Q2 2024 Earnings Call

Company Participants

- Chris Kempczinski, Chairman and Chief Executive Officer
- Ian Borden, Executive Vice President and Chief Financial Officer
- Joe Erlinger, President, McDonald's USA
- Mike Cieplak, Senior Vice President, Treasury & Investor Relations

Other Participants

- Brian Bittner, Oppenheimer
- Brian Harbour, Morgan Stanley
- David Palmer, Evercore ISI
- David Tarantino, Baird
- Dennis Geiger, UBS
- Eric Gonzalez, KeyBanc Capital Markets
- Jake Bartlett, Truist Securities
- Jeffrey A. Bernstein, Barclays
- John Ivankoe, JP Morgan
- Jon Tower, Citigroup
- Lauren Silberman, Deutsche Bank
- Sara Senatore, Bank of America

Presentation

Operator

Hello and welcome to McDonald's Second 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 Chairman and Chief Executive Officer, Chris Kempczinski; Chief Financial Officer, Ian Borden; and President of McDonald's USA, Joe Erlinger. As a reminder, the forward-looking statements in our earnings release and 8-K filing also apply to our comments on the call today. Both of those documents are available on our website as are reconciliations of any non-GAAP financial measures mentioned on today's call, along with their corresponding GAAP measures. Following prepared remarks this morning, we will take your questions. Please limit yourself to one question and then reenter the queue for any additional questions. Today's conference call is being webcast and is also being recorded for replay via our website.

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

Chris Kempczinski {BIO 18660246 <GO>}

Thanks, Mike and good morning, everyone. Beginning last year, we warned of a more discriminating consumer, particularly among lower-income households and as this year progressed, those pressures have deepened and broadened. The QSR sector has meaningfully slowed in the majority of our markets and industry traffic has declined in major markets like the U.S., Australia, Canada and Germany. In several markets, we also continue to be negatively impacted by the war in the Middle East. These external pressures certainly weighed on our performance for the quarter, with declines in comparable sales globally and across each of our segments. But there were also factors within our control that contributed to our underperformance, most notably our value execution.

For 70 years, McDonald's has defined value in our industry and we are taking meaningful actions across the world to assert our leadership. The hallmark of a great company is its ability to perform in good times and in bad and we are resolved to reignite share growth in all our major markets, regardless of the prevailing market conditions. This won't happen overnight, but it will happen. The unique competitive advantages of McDonald's afford us many levers to pull and we have the financial wherewithal to sustain our investments as needed. One area of strength is our restaurant teams, who continue to execute with excellence to serve our customers and local communities. Creating a better customer experience has delivered operational improvements, improved service times and increased customer satisfaction across most of our major markets. And it's this relentless focus on execution that will give customers more reasons to visit our restaurants more frequently.

Leading into the power of our core menu also leads to outstanding execution in our kitchens. Our deployment of Best Burger is a great example of this. Now deployed in over 80% of markets, the training and focus on the basics ensures we deliver the gold standard product our customers expect, which is driving elevated taste and quality perceptions. We remain on track to have Best Burger deployed in nearly all markets by the end of 2026. And as we announced late last year, we continue to innovate across our core menu to address unmet customer needs with a more satiating burger that will provide great value for money. This new burger, which we're piloting across three international markets this year includes two beef patties perfectly layered with melting cheese, crispy toppings and a tangy McDonald's sauce. It's a quintessential McDonald's burger with a twist on our iconic familiar flavors. Named the Big Arch, we plan to attest and learn through the end of the year to gather learnings before scaling more broadly internationally.

We continue to have a significant opportunity for growth in chicken, a category that's twice the size of beef globally and growing at a faster rate. By featuring our beloved icons like McNuggets and McChicken, while driving growth in emerging favorites like McCrispy and McSpicy, our chicken sales are now on par with beef sales. The McCrispy chicken sandwich is now offered in more than 55 of our markets around the globe and through our plans to further expand our McCrispy equity, we will continue to capture chicken market share. As we continue to build on our $17 billion brands across our core menu, our digital penetration also continues to grow. Loyalty membership has now reached 166 million members, pacing ahead of expectations as we work towards our ambition of 250 million members and identified users now represent 25% of system-wide sales. We know that engaged loyalty customers spend more and visit more often and as a result, we're driving digital market share gains and continuing to build on our understanding of customer preference, personalization and behaviors.

But as I said in my opening, we recognize that in several large markets, including the U.S., we have an opportunity to improve our value execution. Consumers still recognize us as the value leader versus our key competitors, but it's clear that our value leadership gap has recently shrunk. We are working to fix that with pace. The last several years, our system has sustained significant inflationary cost increases ranging from 20% to 40%, depending on the market. As we absorb these cost increases in partnership with our franchisees, we look for ways to protect restaurant profitability via productivity efforts and selective price increases. These price increases disrupted long-running value programs and led consumers to reconsider their buying habits.

In some markets like Germany, Spain and Poland, the flexibility of their value programs, like McSmart, have allowed them to quickly make adjustments that were embraced by consumers and drove market share gains. In other markets like the U.S. with their $1, $2, $3 value program, a more comprehensive rethink has been required. Our U.S. President, Joe Erlinger, is on the call and will share more about our plans in just a minute. The point is, we know how to do this. We wrote the playbook on value and we are working with our franchisees to make the necessary adjustments. McDonald's competitive strengths are formidable and growing. Our brand is as strong as ever. Yet again, Kantar recognized McDonald's as the world's fifth most valuable brand and the number one most valuable non-tech brand.

