Q3 2024 Earnings Call

Company Participants

- Chris Kempczinski, Chairman and Chief Executive Officer
- Ian Borden, Executive Vice President, Global Chief Financial Officer
- Scott Meader, Interim Treasurer

Other Participants

- Brian Harbour, Analyst, Morgan Stanley
- David Palmer, Analyst, Evercore
- David Tarantino, Analyst, Robert W. Baird & Co.
- Dennis Geiger, Analyst, UBS
- Eric Gonzalez, Analyst, KeyBanc Capital Markets
- Jeffrey Bernstein, Analyst, Barclays
- John Ivankoe, Analyst, J.P. Morgan
- Jon Tower, Analyst, Citigroup
- Lauren Silberman, Analyst, Deutsche Bank
- Sara Senatore, Analyst, Bank of America.

Presentation

Operator

Hello, and welcome to McDonald's Third 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. Scott Meader, Interim Treasurer for McDonald's Corporation. Mr. Meader, you may begin.

Scott Meader {BIO 1707438 <GO>}

Good morning, everyone, and thank you for joining us. With me on the call today are Chairman 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 our 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 re-enter 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, Scott, and good morning, everyone. I look forward to sharing our third quarter performance and the progress we have made on key initiatives against a challenging backdrop for the QSR sector. Before I do that, I want to address the recent E. coli cases related to slivered onions in a handful of US states. While the situation appears to be contained and though it didn't affect Q3 numbers, it's certainly an important development, which I know is on many of your minds.

For over 70 years, McDonald's commitment to food safety has been uncompromising. Nothing is more important to us than the safety of our customers, and we've been proud of our industry leadership in this area. The last serious public health issue in the US associated with McDonald's occurred more than 40 years ago. The recent spade of E. coli cases is deeply concerning and hearing the reports of how this has impacted our customers has been wrenching for us.

On behalf of the entire system, we are sorry for what our customers have experienced. We offer our sincere and deepest sympathies and we are committed to making this right. One of our core values is to do the right thing and that has been and will be our guide as we address this situation. After the CDC first informed us of the investigation, we were able to quickly link the cases identified to slivered onions from one facility at our Taylor Farms supplier. We swiftly removed them from our supply chain.

We understand from health authorities that slivered onions from Taylor Farms Colorado Springs facility are the likely source of contamination. McDonald's has stopped sourcing onions from this facility indefinitely. Importantly, the Colorado Department of Agriculture confirmed on Sunday that they did not detect E. coli in the samples of beef patties from our restaurants and have no further plans to test. This supports our investigation that ruled out Quarter Pounders patties as the source.

Based on this information, we are confident we can return Quarter Pounders to menus. On Sunday, we announced that our beef suppliers are producing a new supply of fresh beef patties in the impacted areas and we expect all restaurants in the US to resume the sale of Quarter Pounders in the coming week. We are proud of our franchisees' unwavering commitment to food safety and for executing our stringent food safety procedures. Doing the right thing also means communicating openly and transparently.

Our US President, Joe Erlinger, has been regularly sharing updates with the system of the actions we are taking and Joe will continue to do so as the investigation begins to wind down. As I said at the outset, serving customers safely is our top priority. We'll never compromise on that. I want to thank the health authorities for their strong partnership. I'm relieved that this situation appears to be contained and I remain confident in the safety of eating at McDonald's.

Let's turn now to the update on our performance in Q3. On our last call, we shared the QSR sector had meaningfully slowed in many of our markets with industry traffic declined in several major markets and that consumers, especially those in the low-income category were choosing to eat at home more often. This trend continued in the third quarter. QSR traffic has remained pressure reflecting industry-wide challenges. And while we anticipated a challenging environment in 2024, our performance so far this year has fallen short of our expectations. While the QSR industry has slowed, we recognize that there are still many factors within our control to impact performance guided by our Accelerating the Arches strategy.

We're encouraged by signs of progress in the third quarter and the more consistent market share traction we are seeing, especially in the US, which included strong compelling value platforms, which is fundamental to the McDonald's brand promise, menu innovation, which excited our customers with great-tasting food and strong marketing prowess that drove engagement on higher-margin core items. We have spoken before about our customers recognizing us as the value leader versus our key competitors. But our value leadership gap has shrunk. In response, we have moved with urgency in partnership with our franchisees to improve our value offerings in most of our major markets.

