McDonald's Corporation (MCD) CEO Steve Easterbrook on Q3 2019 Results - Earnings Call Transcript

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Q3: 10-22-19 Earnings Summary

Press Release SEC *10-Q*

EPS of $2.11 misses by $-0.10 | Revenue of $5.43B (1.14% Y/Y) misses by $-42.39M

Earning Call Audio

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00:00 -59:32

McDonald's Corporation (NYSE:MCD) Q3 2019 Earnings Conference Call October 22, 2019 11:00 AM ET

Company Participants

Mike Cieplak - Investor Relations Officer

Steve Easterbrook - President and CEO

Kevin Ozan - CFO

Conference Call Participants

Eric Gonzalez - KeyBanc

Andrew Charles - Cowen

Katie Fogertey - Goldman Sachs

Sara Senatore - Bernstein

David Palmer - Evercore

John Glass - Morgan Stanley

John Ivankoe - JPMorgan

David Tarantino - Baird

Matt DiFrisco - Guggenheim

Chris O'Cull - Stifel

Brian Bittner - Oppenheimer

Operator

Hello and welcome to McDonald's Third Quarter 2019 Investors Conference Call. At the request of McDonald's Corporation, this conference is being recorded. [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

Good morning, everyone, and thank you for joining us. With me on the call this morning are President and Chief Executive Officer, Steve Easterbrook; and Chief Financial Officer, Kevin Ozan.

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 turn the call over for your questions. I ask that you please limit yourself to one question and if you have more than one, please ask your most preference 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 Steve.

Steve Easterbrook

Good morning and thank you for joining us. Broad based momentum across our markets resulted in a 5.9% increase in global comparable sales for the quarter and our 17th consecutive quarter of global comp sales growth. This was complemented by gains in global guest counts.

Across every country function and level in our system we're seeing improving discipline and robust levels of execution that are guided by our velocity growth plan. Performance that is punctuated by culture that is embracing and leveraging innovation across every facet of our business.

Every quarter, I spend several weeks visiting restaurants and speak with franchisees and market leaders around the world. I come away from these visits inspired by how our actions resonate with customers, never more so than today when our global economy presents many economic, social and political challenges and uncertainties.

Across markets, our success follows a consistent formula; for the customer-first, strive to understand their needs and desires, and constantly find ways to improve their experience. Then empower our people to pull the levers that create delicious, feel-good moments for customers every visit every day. And that is start with strong corporate leadership and system alignment around the vision; engage local franchisees in bringing entrepreneurial mindset, a unique understanding of how to drive growth in their markets and skill at developing innovations that improve efficiency and the customer experience.

Leverage the delicious food that is the core of our menu. Run effective value strategies rooted in deep customer insights and provide outstanding customer experience by running great restaurants. And finally, layer in initiatives to accelerate and sustain growth.

Visiting markets this quarter, in St. Petersburg I saw examples of how the team is pulling velocity growth plan levers across Russia. In a tough economic environment we're meeting customers' needs for taste, quality and value. At the same time, we're empowering our crew to complement McDonald's delicious food with hospitality and convenience for our guests. Our Russian customers have taken notice we're serving more guests and delivering a better experience in our restaurants.

In Portugal, we're seeing balanced growth across all day parts and all menu platforms. Year-to-date our core products are driving roughly half of comp sales growth and McDelivery is providing a meaningful comp sales lift.

In Taiwan, which recently celebrated its second anniversary as a Developmental License or DL led market, the results are showing the benefit of the DL model. Our partner brings strong local leadership, a passion for our brands, greater insight at a local level and financial strength to invest in a purposeful roadmap for growth.

Finally, in Japan, where an aging population, declining labor force and softening consumer confidence are combining to create unique market pressures our team has made strong gains by offering menu items that tap into local tastes, table service that resonates with guests and continued promotion of our digital capabilities, we've grown comp sales in Japan for the last four years.

Across global markets, we're serving up a prudent formula that signals to our customers we care about them.

In my visits with franchisees across the U.S., it's clear to me that excitements return into the system with execution of Bigger Bolder Vision 2020, the ambitious plan we build with our franchisees. Average franchisee, restaurant cash flow is moving in the right direction with 11 consecutive months of cash flow growth through September. We expect this trend to continue through the rest of 2019.

During the quarter, I spent time with next generation franchisees. These are children or grandchildren of franchisees who grew up in the McDonald's system and as adults share a long term perspective on McDonald's proud heritage.

In Minneapolis and Louisville, as in global markets, they are executing the velocity growth plan formula successfully. They're running great restaurants, capturing the benefit from growth initiatives and anticipating new ways to best serve our customers and crew in the future.

Across the U.S., we're getting back to basics with the goal of running fast and friendly drive-thrus. We're providing tools in the kitchen to help prepare our food fast and with the highest quality standards; running national drive-thru challenges which have resulted in improving speed of service; deploying new technology like drive-thru timers, which are now installed in 60% of the U.S. system to ignite crews' competitive spirits and making bold decisions to reduce the complexity of our menu.