We're executing with excellence and our restaurant operations are an area of strength. Our digital footprint within the industry is unmatched and growing as we build one of the world's largest loyalty programs. And we're flexing our investment muscle to accelerate new restaurant openings as we also build consumer, restaurant and company technology platforms that will drive cost efficiencies and accelerate innovation. We do not take these advantages for granted, however and we are committed to delivering for our customers and shareholders every day. Where our customers tell us we have value opportunities, we will address them. Listening to customers and staying agile led to the development of our Accelerating the Arches strategy and I'm confident that it remains the right playbook for our business. Continued focus on gold standard execution and our growth pillars are the right actions to grow market share and return to restaurant traffic growth.

To share more on the U.S. segment, I'll now hand it over to Joe.

Joe Erlinger {BIO 19255680 <GO>}

Thanks, Chris and good morning. It's been a few years since I've participated in a McDonald's earnings call and I want to start by reflecting a bit about the progress McDonald's USA has achieved since that call back in 2021. Over the past three years, we've significantly moved the needle in several areas like loyalty, which has grown to over 20% of our U.S. system-wide sales and over 37 million 90-day active users. We've also improved our chicken market share with the launch of McCrispy. As I said then, it was the accumulation of our decisions grounded in our values that continued to keep the McDonald's brand relevant for our customers and meaningful for our people, providing a strong foundation for future growth. That continues to be our approach as we're now focused on raising the bar on our customer experience considering our customers' current reality.

Since the very beginning and Chris touched on this earlier, we've earned our success through excellent QSC&V, quality, service, cleanliness and value. And as we've evolved our approach time and again over the years to match the changing expectations of our customers, we continue to deliver an exceptional customer experience today. In this last quarter, McDonald's USA delivered its highest ever year-to-date customer satisfaction score. While I'll share more about the $5 meal deal in a moment, both the Bacon Cajun Ranch McCrispy and Grandma McFlurry promotions drove sales, along with cultural buzz and brand relevance. All said, our business performance reflects industry-wide challenges and the current context, one where customers are making thoughtful choices about when and where they eat.

And while we always work hard to provide value to our customers, they're telling us that they want to see and experience even more value from McDonald's. And we're listening, as we remain laser-focused on providing great value to our fans this summer and beyond. So we tapped into ideas that already exist within our system. Our restaurants in upstate New York had been running a local $5 meal deal that was highly successful, performing well with lower-income customers and driving overall incremental sales. By leveraging learnings from within our own system, we brought this to life for customers across the U.S. We've seen a lot of enthusiasm and the number of $5 meal deals sold are above expectations. Trial rates of the deal are highest amongst lower-income consumers and sentiment towards the brand around value and affordability has begun to shift positively.

To date, 93% of our restaurants in the U.S. have committed to extending the offer even further into the summer and there are other ways customers can experience great value at McDonald's. We continue to provide a steady stream of offers on the mobile app, including nationwide Free Fry Fridays, where you can get a free medium fry every Friday with any $1 purchase on the app. And as we work through the important details of a future U.S. value platform, we will continue to make decisions grounded in insights with the customer at the center. At the end of the day, we expect customers will continue to feel the pinch of the economy and a higher cost of living for at least the next several quarters in this very competitive landscape. So we believe it's critical for us to consider these factors in order to grow market share and return to sustainable guest count-led growth for the brand.

McDonald's is uniquely positioned to succeed in this environment, given our size, scale and competitive advantages. We have a fully modernized restaurant estate. We have a simplified menu that focuses on our core, while never shying away from bringing back fan favorites at the right times or pursuing the right new product innovations. We have built one of the largest loyalty programs in the industry and we're continuing to lead with a long-term mindset, making decisions that meet our customers where they are and where they need us right now, while also plotting a path for sustained success.

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

Ian Borden {BIO 15826305 <GO>}

Thanks, Joe and good morning, everyone. As Chris mentioned at the top of the call, despite the very real near-term challenges facing the sector, we remain confident that our long-term strategy, rooted in customer insights and built on our inherent competitive advantages is right for our business. When we combine deep insights with the power of our brand, we tap into what our customers love most about McDonald's, connecting with them on an emotional level through celebrating the rituals and memories that make our brand so special. At the heart of our brand are our local communities and the customers we serve each and every day. Strong restaurant-level execution against our MCD growth drivers, coupled with compelling value will be critical to giving customers more reasons to visit McDonald's more often.

And as you heard from Chris and Joe, we're delivering higher customer satisfaction and improved service times across most of our major markets. Our MC and Ds are deeply interconnected and it's at the intersection of our growth drivers that we continue to deepen our relationships with customers and create a consistent and enjoyable restaurant experience, while offering the delicious and affordable food they love. As Chris mentioned, we still have an opportunity to strengthen our holistic value proposition across markets and we recently met with each of our largest markets. We're ensuring that we have a winning value offering was front and center in every discussion. We're taking a forensic approach to evaluating our offerings and acting with urgency and agility to implement solutions to deliver against customer expectations.

Germany has continued their holistic approach to value with a 360-degree affordability strategy, including McSmart at the center and are consistently driving elevated levels of customer awareness. This is a best-in-class example of listening to the customer, designing a program that meets them where they are and ultimately delivering incremental sales, customer satisfaction and market share gains. As we scale best practices across the system, markets like France and Australia have adopted their own version of the McSmart platform and early results have been encouraging. And in May, the U.K. offered smaller, more affordable bundles of their own with their 3 for GBP3 mix-and-match menu that resonated with customers looking for more affordable options. And to address an opportunity to offer more compelling value at breakfast, which remains the fastest-growing day part in the market, the Canadian market recently launched a new price-pointed beverage value, offering our customers the coffee they love every day, starting at just $1.