Some examples that have launched in the quarter are the UR4 Happy Meals in France, 3 for GBP3 in UK, and in Canada, we're providing value to our customers through price-pointed coffee starting at just CAD1. And to provide our customers with simple everyday affordability they can count on, we are employing strategies that are designed to work together to generate sustainable guest talent-led growth and increase market share. As we have said before, we view good value as including both entry-level items and meal bundles at affordable price points. This means offering Everyday Affordable Price menus or EDAP in our markets. At McDonald's, we define EDAP as a platform with an assortment of items all priced at compelling entry-level price points, generally including breakfast, beef and chicken sandwich options. We will pair EDAP platforms with strong meal bundles to provide our customers with entry-level meals at affordable price points. Blending EDAP and meal bundles under a branded value platform allows us to invest in and build recognition and affinity with our customers. So when they're thinking about an affordable option for food, we're top-of-mind, which is why we've been able to capitalize on branded equities like Loose Change in Australia and the Saver platform in the UK for over 10 years. Value and affordability will remain at the forefront of our conversations with markets around the world as we continue to monitor the environment and listen to our customers.

We spoke last quarter about our belief that delivering value and affordability in markets will have a positive halo effect on the business. And that's a great segue into the work we've driven across the MCD growth pillars this quarter, where we see compounding effects between our value offerings driving traffic and our full margin promotions growing average check. Recently, we launched the Collector's Edition campaign, which brought back some of our most loved keepsakes with a twist, giving fans a memory that they can hold in their hands. Running in over 30 markets, the campaign featured core equities across all dayparts and drove high-check, full-margin traffic into our restaurants. Collector's Edition captured our fans' attention while keeping operations simple and giving customers more reason to purchase core menu items. The campaign drove customers to our restaurants, especially in the US where the promotion ran alongside the $5 meal deal. Collector's Edition maximized the power and scale of our global brand while ensuring local flexibility and cultural relevance to connect fans in unexpected ways.

Similarly, the UK and Ireland [ph] market leaned into a One McDonald's way for creative excellence by tapping into a winning formula starting in our US market. The UK's near sell-out of the Grimace Shake promotion in 48 hours is proof that when we share and scale world-class ideas across markets, we can maximize impact and have our creative work harder for us. Australia also followed suit by bringing Grimace Down Under at the beginning of October with both the world-famous Grimace Shake and the Grimace Meal. And that same formula, listening to our customers, investing in innovation, and pairing that with fresh marketing ideas is working across our core menu offerings as well.

First, we have spoken at length regarding the potential of chicken, which is a massive category worldwide that's twice the size of beef and growing much faster. There is significant room for us to grow our share and we're working to meet the moment and take advantage of its growth. We have continued to see strong progress this quarter with the majority of our largest markets growing share. The US took an exciting step to evolve their menu offerings at the beginning of the month with a limited-time, full-margin offering that has proven successful across several markets in prior years, the Chicken Big Mac. And our plan to scale the McCrispy equity across nearly all our markets by the end of 2025 is on track with the McCrispy Chicken sandwich that is expected to be available in over 70 markets by the end of 2024.

Chicken isn't the only focus in our menu innovation efforts. The pilot of our larger burger offering, Big Arch now in three international markets, Portugal, Germany, and Canada shows that we're listening to consumer taste and delivering. We're encouraged by the results showing the Big Arch has universal appeal with sizable opportunity across markets. And thanks to the success of the pilot, we're accelerating plans and will work with franchisees and partners to deploy the Big Arch faster into more international markets in 2025.

Finally, as we consider our 4Ds, after a successful pilot of ready-on-arrival or ROA in the US, we are working with the rest of our top six markets to deploy this technology by the end of 2025. We know from the US that ROA helps not only with smoother restaurant execution as crew can better sequence in the kitchen, but also drives higher customer satisfaction scores by reducing wait times. And by building one of the largest loyalty programs in the world in just a few years, system-wide sales to loyalty members in the quarter totaled nearly $8 billion globally with our aim to reach 250 million active users by the end of 2027, well within our reach. We continue to demonstrate how markets are getting smarter and closer to the customer by employing a multichannel strategy. We know as we drive loyalty adoption, we increase the frequency of visit and the spend from these customers over time. Despite the external challenges we are facing, the bright spots we see in execution and performance are clear indications that Accelerating the Arches is the right strategy to grow our business over the long term. We know we have more work to do to sustain guest count-led growth and continued market share gains, but I am very confident in our growth strategy and our ability to deliver outstanding execution for our customers.

Now, I'll turn it over to Ian.