And it's working. Thanks to these and other efforts we're seeing continued operational improvements. Customer satisfaction scores reaching all-time high in quarter three and seconds at that drive-thru have dropped by double digits year-over-year.

Now, let me turn it over to Kevin for a deeper dive into our performance around the world.

Kevin Ozan

We're pleased with our continued top line growth momentum. As Steve said global comp sales increased 5.9% for the quarter and each of the operating segments contributed meaningfully to our growth. We also grew global guest counts.

In the US, we delivered another strong quarter of sales growth. Comp sales were up 4.8% despite the increased competitive environment. While US traffic was negative for the quarter and remains our biggest opportunity, we benefited again from a healthy average check increase, driven by both product mix changes and menu pricing.

Our iconic core menu continues to fuel results from the fresh beef QPC and QPC deluxe line extension to core items featured in the buy-one-get-one-for-$1 national promotion. Our customers are showing us that our investment in fresh beef is paying off as we continue to grow burger share.

Additionally, our worldwide favorite's promotion that launched in quarter two and carried into quarter three resonated well, and customers especially loved the strip waffle McFlurry. The sales benefit from our modernized restaurants also contributed to our overall US comp performance for the quarter. We've converted about 1500 restaurants to EOTF this year, and remain on track to complete about 2000 projects by year end. The US now has over 9000 EOTF restaurants or roughly two thirds of the US estate.

Turning outside the US, the international operated market segment once again delivered strong balanced results. Comp sales were up 5.6% with every one of the markets growing comp sales for the quarter and nearly all of the markets also growing guest counts.

The UK, which delivered its 54th consecutive quarter of comp sales growth continues to gain market share across nearly all day parts despite an increasingly competitive marketplace, and declining consumer confidence. The market's performance was highlighted by a promotional food event, featuring double Quarter Pound burgers and spicy McNuggets along with growth in delivery, driving record high monthly sales and guest count volumes in the quarter.

France, marked its 10th consecutive quarter of comp sales growth with continued all time high market share. The market is successfully accelerating on premium and core burgers, a continued focus on their value platform and family business and delivery expansion.

Germany, also marked its 10th consecutive quarter of comp sales growth. The quarter benefited from strong value messages and mobile offers along with maximizing contributions from EOTF.

Looking at the international developmental license markets, which is now our largest segment by restaurant accounts, comp sales were up 8.1%. Each geographic region grew both comp sales and guest counts with Japan, China and Brazil as the largest contributors to the segment's performance.

I recently visited Latin America and had the opportunity to meet with Arcos Dorados our strategic DL partner. Arcos has expanded McDonald's footprint across the region by opening new restaurants and they're also making great progress on modernizing existing restaurants to EOTF. Using local expertise and innovation, Arcos is successfully executing their strategy of delivering an enhanced customer experience, providing the most relevant menu offerings and running great restaurants, despite the geopolitical and economic challenges they face.

Now I'll turn it back to Steve to further talk about the growth accelerators driving our business.

Steve Easterbrook

As we've shared on prior calls, we're moving with purpose to bring the biggest benefit to the most people in the shortest possible time. This means taking bold actions designed to serve more customers tomorrow than today.

Historically, we've achieved sustained compounding growth when we offer new customer experiences on top of a strong base of operational performance. When we launched our velocity growth plan in 2017, we committed to three such new customer experiences, which we call our growth accelerators; experience the future, digital, and delivery. That all about giving customers more control over how they order, how they pay and how they receive their food.

In a short period, we've moved from deployment to real business impact with each of these accelerators. Through our EOTF deployments, we've created more inviting dining environments, easier and faster ordering, and greater hospitality with guest experience leads focused on serving our customers' needs. These efforts are clearly connecting with guests.

With digital, we're working hard to fulfill customers' desire through simpler, smoother and more personal engagement over our digital platforms, including kiosks drive-thrus and our mobile app. Now here was the power of our emerging digital ecosystem on display during the third quarter than in China. The market drove strong comp sales growth, in part by delivering tangible members-only benefits to our digital community, which now stands at 100 million registered members.

Additionally, we benefit from the halo effects of promoting delivery to our growing digital network. We continue to move quickly to deploy dynamic yield, which technology improves our ability to offer customers what they're likely to want, using machine learning to make suggestions based on time of day, weather and popular menu items. The business case is driving rapid adoption. Dynamic yield technology is now in over 9500 U.S. drive thrus with full rollout to nearly every US restaurant with an outdoor digital menu board expected by year-end.

And we're just getting started. Deployment across our existing drive thru restaurants in Australia will be complete by year-end. And we're scoping future deployment for additional markets and applications, eventually including kiosks and our global mobile app. Ultimately, dynamic yield will facilitate a range of personalization benefits, where we can leverage knowledge of the customer, and order patterns to provide a tailored experience in restaurants, at the drive thru and on our app.

Another milestone on our journey to embrace technology to provide simpler, smoother and more personal customer engagement over our digital channels is the creation of McD Tech Labs, which was fueled by our acquisition of apprentice. Our new team based in Silicon Valley brings first mover advantage and a must-with-area for our system voice technology. Apprentice talent and technology comes with the promise of more efficient and accurate ordering at the drive thru and a better experience for our customers.