McDonald's has long been an affordable destination for communities to come together and share a meal, but it's always been about more than just price. This quarter, we continue to elevate the experience, combining our delicious food with unique mobile app and in-restaurant experiences, ultimately delivering value, however and whenever customers decided to order and enjoy their McDonald's favorites. Germany leaned into the Easter holiday with a fun and interactive calendar promotion where customers enjoyed a daily deal available exclusively in the mobile app. From discounts on our most iconic menu items like the Big Mac or Chicken McNuggets to unique meal deals, the promotion drove remarkable engagement and significant growth in loyalty sales.

And Italy drove traffic to our restaurants with summer days, a similar seasonal calendar campaign featuring a variety of exciting meal bundles. And a local favorite, The Frequent Fryer program, returned to the Canadian market this quarter. To engage loyalty members with a new approach to gamification, the market launched a nationwide scavenger hunt for fry icons, which could then be entered on the mobile app for free loyalty points or free fries. Nearly 3.5 million codes were entered throughout the promotion, driving meaningful lifts to the fry category. Even with strong execution against our Accelerating the Arches growth drivers, performance this quarter reflects a pressured industry landscape in the U.S. as well as across many of our largest international markets. Our international operated market comps were negative, reflective of this broad-based pressure where customers continue to be more intentional with the dollars they spend and performance in France.

And in our IDL segment, positive comp sales in Latin America and Japan were offset by the impact from the ongoing war in the Middle East and a less confident consumer in China. Despite the pressured top-line growth we've discussed this morning, we drove adjusted earnings per share of $2.97 for the quarter, a decrease compared to the prior year of about 5% in constant currencies. This was primarily due to a higher effective tax rate of nearly 21% for the quarter, elevated interest expense as expected and less other non-operating income due partially to lower interest income. Top-line results generated over $3.5 billion of restaurant margins for the quarter and a year-to-date adjusted operating margin of over 46%, highlighting the durability of our business model. This was offset by higher G&A due to continued investments in digital and technology as well as enterprise transformation efforts and costs associated with our biennial worldwide convention.

As we've talked about before, driving long-term growth requires making the right strategic and forward-looking investments and we are committed to continuing to invest in our platforms and growth drivers, while relentlessly prioritizing current year run the business spend. While we expect industry challenges to persist, we believe we are well positioned with the unique size and scale that only the McDonald's system can provide. There remains significant power in focusing on what's within our control, offering our customers delicious food at unparalleled value and convenience that will drive future market share gains and guest count growth. With this as our

North Star, we believe we're poised to deliver long-term growth for our system and our shareholders.

Now, as most of you know, this is Mike's last earnings call with McDonald's, so before I close I'd like to take a moment to personally thank Mike for his significant contributions to our brand. He served as a trusted advisor to our senior leadership team by playing a key role in developing and communicating our strategy. Mike has been at McDonald's almost as long as I have and his deep knowledge of our business and ability to foster relationships with stakeholders has been invaluable to me, especially as I've taken on the role as CFO. On behalf of everyone at McDonald's Mike, thank you. We wish you all the best for the future, and with that I'll turn it back over to Chris.

Chris Kempczinski {BIO 18660246 <GO>}

Thanks, Ian. Earlier this month we brought leaders together to discuss our goals and objectives as we further establish McDonald's as a leading global consumer brand. As a team we are committed to act with urgency, cementing our value leadership, growing share in areas like chicken and bolstering loyalty through digital customer acquisition, adoption and retention on a global scale. And we are continuing to lean into our three pillars MC and D as our blueprint and engine for growth, while leveraging technology to transform how we operate across all platforms. Even as the world around us continues to change we know the power of the McDonald's brand will prevail. We're digital forward, values driven and culture led and we'll continue to reinvent ourselves to meet our customers and restaurant teams where they are today and where they're going tomorrow.

With more than 40,000 locations across the globe, we uphold a presence that we believe few in our industry could ever hope to match. We offer the best franchising opportunity in the world, offering a familiar beacon of support for the over 40,000 communities where we live, work and serve. And we're just getting started. We're making progress towards our ambition of 50,000 restaurants by the end of 2027. And when we combine our strategy with great value and high-level execution, we are confident we will further our leadership position. As I close, I want to extend a sincere thank you to our franchisees, suppliers and employees around the world for their continued resilience and unwavering commitment to serving our customers and local communities.

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

Questions And Answers

Operator

(Question And Answer)

Thank you. (Operator Instructions)

A - Mike Cieplak {BIO 20546263 <GO>}

Our first question is from John Ivankoe with JPMorgan.

Q - John Ivankoe {BIO 1556651 <GO>}

Hi, thank you very much. Certainly McDonald's has access to consumer data, consumer information that almost no corporation in the world does. And when I consider six months ago, 12 months ago, it was fairly well known the restaurant industry would see a fairly wide pricing gap versus grocery and many consumers would have drawn down their excess savings from COVID that we would be in an environment where value, quite frankly, would be more necessary. So I just wanted to get a sense of really what changed so significantly from the consumer's perspective relative to your expectations in the last six to 12 months? And if I can, how McDonald's kind of pivots itself from being reactionary from a value perspective, from a consumer trend perspective to more anticipating changing needs before they happen as opposed to after? Thank you so much.

