Q1 2024 Earnings Call

Company Participants

- Chris Kempczinski, President and Chief Executive Officer
- Ian Borden, Executive Vice President and Chief Financial Officer
- Mike Cieplak, Senior Vice President, Treasury & Investor Relations

Other Participants

- Andrew M. Charles, Cowen & Company
- Brian Bittner, Oppenheimer
- Brian Harbour, Morgan Stanley
- Brian Mullan, Piper Sandler
- David Palmer, Evercore ISI
- David Tarantino, Baird
- Dennis Geiger, UBS
- Eric Gonzalez, KeyBanc Capital Markets
- Gregory Francfort, Guggenheim
- Jeffrey A. Bernstein, Barclays
- John Ivankoe, JP Morgan
- Lauren Silberman, Credit Suisse
- Sara Senatore, Bank of America

Presentation

Operator

Hello and welcome to McDonald's First Quarter 2024 Investor Conference Call. At the request of McDonald's Corporation, this conference is being recorded. Following today's presentation, there will be a question-and-answer session for investors. (Operator Instructions)

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

Mike Cieplak {BIO 20546263 <GO>}

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, Ian Borden.

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 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 {BIO 18660246 <GO>}

Thanks, Mike, and good morning, everyone. I join you today inspired from our recent worldwide convention, a time when McDonald's comes together to celebrate the success of our system. The relevance of our brand, power of our Accelerating the Arches strategy, and the collective strength of our system were on full display as we welcomed our global McDonald's franchisees, restaurant teams, suppliers, and company employees to Barcelona.

For the first time in our nearly 70-year history, we held this biennial reunion outside of North America, a testament to the global power of our brand. And were joined by more than 15,000 attendees from nearly 100 markets to discuss how we're reimagining the future across our three-legged stool.

It's clear that McDonald's continues to operate from a position of strength across nearly all areas of the business as we focus on executing the day-to-day at a high level and establishing strong platforms for long-term sustained growth. The first quarter of 2024 marks our 13th consecutive quarter of positive comparable sales growth with 30% growth over the last four years. This success was built by establishing a strong foundation with a strategic plan based in consumer insights and focused on creating relevant marketing campaigns with our brand connected to culture.

At the same time, we're maximizing the strength of our core menu equities and building an industry-leading loyalty base. Combined with our modernized restaurant estate, strong franchisee alignment, engaged restaurant employees, and strong restaurant-level unit economics, McDonald's is well-positioned.

This winning formula continues to drive results, and our customers visiting our restaurants today can easily see our commitment to providing them with a great experience, evident through our strong customer satisfaction scores.

As I reflect on the first quarter of the year, it is clear that broad-based consumer pressures persist around the world. Consumers continue to be even more discriminating with every dollar that they spend as they face elevated prices in their day-to-day spending, which is putting pressure on the QSR industry.

It's worth noting that in Q1, industry traffic was flat to declining in the U.S., Australia, Canada, Germany, Japan, and the U.K. And across almost all major markets, industry traffic is slowing. In the context of a difficult macro environment for the industry, we know our customers are looking for reliable, everyday value now more than ever. That has always been our promise to deliver delicious feel-good moments at an affordable price each and every day.

Staying on the side of the consumer and executing against our plan is our model for driving long-term growth, regardless of the broader landscape. This was the case nearly 70 years ago when Ray Kroc opened the very first McDonald's, and this remains just as true to this day.

As consumer pressures have mounted, we've reacted with agility to proactively meet evolving customer needs. For example, over the past year, we've launched Everyday Value Menus across many of our international markets, including all five of our big IOM markets. Featuring value bundles at various price points, these new offerings provide smaller, more affordable meals to our customers.

In Germany, our McSmart menu has continued its strong performance with record units sold during the first quarter. And in other markets like Spain, our Everyday Value Menu features a convenient bundle for every price point, which continues to drive results. I recently spent time with our market team in Poland and experienced firsthand their renewed focus on value in an environment where significant inflation has created challenging consumer dynamics.

In light of these challenges, I was impressed by the market's ability to quickly identify an opportunity in their everyday value offerings to implement a new entry-level value platform, which is driving traffic back into our restaurants.

And in France, a market which I flagged last quarter, I've been impressed by the speed with which our team and franchisees have moved to address their opportunities. The market now has established their own McSmart value menu with high consumer awareness, which is driving encouraging progress in their business trends.

It's clear that McDonald's offers delicious food at a great value, and customers continue to tell us this through our survey work. That said, we must be laser-focused on affordability, which means good entry-level price points available every day. In the markets where we're doing this well, the business is outperforming. In some markets, however, it's clear we still have opportunities to strengthen our proposition.

As we continue to take a one McDonald's approach to solving problems, the unique size and scale of the McDonald's system gives us the ability to learn from each other, and it's examples like our success with the McSmart value menu construct that we will look to replicate further.

McDonald's has a long history of being the go-to destination for value, and it's imperative that we continue to keep affordability at the forefront for our customers. We literally wrote the playbook on value, and we are committed to upholding our leadership within the industry.

As we've done for the last 70 years, our teams in those markets are working closely with our local franchisees to balance menu pricing decisions with the right affordability strategy in place, and where needed, get more aggressive with our value offerings.

Despite the elevated cost environment we've navigated over the past couple of years, average franchising cash flow and the corresponding margins remain strong. And thanks to the financial strength of our restaurant P&Ls, we have the ability to invest in these traffic-driving initiatives.

Despite these ongoing challenges and pressured consumer spending across our segments, we delivered global comparable sales growth of nearly 2% in the first quarter. And we continue to raise the bar on the customer experience in our restaurants with a focus on strong execution. This is driving improved service times and higher levels of customer satisfaction across our markets.