At the same time, we expect the technology to reduce complexity for our crew. Whether we look across the tech or consumer world we see voice technology playing an increasing role in all our lives. For McDonald's, this is particularly significant because the importance of drive-thrus to our portfolio. Delivery is another area where we've moved rapidly to capture changing consumer habits around service and convenience. Once again, customers are responding, in fact they're now placing 10 McDelivery orders per second on average globally. So whilst we're on this call, customers will likely place 36,000 McDelivery orders.

For 2019, we expect delivery to drive $4 billion or roughly 4% of global system wide sales. That's up from $1 billion just three years ago. And it's now available from about 23,000 restaurants in over 80 countries. Of note our McDelivery global average check remain steady at two times the average restaurant check. Year-over-year, we continue to see double digit or higher McDelivery comp sales increases across many of our major markets.

In the U.S., we saw an increase in average restaurant McDelivery orders in the restaurants where we recently introduced DoorDash as an additional delivery partner. This result is consistent with our experience in other markets. The addition of multiple delivery partners in markets such as Italy, Canada, Russia, and Spain help these markets reach new customer pools by appealing to customers primarily loyal to other apps, and expanding coverage to geographies where existing partners may not have had a presence.

As we add new delivery partners globally to reach new customers, we're also keeping pace with an evolving delivery ecosystem. Delivery remains a big frontier for our business and we still have a long way to go even with our existing customers to encourage awareness and trial.

This year, over 50 markets participated in our third annual celebration of McDelivery, themed McDelivery Night In doubling the number of participating markets from last year. McDelivery Night In generated a 25% plus global McDelivery sales lift that Thursday. A halo effect on the following day drove the most ever delivery orders on a single day for us.

As we prioritize awareness and trial, we are encouraged by data showing that new or lapse users accounted for a significant portion of the global sales lift. We still have a lot of work ahead of us but we're moving forward with great speed, energy and excitement within McDonalds. We are confidence there's plenty of road ahead for success with McDelivery.

Now, I'll turn it back over to Kevin for a deeper dive into the financials.

Kevin Ozan

In prior quarters, I've talked about the franchising we've undertaken to stabilize our business model. The capital, we're investing in EOTF alongside our franchisees to modernize our restaurants and the additional technology investments we are making to grow the business. I also discussed earlier this year that these strategic moves have created some short term financial headwinds, like lower gains on sales of restaurants, and higher depreciation and G&A expenses.

As we're setting up our business for long term growth, I want to take a minute to put our strong operating results for the quarter in perspective. We grew global comp sales by nearly 6%. We grew system wide sales by 7% in constant currencies. That's well over a $1.5 billion of growth across the system. We grew constant currency revenue across each of our operating segments for the second consecutive quarter.

Our franchise margin dollars were $2.5 billion growing $150 million for the quarter or 6% increase in constant currencies. We achieved an operating margin of 44% and EPS for the quarter was $2.11, with growth in margins being offset by lower gains on restaurant sales and a higher tax rate. This performance reflects the strength and stability of our business model, as well as the ongoing actions we're taking to position our business for sustained long term profitable growth.

In addition, consolidated company operating margins increased 20 basis points to 18.6% for the quarter. US company operating margins increased 280 basis points to 15.6%, benefiting from comp sales growth and improved operational performance. IOM company operating margins declined 60 basis points, but we're still a healthy 21.3% as continued labor and commodity pressures more than offset comp sales growth.

In the US, third quarter pricing was up nearly 3% while commodity costs increased about 2%, primarily due to higher beef costs, we still expect the full year US grocery basket to be up about 2% to 3%.

Turning to G&A. Steve mentioned earlier that we're committed to investing in our business for the long term. As we become more efficient with our day-to-day G&A to run the business, we're choosing to invest in technology and R&D, such as our acquisitions of Dynamic Yield, Apprente. The creation of McD Tech Labs, and an increased focus on back of the house efficiencies for our restaurants.

Our year-to-date G&A spend is up 1% in constant currencies, and given our strategic investments, we expect full year G&A to be up about 1% to 2%. Our effective tax rate was 25.3% for the quarter, and we expect our full year tax rate to be relatively similar.

Foreign currency translation negatively impacted our third quarter results by $0.03 per share, given the continued strength of the US dollar. Based on current exchange rates, we expect foreign currency translation to negatively impact Q4 earnings by $0.01 to $0.03, which would result in a full year headwind of $0.20 to $0.22 cents. As usual, this is directional guidance only because rates will change as we move through the year.

And finally, in September, our Board of Directors approved an 8% dividend increase to the equivalent of $5 annually. This marked the company's 43rd consecutive year of delivering a dividend increase for our shareholders and reinforces our confidence in the company's long term strategy. Through third quarter, we returned a cumulative $22.5 billion against our three year cash returns shareholders target of about $25 billion, which will be completed this year.

Steve Easterbrook

As we talk about change and embed a culture of innovation and how we work is important to connect these efforts to our iconic global brand. For over 60 years, the strength of the McDonald's brand has been our ability to offer a compelling menu of delicious and affordable food made with high quality ingredients, and complementing that with hospitality and convenience for our guests.

