for US and IOM, US, as we've talked about, obviously, we had a great two-year trend in the second quarter. As we look a little bit ahead to the third quarter, I think we would see it moderating a little bit in the US on a two-year basis, but still being double-digit and certainly very strong. The IOM segment, on the other hand, will continue accelerating its momentum. Several of the markets, as we mentioned, just opened and reopened in May and June, and so we anticipate strong momentum continuing in the IOM for the rest of the year.

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

A

Our next question is from David Tarantino with Baird.

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

Q

Hi. Good morning. I have a follow-up to that last comment about IOM. I guess on the last call, you had expected IOM two-year comps to stay negative in the second quarter, and obviously, you did much better than that. So I wanted to ask kind of what surprised you to the upside? And then secondarily, do you think as these markets reopen, that you're picking up outsized share relative to your key competitors?

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

A

Yeah, thanks, David. So, yeah, in the first quarter, I think I said that we expected not to get back to flat yet for the IOM on a two-year basis. And obviously, to your point, we did better than that. Certainly at the time, one of the things we were guessing is when each of the markets would reopen, based on regulations going on at the time with no end dates or knowing exactly when they'd allow markets to reopen. So some of the markets were able to reopen a little bit earlier than we had originally anticipated, whether that's certain channels or all channels.

And the other thing that we are seeing is that when we do reopen, business comes back quickly. And so, there's certainly a pent-up demand in some of those markets that had shutdowns again, primarily in Europe. And so we are seeing when those markets reopen, there's significant demand that's waiting to come back, whether that's through the drive-thru, whether that's in-store.

And, as you know, we have a higher percentage of in-restaurant or in-store business in Europe than we do in the US. So it was really important to get the dining rooms reopened throughout Europe. And so that demand and reopening plans, I'd say, have gone a little bit better than we were first anticipating in the first quarter. And now, our expectation is, as long as we don't go backwards on lockdowns again, which obviously, is still a little bit of a risk, but assuming that none of the markets go back through lockdowns, we feel good about continuing the momentum then in all of those markets.

Mike Cieplak

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

A

Our next question is from John Glass with Morgan Stanley.

John Glass

Analyst, Morgan Stanley & Co. LLC

Q

Thanks very much. Chris and Kevin, at your investor event in December, you laid out some targets for G&A and CapEx. And some of that was associated with some technology spend you needed to do and asset upgrades. Has your thoughts evolved on how much you need to spend to achieve those goals? I'm thinking about technology. Are you better off outsourcing some of this, given how fast it moves, versus insourcing, which has been a pressure on the G&A line? Just some updated thoughts on that, particularly as your digital journey has gone six months further versus when you last talked about those targets.

Chris Kempczinski

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

A

Yeah, I'll start off, John, and then pass it to Kevin for any other thoughts. But I think if you go back to what we announced, and certainly we were anticipating in some of our guidance there how we expected the business to evolve over kind of the next three years or so. And so, I think from a G&A standpoint, we're very much, I think, on track with G&A. I do think that there is probably a balance toward maybe getting a little bit more that we outsource versus insource on that. And it's about, for us, ultimately giving the best customer experience.

So it's not, for us, driven by trying to hit a number, per se, but it's about delivering the best customer experience. And I think when you can pick best-of-breed suppliers from out there in the industry, our experience has been that that does tend to work a little bit better.

We referenced previously we do think we'll probably be on the higher end of capital spend from the guidance standpoint, just because of a unit growth opportunity out there but I don't think you're going to see anything that's dramatically different from what we talked about last year.

Kevin, I don't know if you have anything to add?

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

A

No, I would just reiterate that what we talked about for 2022, we obviously haven't done our kind of detailed planning yet for 2022. But the initial guidance we gave, both for G&A and capital, I think still is pretty much intact, which is kind of G&A as a percent of sales and the total capital envelope of around $2.3 billion or so.

So none of that has changed really. And then I think, as we talked about in the investor event, we would expect to get leverage certainly on G&A as a percent of sales longer term. Because what we're seeing on the technology spend is – I don't think spend, the actual spend levels, will go down, but I don't expect it to go significantly up either. So as sales grow, certainly we should get more leverage as a percent of sales, but I think the technology will require a significant amount of ongoing spend going forward, which is why we believe we've got an advantage just from the size and scale aspect.

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

A

Our next question is from Jeff Bernstein with Barclays.

Jeffrey A. Bernstein
Analyst, Barclays Capital, Inc.