In challenging times, there is significant power in focusing on what's within our control to maximize the impact of our strategic plan, offering our customers delicious food at unparalleled value and convenience. And it's exactly this approach that will continue to drive growth.

McDonald's is best positioned to win in the industry because when we combine our strong system alignment with our fully modernized estate, a globally recognized brand, delicious food on our core menu, and the highest level of execution across our four Ds, no competitor can match us. As consumer spending remains pressured and macro headwinds continue, we are laser focused on maintaining our competitive advantages and growing QSR market share.

With that, I'll turn it over to Ian to talk more about our Q1 results.

Ian Borden {BIO 15826305 <GO>}

Thanks and good morning, everyone. As Chris mentioned just a few minutes ago, strong execution against our strategic plan delivered global comp sales of nearly 2% for the first quarter, driven by growth across our U.S. and IOM segments.

As we've said before, as customers continue to be more intentional with the dollars that they spend in a pressured economic landscape, we expect moderated top-line growth this year. In our IDL segment, positive comp sales in Japan, Europe, and Latin America were offset by the impact from the ongoing war in the Middle East. We remain proud of the way our system continues to show up for customers every day, and we continue to work closely with our DL partners to support local communities in the region.

It's during times like this that I'm once again reminded of the resilience of the entire McDonald's system and our ability to deliver delicious feel-good moments to our customers in any environment, which I've seen time and again in my 30 years with McDonald's. We continue to drive a One McDonald's Way approach to our creative excellence this quarter, combining local cultural relevance with global reach to engage a new generation of McDonald's fans.

In more than 30 markets around the world, including the U.S., we tapped into a new global community with a truly unique brand campaign. While McDonald's has long been an enduring brand across communities, in Anime we're known as WcDonald's, a fictional restaurant we brought to life for our fans this quarter.

By featuring our Chicken McNuggets alongside a new dipping sauce, theme packaging, and bonus gaming content with a mobile app purchase, we created brand excitement and lifted McNugget category sales. Our fans' passion for the McDonald's brand and for the WcDonald's universe quickly spread across social media in the U.S. with over 6 billion impressions and nearly 100,000 mentions.

Our delicious burgers were also featured across many markets this quarter as we continue to showcase our strength in beef with a consistent approach to improving our fan favorites. Now deployed in over 80% of our restaurants globally, Best Burger was recently introduced in France this quarter, delivering hotter and juicier burgers.

Early results were promising with lifts across our core burger categories and improved customer satisfaction in both our taste and quality scores. And in the U.S. where we're now fully deployed across the country, we celebrated the national launch of Best Burger with an iconic character at the center of our advertising.

Tapping into the nostalgia of the Hamburglar, the campaign drove a significant lift in the Big Mac category and contributed to record customer satisfaction scores in the market. The progress we've made with our core burgers highlights what McDonald's can achieve when we tap into the full power of our system size and scale. We'll continue to showcase that small changes can add up to deliver big improvements to both taste and quality by scaling Best Burger to nearly all restaurants by the end of 2026.

And as we look to further build on our leadership in beef, our team of chefs from around the world have created a larger, satiating burger. We'll be testing this burger in a few markets later this year, ensuring that it has universal appeal before scaling it across the globe.

We also celebrated our menu in the mobile app this quarter, combining the strength of our core equities with new and exciting digital experiences for our customers. Across our top markets, digital penetration is growing as evidenced by our increased loyalty sales and record mobile app orders, leading to greater frequency and increased spend by loyalty customers. We're also growing digital share as we leverage learnings from across markets in areas like gamification.

Australia featured McDonald's world-famous fries at the center of a digital campaign and offered customers a chance to win by digitally redeeming their game pieces. Powered by a seamless digital experience, the campaign resulted in incremental customer acquisition and increased the market's loyalty sales. The U.K. market also drove strong loyalty results with the return of their Winning Sips digital experience, encouraging customers to add a drink to their order with a chance to win on every cup.

Customer engagement in the mobile app increased with digitally redeemed game pieces, and we drove record growth in 90-day active users in the market. Because of unique digital experiences like Winning Sips, our loyalty members continue to engage more frequently, with nearly 75% of our total loyalty user base in the U.K. active during the last quarter.

We know the experience we provide, whether through our mobile app or in our restaurants, is a significant driver of how often our customers choose to visit McDonald's. But providing our delicious food at the right price is equally critical, especially in today's environment where consumers all over the world are paying more for everyday goods and services.

As Chris mentioned a few minutes ago, a strong value proposition continued to drive results within several of our markets this quarter. This consumer-centric approach to providing our customers with compelling value at affordable price points continued to drive strong results in markets like Germany, Spain and Poland and led to QSR market share gains. As we remain agile to meet the needs of our customers around the world, we'll continue to use our size and scale for the greatest impact, sharing what is working to drive consistency and enable speed.

Turning to the P&L, our global top-line growth drove adjusted earnings per share of $2.70 for the quarter, an increase over the prior year of about 2% in constant currencies. Adjusted operating margin for the quarter was nearly 45%. Despite the pressured consumer spending environment we've discussed this morning, top-line results generated nearly $3.5 billion of restaurant margin for the quarter, an increase of about 4% in constant currency.

This was partially offset by higher G&A costs as we continue to invest in our strategic transformation efforts and growth opportunities such as digital, as well as costs associated with our biennial worldwide convention that Chris mentioned.

Our adjusted effective tax rate was 19.9% for the quarter. As we've talked about before, driving long-term growth requires making the right strategic and forward-looking investments. The resilience of our business and our overall financial strength put us in the ideal position to invest in critical areas that deliver against customer needs, as well as unlock efficiencies for our people and our business.