An integral component of that brand magic is meeting consumers on their terms, in places where they congregate, whether it would be in small towns or urban centers, on the sidelines of work or play or on the various other places where communities come together. A brand on its essence is a promise and our promise has largely remained unchanged over the years.

What has changed are the ways in which we fulfill that promise. The world is different than it was in 1955. Different today, even it was four years ago, when we launched our turnaround. We're keenly aware that we have to be out ahead of these changes, investing, executing and growing with a deep sense of urgency and purpose.

Our strong performance in the third quarter and over the past 17 quarters didn't happen in a vacuum, is the result of our people firmly committed to our velocity growth plan, and the culture of innovation that is driving that plan.

That culture of innovation is rooted in a relentless focus on the customer experience, making the jobs of our restaurant employees simpler and more rewarding, and building an operational foundation for long-term growth and competitive success. Operational and marketing innovations have been embedded into our DNA since the opening of store number one Des Plaines, Illinois.

Each time we innovate collectively with our franchisees and supply chain partners, whether by founding Hamburger University in 1961, introducing the Big Mac in 1968, opening the first drive-thru in 1975, introducing extra value meals in 1991, launching all day breakfast in 2015 or accelerating delivery in 2017, we plant seeds that result in sustained growth for our business. Indeed, it is through this approach that we've been able to grow guest counts, strengthen our three legged stool of employees, suppliers and franchisees and build an enduring brand for the legacy of sustainable growth.

This is not to say our company and our industry going to face challenges ahead. We have before and we will again. But by having the right people in the right places, supporting them with resources and investments they need and embedding a culture of innovation to how we work, we know we can deliver on our brand promise in any environment and sustain the growth trajectory, which has defined this business for over half a century.

With that said, let's begin our Q&A.

Question-and-Answer Session

Operator

[Operator Instructions]

MikeCieplak

Our first question is from Eric Gonzalez with KeyBanc.

EricGonzalez

Hey, thanks for taking the question. You have a large hamburger competitor announcing its intention to enter the breakfast day part with the big ad campaign and promising to drive a 10% sales mix almost immediately. I was just wondering, if you can comment or discuss your thoughts on how that might impact the industry in 2020? And if you see the industry shifting, again towards heavy discounting in the morning?

And I recognize you might not want to give too much away, but if you could comment on how you see this playing out among your competitors, as they try to protect its share, it will be really helpful? Thanks.

SteveEasterbrook

Thanks, Eric. Steve, here. By the way, apologies to everyone if I'm coughing a little bit through this call, I'm just a bit under the weather at the moment. But yes, so breakfast is a competitive day part, I mean, we've seen competitors ramp up their activity during this year as well actually. So having another entrant in next year will just ensure that market share fight remains as competitive as ever.

I'm not sure if it's really going to be anyone's huge best interest to have it too much value or discount led. But it is an important day part for us to protect and grow. I think for us, we are encouraged this current quarter, because breakfast has been a little behind the rest of the day's performance until this quarter, and we've seen our breakfast sales growth, pretty much in line with the sort of sales growth we are seeing across the rest of the day.

So I think that gives us encouragement that the actions that many of our local coops are taking to fight this on a local level and beginning to get some traction. So -- but we operate in a competitive market, whether it's breakfast or all rest of day. So we’re used to fighting for our share and we'll carry on doing that for next year for sure.

MikeCieplak

Our next question is from Andrew Charles with Cowen.

AndrewCharles

Great. Thank you. Kevin, you talked about year-to-date SG&A growth of roughly 1% with 4Q implied obviously step up to make the full year guidance of 1% to 2%. And I guess just given the accelerating exit rate of G&A in 2019 and the creation of McD Tech Labs to evaluate future technological opportunities. How should we think about what this means for 2020 G&A with street broadly has you pegged at flat G&A dollars?

KevinOzan

Yes, thanks, Andrew. So as I mentioned, our full year spend is expected to be up 1% to 2%, we're up basically 1% through year-to-date. So obviously, you can do the math for fourth quarter. But, as I mentioned in my prepared remarks, we are more efficient on our day-to-day G&A, we're choosing to invest in certain areas of technology and R&D, Dynamic Yield, Apprente, McD Tech Labs, and back in the house some efficiencies that are increasing the G&A certainly slightly this year. And my expectation is that the G&A would be higher in 2020 than is in 2019, mainly because as you know, our acquisitions of both the Apprente and Dynamic Yield happened midyear this year. So we'll have kind of full year impact of those in 2020.

I'd say we believe these investments are really important to help set us up well for long term growth. And so we believe that the right thing to do, as you know over the last several years, we've lowered our G&A, both in absolute dollars as well as significantly as a percent of sales. As a perspective in 2014 G&A was 2.8% of sales, this year will be about 2.2% of sales.

And really what we're focused on is driving growth and operating margin. And our belief is that we're going to have to spend some money in order to be able to drive operating margin that certainly has grown significantly, again from about 29% to 30% back in 2014 to mid-40s now. So you should expect the G&A will be a little higher in 2020 than is in '19. But to us, it's really about driving top line and bottom line growth.