A - Chris Kempczinski {BIO 18660246 <GO>}

Hi, John, thanks for the question. You're right in that last year, you may remember we were talking about there being pressure on the consumer and particularly that low-income consumer. That was notable in a few of our major markets. And what has happened in the intervening period of time is that we've seen more markets have the same sort of slowdown. And it is certainly most pronounced with that low-income consumer, but we're also seeing an impact with larger groups, particularly around families in Europe that we're seeing this as people are just looking to economize. You're also right that we're looking at a continued gap between food at home and food away from home inflation. The gap is about 3% right now or 300 basis point gap between the two. So you are seeing consumers being much more discretionary as they treat restaurants. You're seeing that the consumer is eating at home more often. You're seeing more deal seeking from the consumer.

And you're just seeing, I think, a trade down even within either units per transaction or within mix. All of those things for us are indicators that the consumer across a number of these markets is being very discriminating and I would point out consumer sentiment in most of our major markets remains low. And so your point around how do we make sure that we're anticipating where these customers are going and what the value is required, I think, is a fair question. And what we've done is, in a number of places, you've seen us and heard us talk about what we're doing with McSmart, what we're doing with McSaver, some of the things that we've put in place in the U.S. But I think it's also clear to us that in several markets, in a number of markets, that you need to have a broader value platform and that trying to move the consumer with narrow offerings that are one item or a few items is just not sufficient for the context that we're in. And so what's going on in markets around the world is looking at how do we further broaden what some of the value platform offerings could be as we also perhaps look for other places that we can dial down.

And that conversation, as you know, with our franchisees takes a moment. It's not something that happens immediately, but I would say that there's good recognition across our franchisee base that we need to be providing value, we need to be providing a broader level of value, and at the same time, we've got a lot of other levers. So this is not all about value. We've got levers around what we can do from a menu standpoint. We've got some great equities that we need to be driving there and there's more we need to be doing from a marketing standpoint and stepping up on marketing. So I'd say the changes that we're working on and talking about with our markets, yes, it's around value. It's making sure that as we're facing certainly a more difficult environment than even what we anticipated last year that we've got that value offering, but we're also using the other things that are at our disposal to get this business back to where we know it should be performing.

A - Mike Cieplak {BIO 20546263 <GO>}

Our next question is from David Palmer with Evercore.

Q - David Palmer {BIO 6061984 <GO>}

Thanks. Congratulations, Mike. Thank you for your help all through the years. As far as my question, I guess I'd like to focus on the IOM countries. How do the challenges in your key markets differ from the U.S. in terms of market share versus the informal eating out sales trends? In the U.S., it feels like McDonald's is still in a state of searching and perhaps negotiating to find the right value message ahead of menu news that might happen later. Are you at a similar stage of searching and perhaps negotiating with franchises about value overseas? Where are you in terms of how satisfied you are, where you are in terms of the value message? Thanks so much.

A - Chris Kempczinski {BIO 18660246 <GO>}

Yes, thanks, David. I'll have Ian start and then if there's anything I need to add, I'll do that, but Ian, I'll let you start.

A - Ian Borden {BIO 15826305 <GO>}

Sure. Good morning, David. Thanks for the question. Look, I mean, I'll just start I think with a bit of context, which is as you heard Chris in his opening remarks talk about, I mean, I think the pressures on the industry and consumers that we're seeing are broad based in nature and I think if you look across our IOM markets, which you will know historically, I think we've had a have been a real strength to our system, I think that external pressure has heightened and I think certainly gotten more significant in several of those markets through the second quarter and so I think it's still what I'll call an evolving situation. We've talked a lot about value and affordability over the last couple of quarters. As you know, we've kind of highlighted McSmart, which is an entry-level meal, affordable meal option that we put in place in Germany at the beginning of 2023 and Germany has been consistently one of our most strongly performing markets, even in a much more difficult context over the last couple of quarters in the marketplace.

So I think it's, part of it is just the evolution of what's happening with the consumer, what's happening with the industry. I think we have strong alignment, engagement with our franchisees across our international markets. I think we're working very collaboratively and constructively to get the right programs and platforms in place from a value and affordability standpoint. I think part of it's just been the landscape and the consumer is evolving and those platforms and offers have needed to be sharpened, and I think better positioned to be delivering in the current context. And so I think we're moving with speed and pace, as you've heard us talk about before, but the environment I think has been changing and context has been evolving, and I think we're just trying to get ahead of that, as we've talked about in kind of our opening remarks.

A - Chris Kempczinski {BIO 18660246 <GO>}

Yes, what I would just add is, if you look at our IOM markets, the good news is, if you think about Germany with McSmart, you've got Canada with McPicks, you've got the U.K. with Savers menu, Australia has McSmart and also Loose Change Menu, France has McSmart. We have the value platform established in those markets and there's good consumer awareness of those value platforms. The work that's underway and Ian alluded to this, is making sure that underneath those value platforms, that we have the right items at the right price points to reflect where the market's at today. And so there are markets like the U.K., for example, where they're making changes to the menu in France as well. They're adding a EUR4 Happy Meal.

So there's changes that are happening underneath those value menus to make sure that we are appropriately positioned for what we see now as the market context. But the fact that we have those menu platforms established, that there's good awareness on those, I feel like that is a positive versus in the U.S. where obviously they're starting to do a little bit more work about what the long-term value platform is going to look like.

A - Mike Cieplak {BIO 20546263 <GO>}

Our next question is from Brian Harbour with Morgan Stanley.

Q - Brian Harbour {BIO 19285890 <GO>}

Yes, thank you. Good morning. I had a question on digital, right, because obviously it's continued to grow, you've continued to add members and there's actually a lot of really good value available on that platform, but it hasn't really offset some of the sales challenges that you're seeing right now. So I guess, what gives you kind of the confidence that, that could change, or what do you think needs to be done differently there? Do you think it's kind of resonating and is that, a place to continue to drive value going forward?