This includes new restaurant development as we look to accelerate the pace of openings and grow our footprint to 50,000 restaurants by the end of 2027. Development for the year is off to a strong start across markets, including in China where we recently opened our 6,000th restaurant, and we are pacing on track against our global plan.

In addition to restaurant development, we're also investing for long-term growth in areas like digital and technology, as well as our transformation efforts within our global business services organization. By leveraging the full strength of our global scale, we'll build new and modern capabilities and ultimately unlock speed and innovation for our entire McDonald's system.

Despite the headwinds that persist, we remain well positioned with the unique strength and scale that only the McDonald's system can provide. As Chris talked about up front, we are focused on how we can further leverage this across our consumer, restaurant, and company platforms.

With our system aligned on the right strategies moving forward, along with the financial strength of our franchisees, suppliers, and the company, I remain confident that we will continue to deliver long-term growth for our system and for our shareholders.

And with that, let me turn it back over to Chris.

Chris Kempczinski {BIO 18660246 <GO>}

Thanks, Ian. We like to say that when culture calls, McDonald's answers. With a brand that is renowned throughout the world and marketing that is resonating in culture and with consumers, it's no wonder that we've been recognized yet again as one of the world's most effective marketers by work in association with Cannes Lions. We're elevating our creative excellence, scaling great ideas globally, and building meaningful relationships with the next generation of consumers.

Breakthrough campaigns, a great tasting menu, and personalized experiences will drive customers to McDonald's again and again as they come through the physical doors of our restaurants and the digital door of our mobile app. And in this environment, with pressured QSR traffic, we have an opportunity to get the customers who already visit to visit more often.

As more customers make purchase decisions based on personalized recommendations on their phones, driving frequency means using our digital capabilities like loyalty to know and serve our customers better than anyone else.

With the insights powered by our loyalty members, we will work to deliver the right message at the right time to the right consumer, encouraging those who already love McDonald's to visit even more. And when we shift marketing investment from traditional mass media like television, print, and billboard ads to collective investment in modern digital capabilities to personalize the experience, we drive profitability.

And successfully delivering personalized experiences depends on transforming our restaurants to deliver what customers want, hot, fresh orders delivered with convenience and accuracy.

The future restaurant experience is already underway in markets across the world, whether it's ready on arrival, a dedicated drive-thru lane for digital orders in China, or other flexible format concepts. And by building the technology infrastructure to support the three long-term platforms we've discussed we will create a more reliable experience and operate more efficiently.

We've talked about the ways best-in-class marketing and our iconic menu fuel the brand, but there's another component. Each and every day, our McDonald's system strives to fulfill our purpose of feeding and fostering communities locally, and there's no greater example of our decades-long dedication to driving positive impact than our work with Ronald McDonald House Charities.

This year, we're celebrating the 50th anniversary of Ronald McDonald House Charities, providing essential services that remove barriers to health care, strengthen families, and promote healing when children need it most. Since that first house opening, the charity's global footprint has expanded significantly, and they've helped tens of millions of families through the hardest of times.

With more than 385 programs running across the world, the organization is providing support for families across 90% of the world's leading pediatric hospitals and extending care through more than 2 million overnight family stays each year.

Before I close, I'd also like to take a moment to recognize Rick Hernandez for his many contributions to the McDonald's system throughout his 28 years of service on our Board of Directors. And as I assume the additional role of Chairman following our Annual Shareholders Meeting next month, I look forward to working alongside our new lead independent Director, Miles White, and the rest of the entire Board to continue to deliver strong performance, united under an aligned company voice.

I am confident that the system is focused on the right priorities with Accelerating the Arches as our playbook, evolving to meet the customer needs of tomorrow, and laying the foundation for future growth.

With that, we'll take questions.

Questions And Answers

Operator

(Question And Answer)

Thank you. (Operator Instructions)

A - Mike Cieplak {BIO 20546263 <GO>}

Our first question is from David Tarantino with Baird.

Q - David Tarantino {BIO 15144105 <GO>}

Hi, good morning. My question is on the comps outlook. I think, Ian, you mentioned on the last call that you had expected comps in the U.S. and IOM to settle to the 3% to 4% range this year. And now I think your commentary suggests you're operating in a tougher climate than when you gave that guidance.

So one, I wanted to ask if that range is still in play in both of those markets in your view? And then secondly, for the U.S. specifically, do you think a more concerted or more aggressive value approach is needed to get there in the current environment? Thanks.

A - Ian Borden {BIO 15826305 <GO>}

Hi. Good morning, David. Thanks for the question. Let me start, and then I think Chris will probably jump in to kind of build out on whatever I say.

But, look, what I would start with is, as you know well, we don't typically give comp guidance. I think what we were trying to do as we looked back was to provide a directional perspective on what we felt the industry kind of historical range looked like in more typical years. As you know, we talked about '24 being a year where we felt top-line was going to moderate. I think four months into the year, I think what we can say is clearly 2024 isn't going to be a typical year for the broader industry.

I say that because we're certainly seeing, as you heard in our upfront remarks, that the macro headwinds have been more significant than I think we even anticipated coming into the year. And we continue to see those macro headwinds as we have started quarter two. And, frankly, many of

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our large international markets and the U.S. and I think we expect in the U.S. that we're going to start the quarter roughly flat from a comp sales perspective from what we can see so far.

And so I think what we're seeing is in many of our largest markets internationally and the U.S. that the industry traffic is either flat or we're certainly seeing declining trends. And I think as a result of that, we believe we're going to likely probably be below that historical range that we had indicated.