Q

Great. Thank you very much. Just getting back to the inflationary environment topic, clearly, the franchise model helps to insulate corporate. I'm just wondering how we think about your outlook for the system in terms of commodities and labor will be over the next 12-plus months. As a system of your size, I would think you'd be a pioneer, have pretty good visibility. And if the pressures are outsized, which I would presume, I'm just wondering how those conversations go with franchisees. I know you mentioned that their cash flow or profitability have peaks. But do you think the message is that you prefer to maybe take a hit to the margin to sustain the strong sales momentum or are there incremental cost savings or do you consider incremental menu pricing? Just wondering how you think about that, based on what your outlook is for commodities and labor over the next 12-plus months. Thank you.

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

A

Yeah, sure. Well, in 2021, we're seeing pretty muted inflation. It's, call it, 1% to 2%. Now, we're hedged in a lot of our categories there, so we're benefiting from that. It's probably a little too early for us to give an outlook to what 2022 looks like. We typically have that number that we start talking about with franchisees in October.

And we certainly hear and recognize some of the challenges that are out there from an inflation standpoint. But we also have, as you mentioned in your question, things to our advantage around our size and some of the relationships that we have with our suppliers, that we think that there are going to be ways that we could perhaps offset some of that.

So I think it's right now, a little bit premature to say necessarily that we're going to be in a significant inflationary environment next year. I'm hopeful that we're going to be able to manage that to something that is a little bit more in line with kind of our historical range that we've seen on that.

We are seeing challenges related to some of the supply chain issues, but it's on the equipment side particularly. So it's equipment, getting equipment manufactured in Asia, getting that over into markets that maybe have bigger unit growth aspirations. We're also seeing the chip shortage as something that's rippling through a little bit on the equipment side. So we are closely monitoring what's happening with equipment and just making sure that we've got the plans in place there, because that tends to be a longer lead item on things.

From a pricing standpoint, I would lastly just say, the pricing that we've taken this year, roughly around 6% or so I think in the US, that is about in line, maybe a little bit ahead of where the overall inflation is when you add in the labor inflation with food inflation. So I think our system is being disciplined. And they certainly recognize that we can't get ahead of where the customer is. And we've got to make sure that we stay competitive on pricing.

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

A

The only thing I'd add is, that 6% that Chris just threw out, that's year-over-year, second quarter this year versus last year. Most of that was pricing that was taken over the last year, because we only increased prices about 0.5% actually in the second quarter. And, as Chris mentioned, a lot of that is being driven by labor inflation pressure, along with some food cost increases. But, as he said, we're pretty locked in with price/cost, commodity costs for this year, so we feel good about that. Certainly if the inflation pressures continue into next year, that would impact everyone, including us. But right now, I think we feel pretty good about where we are.

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

A

Our next question is from Greg Francfort with Guggenheim.

Gregory R. Francfort
Analyst, Guggenheim Partners

Q

Hey, thanks for the question. Maybe just a follow-up to that. I see – I know your company margins in the US are up 400 to 600 basis points, but – I assume the franchisees are probably similar. How do you think that, I guess, trends over time? Do you think franchisees will underprice peers to try to take share? Does that get reinvested into labor or do you kind of run at a higher margin rate permanently? I'm just trying to think about how that dynamic plays out in terms of reinvestment over time. Thanks.

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

A

Yeah, thanks for the question, Greg. Couple things. On margins, I guess, let me start with company margins, because I think you guys maybe use those as a proxy for how the franchisees are doing. Certainly, we had very strong company margins in the second quarter here, some of that being driven by the higher average check. I think as we progress, we expect that to moderate a little bit: one, from the higher wages that just began in the second quarter and will continue obviously; and two, we think there may be some moderation on the average check, although we haven't seen that yet, but I think we're anticipating average check potentially to come down a little bit.

From the franchisees' side, as I mentioned, they still have record operating cash flow through May of this year. They're up over $100,000 in their cash flow over last year. So they certainly have the financial strength to be able to continue to reinvest in the business. And I think, in general, on pricing, both we and our franchisees take a more consumer research-based approach than we would have several years ago, and so it's based on consumer research. It looks at local prevailing market conditions. It looks at the competitive set within each area. And then, franchisees and the company, obviously, each make our own pricing decisions after that. But I think overall, we feel pretty good about the margins, but I would expect the US to moderate a little bit from where we were in the second quarter.

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

A

Our next question is from Pete Saleh with BTIG.

Peter Saleh
Analyst, BTIG LLC

Q

Great. Thank you. I wanted to ask about the dining rooms and the reopening of dining rooms. I think you guys said 70% of dining rooms are open today, and you expect 100% by Labor Day. Are you guys getting any pushback from franchisees on this issue, given the ongoing staffing issues and really the record cash flows that they're experiencing? I'm just wondering if they see any reason to reopen their dining rooms.

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

A

Well, I think our franchisees recognize that the dining experience is an important part of what we offer at McDonald's. And, certainly, as we look at our competitors, we're also seeing that they have, in many cases, their dining rooms open. So I think our franchisees certainly understand that we need to get the dining rooms open. I think the question that you're kind of referencing here is just about the pacing of it. We're 70% opened today and on our way toward getting to 100%.