SteveEasterbrook

Just to hook on that as well. I think if we take Dynamic Yield as an example, clearly, we've absorbed the incremental G&A that comes with the acquisition. I think part of how we challenge ourselves here is to generate the return on that investment as fast as you can.

And I think we've been encouraged by the fact we have the Dynamic Yield technology now in 9500 drive-thrus in the US.

And we're pretty much rolled out across the entire Australian system as well now. And with other of our larger international markets lining up. So we think it's -- we challenge ourselves in terms of being physically responsible, but growth is kind of the primary driver of all of our ambition. And I think these investments are enabling that for sure.

MikeCieplak

Our next question is from Katie Fogertey with Goldman Sachs.

KatieFogertey

Great, thank you. You guys started to test out the beyond plant based burger in Canada. I'm wondering, as you saw the quarter unfold did you guys think that not having a meatless burger was a headwind to your sales? How are you thinking about that opportunity here? Thanks.

SteveEasterbrook

We're interested in this clearly. We've taken the plant based product to Ontario, Canada. We've got 28 restaurants now. We only launched it with a couple of days of the quarter to go. So very early days. Clearly, there's been competitive activity, which you will all be aware of, which I'm sure has helped create some more immediate interest or some shorter term, certainly response, consumer response. I guess what we're interested in is really how best to position this, get a sense of the, as they call it them the Flexitarian customer really what is their appetite for this, no pun intended, but would it drive incremental visits, is it option just to switch out from time to time.

We want to get the taste right. We want to get the marketing right. We want get the operations right. So there's a number of important factors that we're learning quickly. And we think Ontario's a great spot because it will give us a good read across North America frankly, but also into the developed markets in Europe as well. So we think the read across will be beneficial and help us speed up our intelligence on this. So more to come clearly. But it's an area of interest for sure.

MikeCieplak

Our next question is from Sara Senatore with Bernstein.

SaraSenatore

Hi. Question about technology spend. And then just a quick clarification on what Kevin just said. First, I guess you're spending a lot of money on technology as you pointed out. And certainly makes sense to leverage scale to make these investments. But our sense is that a lot of your competitors, at least in the U.S. are doing, are also doing well perhaps without as much of an investment and to your point about traffic. So a little bit of a headwind for you.

So I guess, how do we have confidence that, the amount that you're spending or the magnitude is the right amount that it isn't perhaps too much or that there is an ROI on this over time.

And then just a clarification wise, Kevin, you mentioned you want to see growing margin rate. So it sounded like you - or growing margin, it sounded like you were talking about rate as opposed to margin dollars. So should we expect margin rate to continue to expand from here? Thanks.

KevinOzan

Yes. Let me start with the last one first, take care of that one, and then I will come back to the tech spend. When I talk about operating margin, I was talking about kind of the mid 40% range. But certainly you should expect that operating margin dollars will grow.

Just as a perspective, if I think about kind of our restaurant margin dollars through year to date, through September, we've grown restaurant margin dollars, about $450 million in constant currency. So you should expect that our ambition is to continue to grow those margin dollars as we continue on. And our expectation is to continue growing those margin dollars.

Some offset to that will be G&A, obviously. And as I mentioned, we think G&A will go up some in 2020, but certainly not anywhere close to offset growth and margin dollars, which should mean that our expectation is that operating margin dollars would continue to grow.

Relating to tech spend, I'll say a couple things. And then if Steve wants to chime in, he's certainly welcome. It's an interesting question, but I don't know how to prove to you or convince you, let's say that we're spending exactly the right amount. I'd say a couple of things. One, I think we have certainly proven internally and hopefully externally, that we have put discipline around our G&A processes, and that we are investing in things that are driving growth for the business. As Steve mentioned, the way we look at our spend is to determine what kind of return we expect to get on that spend. And that helps drive a determination of what we will spend.

We were, as you know, certainly a couple of years ago, a little behind on our technology spending so that we did have to spend some in the last couple years. I'll say just to get infrastructure and things set up the right way.

And then finally, I'd say our intent is to set ourselves up for sustainable long term growth. And that's why we're investing in technology today. Our belief is those who aren't investing in technology, at some point will be behind and will need to catch up. And we'd rather be a little bit ahead of the curve and spend the right amount that we think will drive future growth.

SteveEasterbrook

And I just pull that I think the part of the performance that we're showing, say through 2019, is a result of some of the technology spend that we've invested the last two to three years. And if I was a backtrack, say four or five years, the majority of our tech spend was backup house type spent just to keep the restaurants operating. That we've really got much more consumer facing. So that's kind of a new era to spend for us. But we begin to see the results that we want. As we see the cell phone or kiosk usage increase around the world, we see the average check growth that comes with it.