I think what's important is clearly we don't control the macro context around us. And so what we're focused on, as always, is listening to the needs of consumers, making sure we're making the appropriate adjustments in our business to deliver against those needs, and, of course, is always ensuring that we can do it better than anyone else.

And I think affordability is clearly an area where consumer expectations are heightened. I mean, I think consumers are obviously dealing with a lot in the current macro context. Obviously, they're getting hit, I think, across their full basket of goods and services by all the inflationary impacts.

I think, importantly, we've got a really long and strong history of being a leader in both value for money and affordability. We've obviously been through these difficult contexts many times over time. I say that because I think it's important that we know what we need to do. I think we know how to do it well.

And the financial strength of our business puts us in a position to be able to do that better than anyone else, and I think that's what we're going to make sure we're delivering against, and each of our large markets is positioned for success against those current consumer expectations.

And then turning to value in the U.S., I think it's important to first recognize that there is some great value that our system, our franchisees, are offering in the U.S. 90% of our system in the U.S. is offering meal bundles for $4 or less, and if you look at digital value, we've got some great digital offers out there.

I just opened my app while I was waiting to jump on this answer, and we're offering right now a Big Mac for $0.29 when you buy a Big Mac, or you could get 30% off McCrispy, so there's a lot of great value out there, but I think the issue that we have in the U.S. is in an environment where everybody's out there with a value message, there's an opportunity for us to drive better awareness of what our value platform is.

And one of the things that's going on in the U.S. right now is the value message that I was talking about, we're doing it in 50 different ways with local value, and what we don't have in the U.S. right now is a national value platform at the same time that our competitors are out there with a national value platform.

So the opportunity for us in the U.S., I think, is to get more aligned as a system around a strong national value proposition that we can then use our media scale to drive high consumer awareness on it, so that's what I know Joe and the team are focused on the U.S., and as I look at the U.S. compared to other markets where we're having success, you've got to be able to have high awareness, and that's, I think, the big opportunity for us going forward in the U.S. business.

A - Mike Cieplak {BIO 20546263 <GO>}

Our next question is from Brian Harbour with Morgan Stanley.

Q - Brian Harbour {BIO 19285890 <GO>}

Yeah, thank you. Good morning, guys. I guess given kind of the response to that prior question, what's some of the timing on that value plan, especially in the U.S.? Do you think that we'll start to see some improvement in the second quarter? Do you think it sort of takes longer than that? What else could we think about from a sales driving perspective or maybe a product perspective that will be noticeable U.S. comp drivers as we think about this year?

A - Chris Kempczinski {BIO 18660246 <GO>}

Sure. Well, I think what we've seen, if I turn to France as an example, France, I was talking about last quarter as having a number of areas of opportunity, and in my prepared remarks, I noted that that system in France came together very quickly around a national value program that they then put significant marketing support against and they got to north of 80% awareness in a very short period of time That's starting to drive encouraging trends in their business results.

I think what that highlights is, it's not about, how quickly can you see the business impact when you have a strong marketing support against a compelling value platform? It's how quickly can your system move and pivot to getting that in place?

And I know that that's something that the Joe and the U.S. team are talking with U.S. franchisees on. I think again, there's lots of great value that we have out there at a local level. But it's how do we come together in the U.S. around a stronger national value platform that can compete?

How long that takes? I think is going to be, up to individual conversations that happen in the market, but it's clear that once you have that in place, the business can start to respond pretty quickly.

A - Ian Borden {BIO 15826305 <GO>}

And maybe just the only build I'd add to what Chris said Brian is I mean, I think, I know as Chris said our U.S. leadership team is really -- is working really closely with our Owner/Operators.

I think we have a good understanding of what we need to do kind of how to do that well, and we're going to move obviously as quickly as we can together with Owner/Operators to kind of address that opportunity. And we've seen that work really well in other markets globally as Chris was talking about.

A - Mike Cieplak {BIO 20546263 <GO>}

Our next question is from Dennis Geiger with UBS.

Q - Dennis Geiger {BIO 19694619 <GO>}

Thank you. Wondering if you could speak a little bit more to kind of what you're seeing with that U.S. consumer whether it's by income cohort or spending pattern? And then sort of beyond affordability and aligning the system on a national value plan. Can you speak at all to sort of some of the other key levers that maybe can be supportive of U.S. sales growth in the current environment? Thank you.

A - Chris Kempczinski {BIO 18660246 <GO>}

Sure, well, I think one of the things that we noted when in our opening is that the consumer is certainly being very discriminating in how they spend their dollar and the inflation that has occurred over the last couple years in the U.S. I think there's certainly created that environment.

And while, it may feel it may be more pronounced with the lower-income consumer I think it's important to recognize that all income cohorts are seeking value. And so our focus is on making sure as I said that we're offering strong value to our customers and that's going to have benefits not just a low income, that'll have benefits to middle and upper income as well. And so the actions that you take are the same regardless of the income cohort that you're talking about.

From other sales drivers standpoint, I'm not score. I feel really good about where we're at in the U.S. As I look at, most importantly, how we're running our restaurants, our franchisees in partnership with our U.S. team are doing a really nice job of running strong restaurant operations. We're seeing improvements in speed of service. We're seeing the turnover in our restaurants is down. All of those things in combination are improving customer satisfaction. We're seeing our satisfaction scores increase in the U.S.

And then we will, of course, have menu innovation that happens throughout the year. It's part of what we do. I'm not going to get into detailing exactly what the menu innovation is going to be and when it comes. But certainly, you can expect that we will use menu innovation as well to find ways to engage our customers.