There is difficulty, as I mentioned earlier, about some of the staffing. So that is, I think, one thing that maybe is a little bit of a moderating effect on the pace that we've been able to get our dining rooms open. But broadly, there's not pushback. There's not anybody kind of questioning why we need to have dining rooms open. It's a key part of what we offer here at McDonald's. We just have to work through some of the kind of what I would call transitory issues right now to just be able to get there by September.

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

A

And it is helpful, obviously, to just relieve some pressure in the drive-thru certainly to open the dining rooms. We are seeing not sales level go back to where they were in the dining room pre-pandemic, but certainly some of the drive-thru sales are transferring over to dining rooms when we do reopen those.

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

A

Well, and I would just maybe last thing on this, I mean, we are seeing a lift.

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

A

Yeah.

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

A

So, when you open the dining room, you get a sales lift. And I think that, more than anything, is probably what will motivate franchisees to get the dining rooms open.

Mike Cieplak
Senior Vice President, Treasurer & 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

Thank you. So on digital, the US offers such a convenience in access with 95% drive-thrus across the asset base. So what is your confidence in being able to drive an increase in digital utilization through your direct digital channels, given already such great access? And then, is there anything you can share on the frequency of an average McDonald's customer or to what extent drive-thru transactions are impulse buys versus planned purchases?

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

So on the first, what gives us confidence, I think it's just what we're seeing with customer reaction to loyalty already. We have, as you referenced, a great drive-thru business, but consumers, and particularly younger consumers, increasingly are looking at the app as sort of the way that they want to be interacting with McDonald's. And so, our ability to actually have the app connect through the drive-thru, to be able to have loyalty be embedded in part of the drive-thru experience, I think all of these things are part of the vision of these different service channels, different ways of accessing McDonald's. They all have to work kind of seamlessly together on that.

And we're seeing good uptick. I mean, we had targets around where we wanted to see digital guest counts in restaurants, not just in the US but around the globe. And we are either meeting or exceeding the growth that we're looking for in our digital guest counts. So the customer is responding. The customer is excited about having a digital relationship with McDonald's, and they see the power of what the app can do for personalizing their experience. So that's what gives me confidence. It's just the numbers that we're seeing as a part of this.

As to the question around drive-thru, maybe I'll have that be something that Kevin answers on just purchase impulse and...

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

The only thing I'd say is, like the loyalty program that obviously we just launched, what we saw in our pilots are that loyalty did drive digital adoption and also shorter purchase cycles or greater frequency of visits, if you will, of loyal customers. So we have seen that the digital engagement will generally drive people to – the loyal customers, certainly, to return more frequently than they would have otherwise. So the digital engagement is just another piece of the whole ecosystem, as Chris talked about. And there are people that do plan the outings in addition to obviously the impulse drive-thru sales.

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

And as we said in the release, we had $8 billion of digital sales in the first half of the year. It's up 70%. So again, it goes back to the point, what gives me confidence is just the business results that we're seeing and the customer response to it.

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

Our next question is from John Ivankoe with JPMorgan.

John Ivankoe
Analyst, JPMorgan Securities LLC
Q

Hi. Thank you. Two related questions, related points, I guess. I mean, certain markets, like France, have talked about vaccine passports, I mean, I guess beginning in September, I think. What do you understand that to actually mean, if you were to actually have to enforce that in terms of how that could potentially impact in-store consumption of your product is kind of the first point. And as we think about these franchisees, maybe you need to put some technology and staffing around that. Is there any thought that some of your increased technology spending that you've been talking about, things that are obviously very value-added for the franchisee, could over time be offset by some increase in the franchise revenue that you receive? Thanks.

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

So I think your first question about what's happening at the country level, vaccine passports, I would hate to even hazard a guess because it seems like it's changing by the week, sometimes by the day, on that. I think what we've shown, though, through the last 18 months, is the ability of our system when they're having to deal with different things at the local level, for our ability to respond as a system. And I think that's just, again, goes back to being a franchise business, having local owner/operators that are able to kind of make these adjustments and pivot there.

So, again, I'd hate to hazard sort of what's going to happen where and when and how that impacts us. I think I would just point out, again, that we've done a pretty good job, I think, of navigating a whole bunch of changes over the last 18 months. And that certainly gives me confidence as we look forward on sort of what the next phase of this looks like.

From the standpoint of the things that we're talking about and ways to deliver value to the franchisees, I think, for us, we're certainly not looking at any of these things through the lens of who pays for what and an opportunity to maybe go after anything on the revenue side there from a franchise standpoint, because, frankly, we're too far away from any of that. So Apprente earlier, Apprente is still going to require significant work to go from 10 restaurants to what ends up being hopefully 10,000 restaurants in the US. And as you get a better sense of what that might deliver as labor savings, what the cost of that, I mean, all those things we need to learn a lot more before we would ever contemplate what that means between the profit split with us and franchisees, so premature for us to have any thoughts or conversations on that.