A - Chris Kempczinski {BIO 18660246 <GO>}

Yes, it's a great question. We feel really good about our digital business and we're seeing strong performance on the digital business, as I alluded to in the opening. I think the challenge on digital right now is basically only about 25% of our customers are on digital in terms of identified customers. And so as you think about what you need to do to drive the overall business, we just don't have digital yet at the size and with the penetration that's needed to move the entire business. And I think some of what has happened as you sort of look at things is we probably were a little over-rotated on digital versus broad everyday value that we're offering available to all consumers, those who maybe aren't yet on our digital platform.

So that's the work that's underway. I think in time, certainly as you know, digital is going to continue to grow for us. We're going to get more and more customers on our digital platform. And I think in a couple of years' time, particularly as you get to 250 million users, that's a different conversation about how digital can drive value. But today, we just don't have the penetration where we need it to be to move to 75% of the business that's not on digital, and so that's the value work that we just have been talking about.

A - Mike Cieplak {BIO 20546263 <GO>}

Our next question is from David Tarantino with Baird.

Q - David Tarantino {BIO 15144105 <GO>}

Hi, good morning. A couple of questions on the U.S. value initiatives. First, I was hoping you could elaborate on the effectiveness of the $5 meal deal that you're running and whether you're seeing the sales or traffic inflection you had anticipated from that program. And then secondly, I think, Chris, you mentioned it's necessary to have more of a platform idea in all of your key markets. And I'm just wondering, in the U.S., how those conversations are going with franchisees and whether franchisees are supportive of a broader national value platform and when that might happen? Thanks.

A - Joe Erlinger {BIO 19255680 <GO>}

Thanks David. I appreciate the questions. Relative to the $5 meal deal, it's really performed and done exactly what we wanted it to do. First, we wanted to see a change and improved brand perceptions around value and affordability and it's done that. We wanted to make sure that it connected with the single user, especially the lower income consumer and we've seen that through increasing trial rates by that consumer base. Our two lowest income cohorts, the under $45,000 cohort and the $45,000 to $75,000 cohort saw an increasing trial and participation around the $5 meal deal throughout the life of the promotion, which was incredibly encouraging. And then lastly, obviously, we wanted to see a shift in guest counts to drive both the short and long-term health of the business, and ultimately, I believe in guest count-led growth. And while it's begun to do that, it hasn't yet translated into sales.

The average check though has been over $10 for the $5 meal deal, so we do feel comfortable about the add-on that's happening as part of that program. Relative to the longer-term platform, obviously, this is a big investment for us and our franchisees. When you think about the Dollar Menu, which existed for over 10 years and when you think about Dollar Menu 1, 2, 3 that's been in place now for over six years, we just need to be very thoughtful and considerate as we work through what our national everyday value and affordability platform will be. That work is happening in good partnership with our franchisees and so we're comfortable that we'll get to the right answer. There's no question that the franchisees see the impact and the importance of a value -- national everyday value and affordability platform and so we're working through that at pace with them.

In the meantime, obviously, we're continuing to offer consumers great value with the $5 meal deal extending in 93% of our restaurants into August and we're working with our franchisees to extend that even longer. We continue to offer great value via the app, which Chris just talked about a bit and we also continue to have a lot of local deals at what we call our business unit level. So we'll continue to squarely offer our consumers value throughout the summer and into the fall.

A - Mike Cieplak {BIO 20546263 <GO>}

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

Q - Sara Senatore {BIO 22426028 <GO>}

Great. Thank you. I wanted to ask about the sort of margin implications, and in particular, maybe talk about whether you'll need additional franchisee support for either U.S. or IOM. Specifically, I know we seem to be seeing actually some deflation in some beef trimming and other cuts, which is very different from what we have been seeing. So to the extent that you are offering more value, you'll have a permanent value platform. Is some of that funded by lower input costs such that maybe there's less margin pressure? Or is that something that you'll have to address with franchisees? I know in IOM markets, you had given some franchisee support. I'm not sure where that stands now. But is there any contemplation of, again, investing either behind franchisee or perhaps contributing to marketing funds? Anything from McDonald's corporate to help, I guess, lessen the burden? Thanks.

A - Ian Borden {BIO 15826305 <GO>}

Good Morning, Sara. It's Ian. I'll start and then I think maybe Chris or Joe might jump in at the end. Look, I mean, I think as you said, from a margin pressure standpoint, I mean, obviously, the top-line performance has been more muted, so that obviously creates a level of pressure. But I think if you use kind of our Mc-OpCo margins as a bit of a proxy, you would have seen that they've -- they held up pretty well through the quarter simply because, as you noted, we're certainly seeing much lower levels of inflation in areas like food and paper, which are down at the kind of low-single digit level. I mean, obviously, labor inflation, particularly in the U.S. is a little higher still, especially with some of the minimum wage changes in places like California.

I think in terms of just kind of maybe kind of trying to answer the broader part of your question, I mean, value and affordability is kind of a fundamental part of our business model. And I think our owner-operators understand that and obviously understand that, that's something strategically that we always need to have in place. As you would have heard us talk previously about, I mean, we don't subsidize pricing. So we want to get to the right outcomes and do that in a way that it's going to be sustainable and profitable for both our operators and for McDonald's. And I think over time, we know that strong affordability and value is what drives volume-led growth, as you heard Joe touch on and volume obviously is ultimately what drives sustainable profit and cash flow for the business and for the system.

I think as we get some of these ideas in place, obviously, we want to bring them to life in creative and effective ways and we're going to put all of the resources of our system, again, making sure that we execute this and put ourselves in a position to win in a difficult environment. But I may just kind of let Joe or Chris weigh in.