And lastly, I would just point out, we always have to be finding ways to be driving consumer interest around great marketing plans. And if we're doing great marketing, you can grow the business just with your core menu. And so I know the U.S. team, along with our agency in the U.S., Wieden and Kennedy, they're continuing to look for what's the next big idea that we have from a marketing standpoint to drive the business. So multiple levers at our disposal.

A - Ian Borden {BIO 15826305 <GO>}

And Dennis, maybe I'll just build on what Chris was saying, because I think it's such an important point. I mean, the foundation of our business, the vast majority of our business, is in an incredibly strong position.

I mean, I think we come into this more challenged macro environment kind of in an advantaged position. And I think the emphasis would be we have a fully modernized estate, as Chris kind of referred to. We've got, I think, a marketing and brand engine that's best in class, meaning I think the team continues to deliver great creative execution. I think that's resonating with customers in culturally relevant ways.

We've got our system financial strength that's at one of its strongest points in our history. So we've got the ability to kind of lean into opportunities together because of all the work we've done over the last couple of years.

And then if you think of our three Ds of delivery, drive-through, and digital, we have a leadership position in each of those areas. We're continuing to invest to drive growth in those areas. Delivery, for example, the U.S. business kind of hit all-time highs in the first quarter. Delivery is -- sorry, digital, as you know, we've made a lot of progress in. And we know we continue to drive growth in digital more broadly.

So I think we feel really good about the vast majority of our business. We just know the consumer is looking for more on affordability and value, and we're going to lean in and make sure we can meet those needs.

A - Mike Cieplak {BIO 20546263 <GO>}

Our next question is from John Ivankoe with J.P. Morgan.

Q - John Ivankoe {BIO 1556651 <GO>}

Hi, thank you. I was wondering what kind of opportunity or maybe need that we have to address core menu pricing in the U.S. And I speak specifically about things like quarter pounder combo pricing or Big Mac combo pricing that can actually be very different across the restaurant base, even within a given market.

And, obviously, the press will communicate some of the highest pricing in certain stores as you talk about what the direction of pricing has happened to McDonald's across the country, even if it is just certain stores. So is there a need or an opportunity to kind of get back and communicate around core menu pricing to kind of give the perception of value for consumers that maybe even are outside of the value menus of what we did pre-COVID? Thank you.

A - Chris Kempczinski {BIO 18660246 <GO>}

Sure. Well, let me start with I think it's important to recognize that if you look at margins in the U.S. today, restaurant level margins for franchisees versus where we were in 2019, we've just now rebuilt franchise restaurant level margins back to where we were in 2019. So the pricing that's been taken over the last several years was all taken as a means to offset what we were seeing around quite high labor inflation and quite high commodity food and paper inflation.

So restaurant margins are now back to where we are -- where we were again in 2019 in the U.S., which then says to me that we do have the ability to be thinking about what we do from a value proposition going forward.

And I talked about that in my answer to the earlier question. I think the idea of where do we need to stay from a pricing standpoint on core menu? We've done a lot over the last several years building our pricing capabilities, and the pricing capabilities that we have happen at the local level.

So we will go and we will take a look at what are the competitive products around us, what are they priced at, and how do our products match up against that? And all of that is then used to inform at the franchisee level, at the restaurant level, what our relative pricing is.

So I think from where we are, I feel like we are in a decent shape from an overall menu standpoint. Yes, there will be the one-offs that get sensationalized and reported on, but again, our opportunity is we need to speak in a more compelling way with one voice about what are those entry point affordable price points that will be attractive to consumers, and that's what the focus for our U.S. team, I know, is.

A - Ian Borden {BIO 15826305 <GO>}

Maybe, John, I'll just build a little bit on what Chris talked to, because I think, maybe the way to think about it is what do we think good looks like in getting value and affordability right? And I think we would say it's a couple of things.

It's making sure, as Chris said, we've got those entry-level items at affordable price points for people or for consumers. It's making sure that we've got an entry-level meal bundle that's at an affordable -- compelling affordable price point, and doing that generally with products that consumers know and that we've got strong equity behind. And then I think if breakfast is a big part of our business, like it certainly is in the U.S., making sure we've got compelling value at breakfast as well.

And I think, obviously, from an executional standpoint, we've got to make sure we've got the right products at the right price. And we've got, as you've heard Chris talk about, that consumer awareness at a level of significance so that consumers are aware of the offers and the affordability price points. And that's going to influence their visits as we look forward and they're looking across different options.

So again, I think we're working hard to make sure we're delivering against each of those opportunities. And as Chris talked about, in markets where we've done that well, we're seeing really strong performance. And that's the opportunity we're focused on making sure we have in place in each of our top markets.

A - Mike Cieplak {BIO 20546263 <GO>}

Our next question is from David Palmer with Evercore.

Q - David Palmer {BIO 6061984 <GO>}

Thank you. You noted the customer satisfaction scores had been heading higher. And that definitely doesn't surprise me, given all the improvements to the restaurants and digital and the core food renovations. But I guess what does surprise me is that the gap to the industry, at least in the U.S., has eroded and that outperformance gap.

I wonder whether it's the surveys or certain consumer trends as you slice it thin, even day parts. What are the insights about why that gap has narrowed? Because it has been surprising. Is it just an entry price point opportunity in the value scores that you're seeing with certain income cohorts? And how does the opportunity for the U.S. differ from maybe some of your other international big five markets? Thank you.

A - Chris Kempczinski {BIO 18660246 <GO>}

Sure. I think on our overall satisfaction, again, we look and we're seeing improvement across all of our major markets on satisfaction. And as you noted, there's multiple aspects to that. I think where we see the one opportunity, as you sort of then decompose drivers of satisfaction, certainly in some markets, we have seen that our relative superiority on affordability has declined.