As we invest in the outdoor digital menu boards, and then you can plug in, dynamic yield capabilities, we start to see, again, average check growth come from there. Or even just as simple as getting our infrastructure setup to enable us to meet home delivery, for example. And now integrating those apps into our global mobile app. This all takes investment, but it either makes you see the driving visits or driving check, but it's also driving some efficiencies. But it's not always about acquisitions either. So obviously, we've made a couple of acquisitions this year, which clearly gives us an incremental G&A, which we just spoke about.

But again this is also just ongoing investment, through our innovation center around modernizing the equipment stack, if you like and getting that kind of ecosystem functioning more effectively to help our management crew run the restaurants better. So I would say some of the proof points are out there already. But we're excited about continuing to drive efficiencies through technology and also grow through technology. So more to come.

MikeCieplak

Our next question is from David Palmer with Evercore.

DavidPalmer

Thanks. Good morning. Question on earnings. Obviously 2019 is not going to be a year of earnings per share growth, but there's been significant drags in there, lease accounting tax rate, G&A step ups, currency, maybe seven plus points of drag and all those things to all together. You mentioned G&A being somewhat higher for 2020. But just thinking about what you should do in 2020, in terms of earnings versus that high single digit algorithm?

What are some gives and takes aside from G&A that we should be thinking about? And then on free cash flow, is your CapEx outlook still the same with your CapEx dropping from about $2.3 billion in '19 to about half that by 2023? Thank you.

KevinOzan

Thanks, David. Okay, let me try and going through all of that. So, regarding 2020, I guess let me first say this, we still have strong belief in our long-term algorithm and target. So I'll start with that. Regarding 2020, if I think about this year just to put this year in perspective that obviously leads into 2020. Year-to-date again September right now, we've put up a 5.9% Global comp, 5% in the US, 7% system wide sales growth in constant currencies.

And as I mentioned to Sara's question, that has resulted in about $450 million of restaurant margin growth in constant currencies year-to-date. We do have higher G&A this year because of the dynamic yield apprentice. We will have higher G&A next year because of those as well as just the amortization of some of the tech investments we've made.

As I think about the gives and takes, the other couple things will be this year we'll have nearly $200 million lower of restaurant gains. We will likely have some lower gains even next year, certainly not to the extent of this year. We will have continued incremental EOTF depreciation, again, not to the level of this year's increase, which was roughly or a little bit over a $100 million dollars on franchise margins. We don't expect the incremental to be as much in 2020, but we will still have some incremental depreciation on those.

So that's some of the pieces. What I would say is, we feel good about -- well, let me go to CapEx first, I guess. CapEx as you mentioned, it'll be roughly $2.3 billion this year, roughly similar amount next year, and then it should fall bit below $2 billion after that. So that regardless of that we believe that free cash flow will continue to grow year upon year. That's how our model shows it right now.

And I'd say based on our algorithm, and the way we've looked at it. I feel good about the business model. I feel good about our ability to grow margins and drop back to the bottom line. I certainly feel good about our strategy. And I feel good about the investments we're making in technology and R&D that we think will help set us up well for long-term growth.

MikeCieplak

Our next question is from John Glass with Morgan Stanley.

JohnGlass

Thanks very much. If I can just come back to maybe the current quarter in the US and the comps which is 4.8, were strong, but they weren't as strong as the prior quarter at least and you've got building EOTF momentum. You talked about dynamic yield, you talked about expanding your aggregator networks, so all those would point to better results. And they were slightly softer, at least sequentially.

So what were the offsets? Where are you seeing, how did traffic fare relative to last quarter? I think you were sort of optimistic traffic was a little better last quarter, but maybe it wasn't sustainable. So was it being just a relapse then to normalization? A little more color on what changed in the business third quarter in the U.S. versus the prior quarter?

KevinOzan

Yes. I'll start and then I will let Steve chime in just so he can save his voice a little bit. Traffic for the third quarter, I'll say there wasn't a meaningful change in traffic trends in the third quarter for the U.S. versus the first couple quarters. So it's still negative. As I mentioned, it's still our largest opportunity, but not a meaningful change in trend in the third quarter versus second quarter.

You will recall as we mentioned on our second quarter call, we had a couple benefits in second quarter, one related to the timing of Easter holiday, one relating to some promotional activity we had related to Filet O Fish that helped second quarter I'll say be a little bit above trend, if you will.

So third quarter -- if you think about two years stacks, third quarter is relatively similar to first quarter. And the other thing I'd say related to within the quarter, because I know there's been some chatter out there about how the quarter got weaker for us as the quarter went on. All three months were relatively similar in terms of comp sales. So each month was between a 4.5 and 5.5 comp. So it's not like -- it's not like the worlds fell off in August or September or anything like that.

And the other thing I would say is, there is certainly was some competitive pressure mid-August, probably through mid-September. That seemed to lessen as we ended the quarter. So I think all of those factors kind of impacted our net result in the order. As you mentioned, EOTF, is a benefit -- third quarter benefit was relatively similar to second quarter benefit. And I would expect that to be similar in the fourth quarter before it starts leveling off for next year.

SteveEasterbrook

I think the only thing I would add is if we kind of drill into our detail of points ones here and points one there. Some of the work we've done on simplifying our menu as I mean we've had a little bit of resistance when we move away from say signature crafted.