Ian Borden {BIO 15826305 <GO>}

Thanks, Chris, and good morning, everyone. We acknowledge that our performance so far this year has fallen short of expectations with negative global comp sales for the quarter amid a challenging industry environment. However, US comp sales were positive for the third quarter, which was driven by taking action on what we can control, providing compelling value, generating menu excitement, and using the full power of our marketing. As a result, the US outperformed the QSR industry comp sales and comp guest counts for the quarter. In fact, this quarter's comp guest count gap to most near-end competitors was the highest since the first quarter of 2023. This was achieved through a combination of more compelling value through the $5 meal deal, alongside great marketing such as the Collector's Edition campaign, which delivered a significant increase in average check for its two-week run before selling out.

Consistent with what Joe said last quarter, we wanted to see three things from the $5 meal deal. First, improve brand perceptions around value and affordability. Second, making sure it connected with the single user, especially the lower-income consumer. And third, a shift in guest counts to drive both the short and long-term health of our business. The $5 meal deal has done just that and continued drawing customers back into our restaurants throughout the quarter, maintaining an average check north of $10 and being profitable for our franchisees. We saw increased traction, particularly with low-income consumers successfully growing traffic share with this group for the first time in over a year. That is why, together with our US franchisees, we've committed to extending the $5 meal deal into December as we work towards sustainable guest count-led growth.

Looking forward, our US leadership team is solidifying the details behind the future US value platform, working together with our franchisees to get it right for our customers by blending the best thinking from around the world as well as our own history in the US. We have plans to introduce the more holistic US value platform in quarter one next year. While value has been at the forefront of conversations, we have remained laser-focused on running great restaurants. We ignited our restaurant crew's competitive spirit in the US by running competitions aimed to increase guest counts, improve the speed of service, and refine our digital execution and it worked.

The US customer satisfaction scores reached an all-time high and service times at the drive-thru have dropped by double digits compared to last year. This focus on operational excellence was also true internationally, where across all big five IOM markets, we increased customer satisfaction scores compared to last year. And while we will continue to focus on ensuring we have the right price points for our customers, we will not forget about all of the intangibles that create great value, knowing that providing a great experience, particularly now is fundamental.

Turning to our international business, our internationally operated market comp sales were negative for the quarter, reflective of the contracting QSR industry where customers continue to be more intentional with the dollars they spend, mostly driven by France and the UK. While we continue to have opportunity on value and affordability in France, we have started to see signs of improvement in market trends since the launch of the McSmart menu. We also know that we have an opportunity with families and the UR4 Happy Meal, which commenced in late August is providing an uplift to that category. We are working at pace with our franchisees in IOM markets to offer everyday affordable price menus coupled with entry-level meal bundles as we are not consistently delivering both in all markets today. We will continue to take a forensic approach to evaluating our offerings, acting with agility to ensure we are delivering against the expectations of our customers.

We are beginning to see progress. For example, in the UK and Germany, we have grown traffic share in environments that have further deteriorated since Q2. The UK drove excitement amongst customers by providing compelling value propositions across all occasions with the return of the 3 for GBP3 menu by providing a GBP2.79 breakfast bundle and by capitalizing on consumer excitement through the launch of the Grimace Shake discussed earlier. And being further inspired by the success seen in the US, the UK recently launched a GBP5 meal bundle to further strengthen value positioning.

And in Germany, we saw another great example of layering on a full-margin item with the Big Arch pilot on top of an already successful McSmart platform providing halo effects to the business. And building upon McSmart's success, Germany enhanced this platform with the launch of an expanded McSmart menu at the end of September. This extended the range of affordable meal bundle options at different price points to meet our customers where they are and we are seeing a strong initial consumer response and positive incrementality.

And in our IDL segment, positive comp sales in Latin America were offset by the impact from the ongoing war in the Middle East, as well as performance in China continuing to be negatively impacted by weaker consumer sentiment and spending. As we have stated before, as long as the war in the Middle East continues, we expect our business to continue to be impacted.

Turning to the P&L, adjusted earnings per share was $3.23 for the quarter, an increase compared to the prior year of about 1% in constant currencies. Despite the pressured consumer spending environment, we've discussed this morning, top-line results generated over $3.8 billion in-restaurant margin for the quarter. And our year-to-date adjusted operating margin of nearly 47% highlights the durability of our business model.

Results for the quarter reflected lower G&A spend, primarily due to lower incentive-based costs and continued prioritization around current year run the business spend.

We continue to invest in our strategic transformation efforts, focused on forward-looking investments that will drive long-term growth and efficiency. As expected, results also reflected higher interest expense. And we now expect the company's interest expense to increase by approximately 11% for the full year. And our adjusted effective tax rate for the quarter was about 21%.

With respect to the remainder of the year, we are reaffirming the other aspects of our financial outlook for 2024 under the assumption that the public health situation that Chris spoke to upfront will not have a material impact to our business.