And I think if there's any pressure on overall satisfaction or if there's anything that's closing it, it's probably losing some of that relative superiority on affordability. Again, that's not in all markets, but that's in a few markets.

It's important to still note we still are viewed as a superior value proposition, but the degree of gap in a few markets has narrowed, and so that leads back to all the things that we've been talking about on this call as things that we need to be focused on.

A - Ian Borden {BIO 15826305 <GO>}

David, just maybe to build, because I think experience, as you noted, is encompassing of a number of different factors. I mean, I think we know we're driving better speed of execution consistently across our top markets. We know when we put capabilities in place, as you've heard us talk about previously, like ready on arrival, which is in place in the U.S., that we're delivering hotter, fresher food as customers arrive to our restaurants and delivering an overall better experience.

I think the sharp point, and Chris mentioned this, is we've got that opportunity on affordability, and we're really laser focused on making sure we can meet the need that consumers are expressing in the current context, but we feel really good about all the other aspects of the experience and how we're delivering against what customers are expecting.

A - Mike Cieplak {BIO 20546263 <GO>}

Our next question is from Eric Gonzalez with KeyBanc.

Q - Eric Gonzalez {BIO 19845547 <GO>}

Hi, good morning, and thanks for the question.

A - Chris Kempczinski {BIO 18660246 <GO>}

Good morning.

Q - Eric Gonzalez {BIO 19845547 <GO>}

On the pricing discussion, -- good morning. On the pricing discussion and I appreciate the point that your store level margins are back to 2019 levels, but perhaps you could speak to the current level of year-over-year pricing and your current inflation expectations for food and labor this year? And then just maybe whether you've seen any changes in the flow through of that pricing or any elasticity changes?

A - Chris Kempczinski {BIO 18660246 <GO>}

Sure. Well, my guess is your question is focused on the U.S., because obviously I could give a different answer depending on where you are in the world, but if I focus just on the U.S., most of the pricing that you see now in the U.S. is carryover pricing. It's not new pricing per se. Most of it, again, is carryover pricing.

That said, we do continue to see there's certainly labor inflation. Much of that is coming out of what happened in California. And on a national level, you could probably see we're expecting high single-digit labor inflation. Again, much of that from the bleed-over of what California introduced. And then on food and paper inflation, I think that's come down to much more historical levels, so we're back at more historical levels on what we see from food and paper inflation going forward.

A - Ian Borden {BIO 15826305 <GO>}

Maybe just to build, Eric, to what Chris said. I mean, the food and paper, low single digits, so I think we have seen kind of favorable movement in this year, although we've still got a fair bit of carryover effect from '23 inflation, certainly into the first part of '24 from both food and paper and labor.

I think what's important to note on pricing is I think our business, including our Owner/Operators, understand that the consumer is price weary. And I think we certainly are going to be prudent and thoughtful about any further price increases that we're looking at for the rest of 2024 on that backdrop and keep working on the opportunity that we've talked about a fair bit already on the affordability and getting that in place to kind of address the consumer need.

A - Mike Cieplak {BIO 20546263 <GO>}

Our next question is from Sara Senatore with Bank of America.

Q - Sara Senatore {BIO 22426028 <GO>}

Thank you. I guess I have one clarification and then a question. You mentioned that the QSR industry traffic it's flat to declining because I always think of this as an industry where traffic is kind of at best flat. So I'm just trying to understand, given you usually have better data than I do, whether that's an inflection point or this sort of traffic trends have been more consistent, which is what it sort of sounds like?

And then the question I have is you mentioned, margins are right back to where they are. I think franchisee cash flow is also back to pre COVID, not COVID peaks. But I guess as you think about maybe investing in value, do you contemplate you're doing anything to support franchisees?

I don't know if it's sort of fee abatements like digital fees or we've seen some other restaurants kind of pull back on those when franchisees are making investments, whether they be capital investments or in other operating expenses. So just as -- is supporting franchisees something that you can do if you really need to reinvest in value? Thanks.

A - Ian Borden {BIO 15826305 <GO>}

Good morning, Sara, it's Ian. Let me take the clarification and then I'll let Chris address your question. So what I said earlier was that industry traffic, and I was talking about across many of our top markets is flat or we're seeing declining trends.

If I talked specifically about the U.S. in quarter one, industry comparable traffic was negative and we expect it to be negative for the full year. And I think that's the context that's important just to give the context to the more challenging macro environment.

A - Chris Kempczinski {BIO 18660246 <GO>}

Yeah, and then turning to franchisee and your question about how we support franchisees, you're right that our U.S. franchisees, and I could go through other markets as well, but they're in a strong position. When you look at franchisee cash flow, we are at, I think, our second-highest levels ever, 2021 being the peak, but we're at very strong franchisee cash flows. We're going to see franchisee cash flows increase in Q1.

And if you think about the balance sheet for our franchisees, the modernization that we did on our restaurants in the U.S. many years ago now was all done in a period of super low in interest rates. And so, any debt that's being carried on the books for our franchisees is at significantly lower interest rates than what we're seeing in the market right now. And so, our franchisees are in a strong position.

As you know, they control pricing. We don't step in and subsidize pricing. But I think the opportunity here is what I mentioned earlier. We have a lot of great value out there in the market. We're just doing it in a very fragmented way. And so, the opportunity for us is, how do you maybe pull back a little bit on all the local value that we're offering, which, frankly, we don't have very high awareness on? And how do you coalesce and drive awareness around a national value proposition?