Now the flip side is helping us run better restaurants and we saw our drive-thru service times in the U.S. improved by around 20 seconds across the quarter year-on-year. So I think we're still making the right decisions for the long term. But Yes, there's going to be a little bit of short term resistance when you simplify the menu. So little bits and pieces but no fundamental shift in momentum.

I mean, it really was balanced sales growth across day parts and across the menu, actually, which I think is what's giving us confidence. And some of the accelerator initiatives that we've launched are delivering consistently the sorts of performance that we've shared with you in the past.

MikeCieplak

Our next question is from John Ivankoe with JPMorgan.

JohnIvankoe

Hi, thank you. Actually a follow up on that as well. You obviously mentioned improving drive-thru times, which is obviously important in record guest satisfaction scores. I mean, these are things that would normally have driven a positive traffic comp, for McDonald's, maybe in the past.

The comments that you made on franchisee store level cash flow. 11 months, I think, a positive year-on-year cash flow. How much of that was due to some of the changes that you made, from a promotional perspective. And, what's the post mortem on giving more of the value back to some of the local partners?

Are you in the place where you think you're optimizing profitability and traffic? Or might there be kind of a shift in balance, if you will in 2020 where we might see more value in words to drive traffic maybe into some extent, at the sake of profitability?

SteveEasterbrook

Yes John, it's. Actually it is that delicate balance, so I mean, to get the consistent top-line growth, and having profitable growth for our enterprise is clearly critical. We want that drives their motivation and drive their confidence, it drives their ability and willingness to keep reinvesting in the initiatives as we've identified.

But we don't want to give up customers. And it's fair to say that the guest count declines we do see. There's a couple of things I'll share with you. One is the lower average check level. So clearly there is a value component in there and it's just a case of how do we address that? Is that more of a local level? Is it a national level? I don’t know, our U.S. team's working through that.

Another way we've cut and diced this is across the US we have 56 co-ops. And if we look at the fourth quarter the most challenged performing co-ops. See clearly 25% of our cost but actually more than more than half of our guests count declines explained in those 14. So we're putting more support and activity into those co-ops to see if we can just pull up that tail which says multi will lift us collectively as well and we're beginning to see traction there as well.

So there's a number of different ways we're approaching this, but we want to remain competitive on value clearly. Getting back to the drive-thru service times, we will see incremental visits as we continue to improve service. Fundamentally we are a quick service restaurant and all trends had been heading the wrong way for too many years. And I'm delighted at how much traction we're getting there given the focus you put on it this year.

And we know customers will notice 20 seconds, particularly the time press customers, those busy peak hours well, that's the breakfast rush or lunchtime. Those savings that they don't necessarily notice it on just one visit. But as we consistently run better restaurants, we believe that will be a strong competitive position going forward.

MikeCieplak

Our next question is from David Tarantino with Baird.

DavidTarantino

Hi, good morning. And just a question on the technology investments you made in specifically dynamic yield. I guess what I was wondering if you could comment on what you're seeing so far as you roll it out and in terms of the customer response or the business impact? And how you see that evolving as I guess customers get more accustomed to using the technology?

SteveEasterbrook

At the moment we've effectively rolled out from core capability of dynamic users. Kind of what we would say suggest itself. The beauty of this is there is nothing that customer has to adjust to, they almost don't know that this experience is happening for them as we've got dynamic digital menu boards. And effectively as they start to place their order, the menu boards respond to that to that ordering process and therefore are more likely to suggest items a customer will want and less likely to show items that customers are less likely to want.

And of course, machine learning helps you improve that and particularly given the transaction levels we have across our business we can learn pretty really -- very quickly. But there's further capabilities as we're learning so for example, there's an area now where they can offer trending now which will actually pick up items either in a restaurant or a local group of restaurants that are proven to be particularly popular at that point in time. So there's kind of get another level of dynamic interaction going there.

And again, at this point, we're only really talking about having it on the outdoor digital menu boards. But suffice to say the team -- part of the investment we're making in the business with talent and expertise is to look how can we integrate that into the cell phone or kiosk and perhaps ultimately the global mobile app as well.

So I think we're at early stages already very encouraged about the results we're seeing. The speed with which we can execute and roll this out, deploy this is really giving us a lot of confidence that we can get this across. I guess we've now got an outdoor digital menu boards in over 10,000 restaurants in the US. And the majority of our full length international lead markets are pretty much fully deployed as well. UK has got a little bit of cash enough to do.

But as I say, this is encouraging operators to invest in the technology because they're seeing the return. And as I say, this is just for the core basic capability and there's more we can add to it.

MikeCieplak

Our next question is from Matt DiFrisco with Guggenheim.

MattDiFrisco

Thank you. I just had a couple of follow up questions. I guess, can you just comment on how that 3% price should look, going forward, is something that is going to be held in?

And then I think in previous quarters, you described how much that was contributing to the check. And 2Q was about third of the check or so. If you could just sort of draw that line for us?

And then a clarification. I think you mentioned on the prepared remarks, hamburger share was gained or you gained hamburger share, but your traffic was negative. Does that imply then there was some near term increased competitive pressure around chicken and you lost a little bit of business and on the chicken side in the near term in the US?