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

Our next question's from David Palmer with Evercore.

David Palmer
Analyst, Evercore ISI
Q

Thanks. I just wanted to ask for a clarification on the previous point on the drive-thru times in the US. And then, I have a question on your McOpCo margins broadly. You mentioned how the drive-thru times had improved by 30 seconds or so and that I think you mentioned that much of that had gone away. My understanding that a good bit of that might have been because of the loyalty launch, if you're talking particularly in recent weeks. So I'm wondering if you could maybe speak to that. And if your experience of that improves in the test markets as you get through a launch phase, that would be helpful as well.

And then with regard to McOpCo, 70% or so of your McOpCo stores are in the IOM. And clearly, that's a market that's just getting going. You had near peak levels of McOpCo margins in the second quarter. I guess my question is, where can that go broadly? Do you think you're going to get to new peaks in McOpCo margins on a global basis? Are there productivity reasons for this beyond what's just going in terms of like the dining rooms being temporarily closed? And I'll stop there. Thanks.

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

A

Yeah. I'll do the service time, and then I'll let Kevin handle the McOpCo margin. So on service time, just to be clear, so we did, as I mentioned, we saw a 30 second improvement over the last few years. More recently, the 3 second slowdown, that's off of the 30 second improvement. So call it a net 27 seconds improvement on that.

The opportunity for us is, as you may remember at the end of last year, David, when we had our Investor Day, we set an aspiration of getting another 20 seconds or so of speed, improved service time through the drive-thru. And the staffing challenges have slowed some of the trajectory of improvement that we're seeing there. But I certainly expect that we're going to be able to get back on continuing to whittle away at service times. I know that's what all the markets, including the US, are focused on. So it's more of just a slowing down of the improvement. There's certainly no meaningful going backward on this thing, and it's just the gains were too hard fought. Nobody is going to be willing to give up on service times. Kevin?

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

A

Yeah. And then, on McOpCo margins, a couple things. As you mentioned, obviously, a lot of our McOpCos are over in Europe in the IOM segment. And we had strong margins certainly in the second quarter. I would expect improvement in IOM margins over the course of the rest of the year. I don't know that we will get back to pre-COVID margins yet for this year, just because obviously, first quarter was still obviously pretty low, as a lot of them – a lot of the restaurants were still, had some restrictions, whether completely shut down or not.

I do think going forward, there is opportunity to continue growing those international margins, at least back to historical levels and potentially even a little higher because of some of the efficiencies you've talked about, as well as average check is still a little bit elevated. And those two things combined are helping both the US and our IOM McOpCos. So I do think there's opportunity to potentially on a global basis exceed our historical high margins.

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

A

Hey, David, let me come back. Your friend, Mike Cieplak here, made sure I answered your question in full. You had a question also about loyalty and impact on service times. So we are seeing when we introduce loyalty, it has a modest impact on service times, about 10 seconds. But over kind of six to eight weeks, as both customers and crew get accustomed to it, we're able to pretty much whittle that back down to neutral on that. So there is an initial service time impact. But, again, over six to eight weeks, we're able to work that out of the system.

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

A

We have time for one more question. We'll go to Jared Garber with Goldman Sachs.

Q

Hi. This this is [ph] Michael on (57:20) for Jared. One quick last question here. You guys have spoken a little about the importance of dine-in reopening to the business more broadly. But with increase in the digital side of the business and the strength in drive-thru and some of those tech enhancements, do you think at all about new formats, whether that's domestic or internationally, maybe to help accelerate growth if the future, non-traditional, et cetera? Thanks.

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

A

Well, I think that's going to be one of the big areas for Manu to think about and look at is do we need to think about format innovation as being part of how we offer this more seamless customer experience. We've got different things out there in different markets, looking at no dining room, as an example, delivery and drive-thru only restaurants.

I know several years ago, we talked to you about McOriginals in France, which was a limited menu. So we've always got things that the markets are kind of experimenting with from a format standpoint. But part of Manu's mandate is going to be to take a look at all of that to understand the customer experience we want to provide and if new formats needs to be a part of that to be able to introduce that. I do think if we do anything on new formats, it's going to be smaller footprint, lower cost than what we have today. But, again, Manu will, probably at some point in the future, be able to share with you more on that.

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

Okay. That completes our call. Thank you, Chris. Thank you, Kevin. Thanks, everyone, for joining. Have a great day.

Operator: Thank you. This concludes the McDonald's Corporation investor call. You may now disconnect.