So I think there's a smart way to do this that can end up being, net neutral to a franchisee P&L. But just using the size and scale of our marketing engine and the amount of media that we spend, I think that's going to be the opportunity for us going forward. And certainly, we're in a good position from a system financial health standpoint to go do that.

A - Mike Cieplak {BIO 20546263 <GO>}

Our next question is from Lauren Silberman with Deutsche Bank.

Q - Lauren Silberman {BIO 19805519 <GO>}

Thank you. I had a follow-up on the value question. You mentioned you're offering value 50 different ways. Can you just talk about what a future national value platform could look like, given how different the cost environment looks like across the U.S.? I imagine price point value could be difficult? And then when you look at what type of value consumers are most looking for, is it price point, lower entry points, bundle deals? Are you seeing an uptick in the value mix? Thanks.

A - Chris Kempczinski {BIO 18660246 <GO>}

Yeah, I'll maybe start and then I'll hand off to Ian. But I think Ian outlined in general a construct that we see as sort of being our successful playbook, which is you need to have good entry-level price points. You need to have a meal deal. And then there needs to be something that, if you have a big breakfast business, you need to be offering value that's specific to breakfast.

And in a number of markets around the world, we're doing that very successfully. Certainly in the U.S., we see that there's different cost environments. But then again, our competitors have those same differences between high-cost markets, low-cost markets, et cetera. And that exists in other markets as well. If you were to go to France, it's much different if you were to go to Paris than what it would be somewhere outside of Paris.

So those differences exist in many markets around the world. I think what our system has historically shown an ability to do is working with our franchisees, how do you think about it from a portfolio standpoint, and ultimately in this business, if you're driving transactions, if you're driving guest accounts, that ends up being a good thing for everybody.

So we have a history of being able to do this. We've done this, as I mentioned in our opening, we've been doing this for 70 some odd years. So I think we understand what it takes, but it happens through a conversation with our franchisees to get aligned around what that national value proposition looks like.

A - Mike Cieplak {BIO 20546263 <GO>}

Our next question is from Brian Bittner with Oppenheimer.

Q - Brian Bittner {BIO 17258322 <GO>}

Thanks. Good morning. As it relates to the operating margin guidance, mid to high 40s range is still a very wide range, Ian, and I fully understand there's a lot of moving pieces in the financial model, but I'm curious with a quarter in the books, if there's an opportunity to perhaps tighten the expectations around that range, as we look towards last year's 47%, is that kind of a good base case target for operating margins this year, or should we anticipate declines similar to like what we saw in the first quarter?

A - Ian Borden {BIO 15826305 <GO>}

Yeah. Good morning, Brian. Thanks for the question. Look, I mean, you hit on it. It's obviously in the context we're working through in '24, there are a lot of variables at play, and I think the macro context means it's difficult for us to kind of predict the forward look in terms of what's the duration of the macro headwinds we're seeing and the depth. So I think that obviously is impacting performance, and as always, our op margin leverage is going to be dependent on, our strength and level of sales growth.

Look, I think I remain really confident in our ability to drive leverage in op margin over time as we're able to kind of continue to drive strong top line growth, and I think, we're confident as we work to kind of address the affordability opportunities we've got, that's going to be helpful in getting sales growth back to the direction we want, and over time, that'll certainly be helpful in continuing to drive leverage in op margin.

A - Mike Cieplak {BIO 20546263 <GO>}

Our next question is from Andrew Charles with Cowen.

Q - Andrew M. Charles {BIO 16591426 <GO>}

Great. Thank you. Chris, looking to learn more about how this national value platform will be different from years past. So I think historically back in 2018, for instance, the Dollar 1-2-3 was launched it looked like it was a negative traffic year for the U.S. business.

Just in, that a regional approach to value had been more successful to brand, despite what you said about competitors that are pursuing more national value. So I'm curious what you think is going to make this time different that will lead national value to be more successful, you think about the constructs of what that will look like going forward?

A - Chris Kempczinski {BIO 18660246 <GO>}

Sure. Well, to state the obvious, it's up to the U.S. team in partnership with our Owner/Operators to define what is a national value proposition look like in the U.S.? As you know, with D123, it took a minute for that program to gain traction, but it then drove very strong results.

I think, certainly if you look at the U.S. performance over the last, many years under D123, I think we're now in year six or seven of D123, that was a very successful platform for us in driving performance across the U.S. business.

The point about, how quickly does it actually impact transactions and turn that around, it goes back to how quickly you can drive awareness with the consumer on that. And the faster that you can drive awareness, the faster you start to see that driving incrementality on the business. So I think, first it's getting the platform defined, making sure that it's compelling with customers, and then making sure that you support it properly to drive the awareness that you need to ultimately impact transactions on the business.

A - Mike Cieplak {BIO 20546263 <GO>}

Our next question is from Greg Francfort with Guggenheim.

Q - Gregory Francfort {BIO 22252878 <GO>}

Hey, thanks for the question. My question is just on the international business, and I'm curious what you're seeing, I don't know if it's maybe from a protest standpoint or just if the business has continued to weaken there into the second quarter in the same way that it's done in the U.S. business, and what you might be doing from a support perspective through the IDL royalty rate or anything like that? Thanks.

A - Chris Kempczinski {BIO 18660246 <GO>}

Sure. I think, if you look at the impact of some of the boycotts in a few of our markets, I wouldn't say things are getting any worse there, and I think in some cases you might be able to look and say perhaps it's getting slightly better in some places. So no big change on that.

I think it's also just worth -- it's interesting to note that in many of those markets our delivery business is holding up quite well, which is kind of an interesting dynamic there. So maybe marginally better in some markets, but as I referenced on an earlier call, we're not expecting to see any meaningful improvement in the impacts on that until the war is over, and we continue to have that outlook on what the Middle East conflict is going to do to our trends. Ian, I'll pass it over to you.