A - Chris Kempczinski {BIO 18660246 <GO>}

Yes, I would just add, I mean, our franchisees in the U.S. are in a very strong financial position. And so they have the financial firepower both in terms of cash flows as well as equity to make investments, and they can make those investments across their P&L. If you actually look at gross margin in the 20 years pre-COVID, we're actually at a high right now versus those 20 years. So we feel very good about the ability of our franchisees to invest via their P&L or otherwise and we are working through with them right now, look at the overall profitability of the $5 meal deal, but we think they've got the ability to invest and so we're comfortable with the position in the U.S.

A - Joe Erlinger {BIO 19255680 <GO>}

Yes, my only add is I just would underline the word that Ian used, which is sustainable. We're only interested in doing things that are sustainable strategies that we can continue. And so that's going to be our guide as we think about where we need to go on these things and there is a lot of I think strength within our system, financial strength within our system to implement the necessary changes, but they have to be sustainable for us.

A - Mike Cieplak {BIO 20546263 <GO>}

Our next question is from Dennis Geiger with UBS.

Q - Dennis Geiger {BIO 19694619 <GO>}

Thank you and thanks, Mike, for all your help. Best of luck. I wanted to focus again on the meal deal. Appreciate all the insights there. Specifically as it relates to customer awareness in the U.S. of the meal deal and sort of thinking about the marketing message or the marketing intensity, is that something you could help frame up for us, where it is right now? Is it something that ramps and kind of related? Just thinking about the timeline generally from a new marketing -- a new value platform or a new, bigger value offer to guest count contribution. Is there a way historically in environments like this to kind of think about how that timeline looks? Thank you.

A - Ian Borden {BIO 15826305 <GO>}

Yes, I think what we're learning from this is the power of our national voice at McDonald's. As we exited 2023, we looked at the value that we had at a local level and felt very comfortable that, that value was compelling, but what we lacked was obviously a strong national voice and it took us some time to work with our franchisees to achieve that national voice. And as we talked about, the $5 meal deal is something that already existed in upstate New York and when you look at when we applied that national voice, what happened in upstate New York, which had already had the deal, trial and participation rates actually doubled in upstate New York. And so you also see then the power of the actual message, the importance of a message actually being price-pointed.

As you know, we have a BOGO, a buy one, get one promotion that we've run in January and we saw trial and participation rates for the $5 meal deal 70% greater than that January buy one, get one window. So that is the power of national marketing, the awareness that, that brings. I won't get into specific numbers around awareness, but certainly when we launch our new national everyday value and affordability platform, building awareness of that platform will be absolutely critical just like we've done, obviously, in the past with Dollar Menu 1, 2, 3 and the Dollar Menu.

A - Chris Kempczinski {BIO 18660246 <GO>}

My only add on the pace question is that ultimately is on us. There's nothing externally that drives the pace. It's all an internal thing. And so we've seen in some markets like France, for example, where there's strong alignment, we can move very quickly. In other places, it requires more conversations because of the breadth of the changes. But at the end of the day, we've shown the capacity to move quickly. And my hope would be certainly that in a market like the U.S., I think Joe and the team are having great discussions with franchisees about the importance of getting to that value platform that we've talked about.

A - Mike Cieplak {BIO 20546263 <GO>}

Our next question is from Jeff Bernstein with Barclays.

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

Great. Thank you very much. Just looking outside the U.S., perhaps, I was hoping to touch on France and China. France, I'm just wondering if you think it's more of a McDonald's specific issue, which I think is what maybe you referred to in the past, versus a macro issue and how you view the competition there. And then in China, I know you mentioned that consumer is less confident. I'm just wondering if you're seeing anything to give you pause on an otherwise aggressive unit growth outlook or maybe a change in strategy, whether you're seeing any U.S. brand pushback or anything along those lines would be helpful. Thank you.

A - Chris Kempczinski {BIO 18660246 <GO>}

Sure. Thanks for the question, Jeff. Well, starting with France, certainly what we've seen in France has been a slowdown. But I think you're also accurate in reflecting that the fact is we're losing share in France. And that suggests to me that there is still an opportunity for us to improve our performance. A couple of things for us. One that we've talked about in the past has been it is a very competitive market right now. We're seeing a competitor there who is being aggressive on pricing. Certainly that's one element. I've talked about some of the things we're doing to enhance our McSmart menu to make sure that we're competitive on pricing. Second, because France has such a meaningful business with families, families is a key consumer for us over there. That's where they're coming back with a EUR4 Happy Meal, so that's addressing the family issue.

And then we are also looking at what can we be doing to make sure that we're engaging with customers around where our brand is positioned. France is one of the markets that has a higher Muslim population. And so when you think about the Middle East, the impact that we're seeing in France has been more than maybe in other markets because of that population. So there's a lot that the team is looking at doing on how do we make sure we're telling our story from a marketing standpoint at the local level. But I think it's fair to say that we have an opportunity to get back to share growth in France. The market the market has slowed down, but the market is still delivering modest, very small growth and we want to participate more in that. In the case of China, China is a very competitive environment right now and as you've seen from a number of other consumer companies, it is highly promotional. Consumer sentiment in China is quite weak and you're seeing both in our industry and across a broad range of consumer industries, the consumer being very, very much deal-seeking.

In fact, we're seeing a lot of switching behavior in terms of just consumers, whatever's the best deal, that's where they end up going. Positively, in that environment, one, we're holding share, so our business in China is holding share and the second thing that I would say is that we are still seeing good returns on our new unit openings. So there's, from our vantage point, a lot of runway around growth on new units and we are laser-focused on the returns that we get from new units. If those were to ever dip below what we would consider to be an acceptable return threshold, we would certainly re-look at our opening pace in China, but right now what we're seeing is that the returns on new openings are holding up and so from our vantage point, the 1,000 restaurants per year pace that we've been on, we're still working toward that number in 2024.