SteveEasterbrook

Okay, I'll start. Price, Matt, let me start with how we think about it. I think we've talked before, but we look at various things. Certainly food-away-from-home is one guidepost. But also, we look at, and the pricing we talk about is pricing system wide which as you know 95% of those restaurants are run by franchisees determining that -- determining that pricing. But certainly I think if they consider their pricing, they're also looking at cost pressures, whether that's labor, commodities, et cetera. And it's really about trying to strategically balance, offsetting some of those cost pressures with kind of what a customer is willing to pay.

So, there isn't a pure formula, that 3% that -- and I think we said nearly 3%, actually it is a little bit below 3%, but close to 3%. And they impact at our comp is actually a little bit less than that, because while the pure price -- what I quoted are pure price increase, but you hit a little bit resistance. And so the actual contribution of the comp ends up being a little bit below that.

But it still is roughly that third, two-thirds, about a third, from price, roughly two-thirds from product mix for various reasons, including dynamic yield, the kiosk usage and delivery, all the things that we've been talking about.

So that's the -- that's the story on pricing. Related to the burger share, so as we said that in the U.S., we did gain hamburger share in the quarter. I think it's fair to assume with everything going on in the quarter with chicken that we did go a little bit the opposite way on chicken. So I think that's a fair conclusion.

So that, if we look at the top 11 markets, we actually gained IO share and QSR share in all 10 of the largest markets beyond the U.S. as well, including some extremely strong gains in markets like the UK, Russia, Australia, France as of all time market share high for example. So I think we are we have proven to be competitive and driving the broader market dynamic around the world actually, which is helping underpin the sales momentum and business momentum.

MikeCieplak

Our next question is from Chris O'Cull with Stifel.

ChrisO'Cull

Yes, thanks. Steve, there's been a lot of discussion about how dynamic yield tech support suggestive selling. But I would think the new digital menu boards would also allow the company to do a better job of price optimization meaning, stores could be able to adjust prices more frequently. Can you describe how the new menu boards or digital boards will change kind of the company's approach to pricing?

SteveEasterbrook

Yes, we typically try to avoid that. And partly just because I think it's part of the brand promise we have the customers is just that reliability in knowing what their typical meal or combination costs. So it has been discussed sometimes through and I know others out there. And that's kind of, if you like ultimate dynamic pricing capability. But that's not really kind of underpinning the business the way we want to do business and to stay away from that.

We try and have a careful thoughtful approach with our kind of pricing consultants if you like. And we just make periodic adjustments and just give customers that that kind of assurance and reliability.

MikeCieplak

Our next question is from Brian Bittner with Oppenheimer.

BrianBittner

Thanks. Good morning. First, just a clarification on David Palmer's question on 2020. Kevin, should we be interpreting your answer in a way that we should be modeling 2020 as a below algorithm year for earnings or no?

And just on the store level margins in the U.S. a meaningful trend change in the margins there up 280 bps this quarter. Can you just dive a little deeper on what specifically changed in the margin dynamics this quarter for the U.S. versus last several quarters and should we expect it to continue? Thanks.

KevinOzan

Yes. Let me talk about the U.S. margins first. In my prepared remarks, I mentioned kind of what I called operational performance improvements. And really what that means, as I'm exciting as this may be is kind of the basics of running better restaurants. We keep talking about just running better restaurants and getting more efficient in running restaurants. But it's things like reducing complexity in the restaurant, simplifying procedures, focusing on efficiencies and the derive thru, being more diligent with our labor, scheduling and staffing, basic food control.

So it's all that stuff that we talk about when it's just managing a restaurant really well. And I think putting more of a focus on that has helped our company operated folks focus on that.

To be fair, I think the other piece, I would just throw in there a little bit. Is there is less disruption going on this year than there was last year from a couple standpoint -- couple pieces. One we're almost completed with EOTF in the company operated restaurants.

So by the end of this year we will have all of the EOTF projects in our company operated restaurant completed. That's one thing that does, is a distraction and disruptions to the restaurant. The other thing as you know is we have been re-franchising over the last several years and that becomes a little bit of a disruption certainly to the company operated business.

So the fact that that's more stable and we have kind of settled in where we are now, I think helps just the stability of running the restaurants on the company operated site. So all of those things I think go into play into why you certainly saw some of that improvement this year. I think as we look forward in the near term in the U.S., we still do have some pressures like the EOTF depreciation, some labor costs.

But I think kind of similar range that we've been in the 15% to 16%ish range in the US is probably a reasonable way to think about it going forward.

Regarding 2020 in the fourth quarter we will give more detail and go through our actual outlook that will provide more detailed guidance. I'll leave what I said for now as general guidance and it certainly we will get into more detail as we get to year end. We’re in the midst of going through our detailed planning right as we speak. And so I don’t want to get too far ahead before we actually complete that process.

Mike Cieplak

That completes our call this morning. Thanks everybody for joining us. Have a good day.

Operator

This does conclude the McDonald's Corporation Investor Conference Call.