A - Ian Borden {BIO 15826305 <GO>}

Yeah, maybe just one kind of build on the headwinds, I mean, I think what I said up front was that the macro headwinds that we were seeing were more significant across a number of our large international markets, and that's continued into the start of quarter two.

I think on support for kind of the IDL, look, I mean, you've heard me talk about this before. I mean, I think when there are external factors that are kind of beyond the control of our franchisees that are impacting the business, and those franchisees are doing everything right and continue to do everything right for the McDonald's business, providing support in situations that warrant it is kind of part of what I'll call our fundamental business model.

I mean, if and when we make decisions to provide support, it's always targeted and temporary. It's always designed to go to our franchisees who are most in need. I think we've talked previously that we have provided some support for some markets that have been impacted in the region. Obviously, we're continuing to look at the facts and circumstances and continue to work incredibly closely with our DL partners.

I would just say that the level of support that's been provided so far has not gotten to what I'll call a significant level, but obviously, we're continuing to stay close and work very closely with our DL partners in the region.

A - Mike Cieplak {BIO 20546263 <GO>}

Our next question is from Brian Mullan with Piper Sandler.

Q - Brian Mullan {BIO 18018644 <GO>}

Thank you. Just a question on CosMc's. I wonder if you could just talk about what some of the early learnings are in your tests in both Illinois and Texas? And then related to that, can you just talk about how you might plan to approach it from here in terms of how you evaluate the stores, what that decision process looks like if you ever wanted to ultimately build more of them next year or beyond? Any color would be great.

A - Chris Kempczinski {BIO 18660246 <GO>}

Sure. Well, I'm going to disappoint you, Brian, in telling that there's not a lot to report. I think what we're still seeing is there's a lot of interest in CosMc's that's sort of curiosity-driven, and as a result of that, it's tough to get a sense of sort of what are the true kind of underlying performance expectations.

As we've referenced in our Investor Day, what we're looking at for the ultimate success on this business is, we've got to have a business that's driving comparable or stronger ROIC to a traditional McDonald's. There would be no reason to be putting any capital against CosMc's unless it was neutral to accretive to building a traditional McDonald's.

That's going to then be a function of what we see around both the absolute unit volumes in that concept, the margins associated with that, and our ability to build these smaller footprint restaurants at a lower cost than what we're expecting.

So all of those things are things that we're going to be assessing in our test market, as I've referenced previously, we have 10 -- we plan on opening 10 restaurants and it'll be a function of unit volumes, it'll be a function of margins, and it'll be a function of what the capital that we need to spend to get these things built. All of that will drive our overall assessment of what the ROIC potential is.

A - Mike Cieplak {BIO 20546263 <GO>}

We have time for one more question from Jeff Bernstein with Barclays.

Q - Jeffrey A. Bernstein {BIO 7208345 <GO>}

Great. Thank you very much. Just following up on the U.S. comps, I know you guys have mentioned the lower income households and the weakness seen there and maybe some trading into food at home. Just wondering if you can maybe compare that to past slowdowns. I feel like the message has always been the benefit of the quick service segment, maybe you lose some on the low end, but importantly, you inherit some who trade down from above, like you said, if everyone's looking for value.

And when that is the context, I think you mentioned that the system franchisees, that the buy-in is there for the incremental value push. I just want to make sure I heard that right, whether there's any sentiment from the biennial in terms of franchisee sentiment, especially with the most recent fundamental easing. Thanks very much.

A - Chris Kempczinski {BIO 18660246 <GO>}

Sure. Well, so I think, it's tough to go back and compare the day-to-day versus our last time that there was an economic slowdown. I think the dynamic that you described is what we do typically see in the business. I think, as you also know, Jeff, that our business over-indexes with lower-income consumer. So there's that consideration.

But I would just go back to we recognize that we're in an environment where the consumer is being price-discriminating. And again, that's not just something that's low-income. I think all consumers are looking for good value for good affordability. And so we're focused on that action.

In terms of franchisee buy-in, that's a process that we work through in every single market to get alignment with our franchisees on what a national value program would look like or if it's about launching a new menu item, what that timing of that would look like. So that's work that the U.S. team is doing in a system that has 2,000 franchisees in the U.S.

I think, there are going to be different people in different places on that. And that getting to alignment ultimately comes through conversation. And, like I said, we've been doing this for 70 years. We know how to get it done. But it just comes through a lot of conversations with U.S. franchisees as it would in any other market.

A - Ian Borden {BIO 15826305 <GO>}

Jeff, maybe just two quick hooks to what Chris said. I think, across markets, I think what our leadership teams are spending time on talking to the business, talking to our franchisees about is what I'll call making sure we've got a street fighting mentality in the current context. I mean, clearly, the macro is more difficult.

Clearly, everybody's fighting for fewer consumers or consumers that are certainly visiting less frequently, and we've got to make sure we've got that street fighting mentality to win irregardless of the context around us. And as I think we've talked a lot today about, our position, our system is positioned with the strength and capability. There's no reason why we shouldn't have the most compelling value and affordability positioning from the focus of a consumer.

Ultimately, we're going to measure our progress through are we taking share. And I think we are, Chris and I, and certainly the leadership teams are laser focused on that. And that's the opportunity ahead, and we're very focused on that.

A - Mike Cieplak {BIO 20546263 <GO>}

And that concludes our call today. Thank you, Chris. Thanks, Ian. Thank you, everyone, for joining. Have a great day.

Operator

This concludes McDonald's Corporation Investor Conference Call. You may now disconnect.