A - Joe Erlinger {BIO 19255680 <GO>}

Jeff, I might just hook on to Chris, because I just want to, I know you were asking about France, but I think it is important just to kind of reinforce a little bit of what we touched on earlier, which is, I mean, I think the external trends and pressures that we're seeing on the industry, on the consumer, I think are broad based across IOM. I think consumers are being, as you've heard us say earlier, more discerning about where, when and what they eat and I would say we don't expect significant changes in that environment for the next few quarters. So obviously, as you've heard us talk a lot about, we're kind of laser-focused on this forensic review of kind of our value and affordability positioning in each of our key markets. We're going to position ourselves to win and we're moving, I think, with a sense of urgency, but obviously at the pace to get that right and as you've heard us talk a lot about, we've got the system strength and know-how to put us in that winning position.

I would just say, I think the third quarter has certainly started similarly to how the second quarter ended and we're seeing I think negative comp trends across IOM, and frankly, across each of our three operating segments.

A - Mike Cieplak {BIO 20546263 <GO>}

Our next question is from Eric Gonzalez with KeyBanc.

Q - Eric Gonzalez {BIO 19845547 <GO>}

Hey, good morning and thanks for the question. I'm just curious about trade-down. In the past, McDonald's was thought of as a defensive option because in economic downturns, it would pull share from more expensive categories. So I'm just curious why you think you might not be getting the trade down that you depended on in the past and whether that's a function of value perception or something that can be addressed in the value construct? Thanks.

A - Ian Borden {BIO 15826305 <GO>}

Yes, thanks, Eric. Well, I think we are seeing trade down, but what we're seeing is that the loss of the low income consumer is greater than the trade down benefit. And so you're seeing with that low income consumer, in many cases, they're dropping out of the market, eating at home and finding other ways to economize, cutting down on trips. So we are seeing the benefit of trade down, but it's just not enough to offset the pressure that we're seeing on that low income consumer.

A - Mike Cieplak {BIO 20546263 <GO>}

Our next question is from Lauren Silberman with Deutsche Bank.

Q - Lauren Silberman {BIO 23544690 <GO>}

Hey, thank you, guys. I wanted to follow up on how you're thinking about comps in the back half of the year. So quarter to-date still running negative. Should we -- are you expecting that to, I guess, continue through the third quarter? When can we start to talk about positive comps in the back half of the year? Is it fourth quarter as a base case right now? Any commentary there would be helpful. Thank you.

A - Ian Borden {BIO 15826305 <GO>}

Hi, Lauren, it's Ian. So just maybe just to reiterate a few things. I mean, I think, as I said, the pressures are broad based. We're seeing those pressures, I think, on the industry and on the consumer across almost every one of our large owned markets globally. And as I said, I don't think we -- I don't -- we certainly don't profess to have a, I think, a crystal ball on how the future will look like. But we don't expect that we're going to see a change in that environment over the next few quarters. I mean, I think that's why we're laser focused on getting value and affordability right. As you heard Chris just say, I think it's not even so much about consumers moving from us to others. It's about consumers in that low income category. And I think families, which are obviously two big cohorts of our consumer base across most of our markets, just eating out less frequently than they have been previously.

I think we're confident that if we get our value and affordability propositions right, if we get them into that winning position in each marketplace, that will encourage consumers to come back when they can. I think if you take examples of what some of our markets have done, I'll use the U.K. as a bit of an example that ran a campaign in, at the end of May, beginning of June, a 3 for GBP3 mix-and-match campaign. They also have done a GBP1.99 Happy Meal offer in the app. When we run compelling, affordable options like that, we know we're able to draw consumers back and we know we are best positioned to be able to do that. So that's certainly what we're focused on. As I said, certainly don't claim that we can predict I think when the environment will turn or when the consumer will turn. I think what we're focused on is making sure that we're winning in the current context in each and every one of our markets and that we're positioned to accelerate our momentum as this challenging environment begins to turn in each and one of our markets as we look forward.

A - Chris Kempczinski {BIO 18660246 <GO>}

Yes, the only thing I'd add is, McDonald's at its essence, this is a growth business and so we're not accepting negative comps as just sort of the way it is because of the consumer headwinds. We absolutely are committed to getting this business back to growth. Foundation of that is the value platforms that we've talked about, but we need to do more on menu innovation. We've got more levers that we can do on digital and certainly getting our marketing to be more of a contributor as it was last year. I think all of those things need to work in combination to get the business back to where we know its rightful place is.

A - Mike Cieplak {BIO 20546263 <GO>}

Our next question is from Brian Bittner with Oppenheimer.

Q - Brian Bittner {BIO 17258322 <GO>}

Thanks. Good morning. Chris, you said in your prepared remarks that your value leadership gap versus the competition has shrunk. And I'm just curious, how are you measuring this gap? What informs you that it has shrunk? And just secondly, what gives you the confidence you can reignite this gap with value at a time when everyone seems to be getting much more aggressive on value? Is it the success you're seeing with the $5 deal or what else is fueling the confidence that this gap can reignite?

A - Chris Kempczinski {BIO 18660246 <GO>}

Sure. Thanks for the question. So there's two ways that we measure value. They're both consumer based surveys, but one is we get to just the overall brand impression and we survey consumers around the world for their brand impression of how McDonald's does on both value and affordability. Affordability being a more specific thing around typically price points, value being a broader metric that speaks to a number of different things. So it's all survey based. Like I said, there's part of it which is looking at brand image and then we also have a second survey that we do around most recent experience, and that gives us a little bit more of a current snapshot of where we are seeing the consumer. And it's been particularly on the most recent visit that we're seeing our leadership gap is shrinking. Our brand image scores around value and affordability, we still are very strong there and we're seeing those gaps hold up. But on the more recent visit that we are seeing some of the pressure, some of the decrease still leading, but that margin may be shrinking a couple of points in a market, for example.

In terms of what gives us confidence about our ability to continue to lead on value, it starts with the fact that for 70 years we've led on value. And for 70 years we've led on value because it's what the brand stands for, and frankly, we can buy food and paper at a better price than anybody else. So we have an underlying competitive advantage that we can buy at a lower price than anybody else in our industry. The other thing is, the way that the consumer defines value, yes, there's a price point component to it. But the other thing that we see in all of our value work is that there are intangibles that consumers think about around how they define good value or not. Things like, for example, how convenient is the restaurant? Things like, for example, how clean the restaurant is? Things like how tasty is the food? Those typically are representing maybe 25% to 30% of consumers' value perceptions. So it's not just about hitting low price points. It's also the overall experience you can deliver.

And as you've heard us talk about in the past, our restaurant estate is in great shape. Our restaurants are running strong execution. Service times are improving around the world. CSAT scores are high. So I think we've got a lot of things from the intangibles that are working in our favor. And as you've heard us talk about on this call, there's other things that we're doing to make sure from a value standpoint and particularly around value platforms and products and price points that we're where the consumer expects us to be.

A - Joe Erlinger {BIO 19255680 <GO>}

Brian, I might just do two little hooks on Chris's, just on that second bit about why we can win. I mean, I just wouldn't underestimate the power of the equity we have in some of our menu items that when we get those items priced at the right price point in the current context for consumers, I think that's unique to us. The scale and level of marketing dollars we have available as a system that we can direct to support these platforms as we get them in place is unmatched. And then, I'll just double-click on one.

Chris touched on the experience. I mean, we've talked the last couple of quarters. I think Joe would talk to the fact that our customer satisfaction scores in the U.S. are at kind of an all-time high for this point in the year. We're seeing that pretty consistently around the world. We're getting faster. We're delivering a better experience. I mean when you put all that together, that's what kind of defines value for the consumer. And we certainly are adamant and relentless that we're going to get that right in each and every market to be in a winning position.

A - Mike Cieplak {BIO 20546263 <GO>}

Our next question is from Jake Bartlett with Truist.

Q - Jake Bartlett {BIO 19145060 <GO>}

Great. Thanks for taking the question. Mine was just really a clarification on your commentary about recent trends and that's the U.S. And I think overall, you said that the third quarter is starting as the second quarter ended. I just want to make sure that, that's true for the U.S. And I guess if that's true and it would I think implies below what was reported for the second quarter. If that's true in the commentary that the $5 meal is doing what you hoped, how does that mesh? It seems like the $5 meal you're happy with, but it doesn't seem to have really driven an improvement. Just want to make sure I understand the commentary there on recent trends and what's driving it.

A - Chris Kempczinski {BIO 18660246 <GO>}

That's right, Jake. So we obviously exited the second quarter as we lapped the Grimace Birthday Meal & Shake with negative comps. And then we have experienced negative comps here in July. The success obviously we've seen is the shift in traffic that we're experiencing. And in my 22 years of experience at McDonald's, traffic and guest counts usually comes before sales. And so we've got some exciting promotions upcoming here in the second half of the year. And we think that if we can get the traffic moving, we'll see customers obviously willing to spend more. Remember that the customer that's coming in for the $5 meal deal, they are buying more than just the $5 meal deal because we see that average check up around a little over $10. So that's why we feel strongly about how the $5 meal deal is connecting in the marketplace and specifically with that low income consumer, which has been our opportunity.

A - Mike Cieplak {BIO 20546263 <GO>}

We have time for one more question with Jon Tower at Citi.

Q - Jon Tower {BIO 22741653 <GO>}

Great. Thanks for taking the question. Maybe just similar line of thinking in terms of your expectations for store margins for the balance of the year. Obviously, you've got some good guides with respect to inflation coming off, but I think pricing is also rolling off a little bit. And now it seems like promotional activity is going to be ramping. So how should we anticipate the impact on store margins, both in the U.S. business and the IOM segment for the balance of '24 and perhaps into early '25?

A - Ian Borden {BIO 15826305 <GO>}

Hi, Jon, it's Ian. Let me try and get that one. Well, look, I think as you would have seen through the first half, even with more muted top-line growth, restaurant margins have held up pretty well. Obviously, as you noted, we will take or certainly expect to take less pricing through the year, just obviously managing through the current context we're in, we still got a fair bit of carryover pricing from 2023. So that certainly helps a little bit. And as I talked about earlier, certainly inflation on food and paper and other cost items outside of wages has come down substantially from where it's been over the last couple of years. So that's helpful.

The U.S., obviously, as I talked about, we've got the wage pressures, particularly from California. So that's certainly a headwind that we're working through. And I think overall, if you think about the year, I think we certainly expect, if I use company-operated margins as a proxy, for those to be down a little bit from where we ended in 2023. But I think pretty good in terms of where you -- when you consider the overall context of what we're working through this year.

A - Mike Cieplak {BIO 20546263 <GO>}

Okay. That concludes our call. Thank you, Chris. Thank you, Ian. Thank you, Joe. Thanks, everyone for joining. Have a great day.

Operator

This concludes McDonald's Corporation Investor Call. You may now disconnect and have a great day.