And finally, in September, our Board of Directors approved a 6% dividend increase to the equivalent of $7.08 per share annually. This marked the 48th consecutive dividend increase, reinforcing our continued confidence in the Accelerating the Arches growth strategy and our ability to continue to drive long-term profitable growth for all stakeholders.

We remain consistent in our commitment to our capital allocation priorities. First, to invest in opportunities to grow the business and drive strong returns; and second, returning remaining free cash flow to shareholders over time through our dividend and share repurchases.

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

Chris Kempczinski {BIO 18660246 <GO>}

Thank you, Ian. One of the things we're known for is our ability to innovate and grow our business at an unmatched scale, while still using our influence to help have a positive impact on the communities in which we operate. Giving Back has been a celebrated part of McDonald's culture since the beginning.

In the wake of Hurricanes Milton and Helene, it has been incredibly challenging across the Southeast US. As a system, we will be contributing more than $2 million in direct and in-kind aid, which includes crew relief efforts and serving roughly 50,000 free hot meals to our most impacted communities across North Carolina, Georgia, and Florida. Thank you to our franchisees, suppliers, and everyone across the entire system for doing all they can to help those impacted in those areas.

Furthermore, I'm extremely proud of the work the McDonald's system does on a daily basis to prioritize driving change toward a more sustainable and inclusive future. Recently, we shared that in 2023, we reduced barriers to employment for 2.2 million young people in communities around the world through training programs and job opportunities, two years ahead of schedule. And we raised $53 million in 2023 through our roundup for The Ronald McDonald House Charities program. In fact, this year we are celebrating the Charity's 50th anniversary, whether it's charitable contributions across all three legs of the stool and from customers volunteering at more than 250 local chapters or product promotions benefiting the charity. The impact of RMHC and McDonald's partnership over the past five decades is profound and we are proud to be its founding and forever partner.

When our system works together to put our customers and communities first, there are a few things we can't achieve. McDonald's is not a stranger to adversity, but we have always risen to the challenge and come out stronger as a business. While there is still work to be done when we execute with precision, whether through a sharp focus on delivering great value or by staying culturally relevant with global campaigns like Collector's Edition, we do succeed even in tough environments. This is why I am confident that Accelerating the Arches is fit for purpose and we have the right plan in place to make our restaurants and company stronger than ever.

And with that, we can transition to Q&A.

Questions And Answers

Operator

Thank you. (Operator Instructions)

A - Scott Meader {BIO 1707438 <GO>}

Our first question is from David Palmer with Evercore.

Q - David Palmer {BIO 6061984 <GO>}

Thanks and good morning. It should probably be said that you had done a great job in those four months leading up to this food safety issue and really stabilizing traffic with the 4 for $5[ph], a lot of this might have seemed unlikely back in May or June. And then it seemed like you're really reinflation the check with the Chicken Big Mac. So obviously, a shame on many levels that this has gone down like this. But I guess the question now is, how can you adjust? How can you help the consumer move on from a marketing stance and maybe a plan going forward? I know you're not going to on a public call to share your monthly plans here. But what are some of the things that you can do or have done in situations like this to help improve the trajectory in sales and help the consumer move on after these food-safety headlines? Thanks.

A - Chris Kempczinski {BIO 18660246 <GO>}

Hi, David, it's Chris. Thanks for the question. And let me just say again that we are certainly very sorry if someone got sick at our restaurant for eating an onion that we used on our QPC. And I am relieved that I think we are now past this and on the road to getting back to serving our customers as we are used to doing.

I think you raised an important point, which is how do we make sure that we are reinforcing the trust that we've earned over the years with our customers on food safety. And I'd say it starts with how we've handled this issue. And I think as you've seen, we have tried to be very transparent on this issue. We worked very collaboratively with the health authorities and we took very swift and decisive action. So I think the first thing is just how we've handled the issue.

Now that we're moving and we view it as being behind us, you're bringing up the second point, which is how do we get the momentum back in the business that we clearly saw leading up to this very unfortunate event. And I think there's a variety of things there, I think certainly, we're seeing success with the $5 Meal Deal. We're going to have food innovation as well in Q4. We're going to continue to be driving digital. And I think we stand ready to do more if we need to make sure that we are bringing the full resources of McDonald's to bear to reengage that customer.

So you saw, out of COVID, we made some moves and we did some things to make sure that we could reengage the customer. And if we have to make some of those same moves in the US, we're prepared to do that. So I think it's going to be a combination of getting back to what was working prior to this very unfortunate event and then supplementing it as needed with additional activity to make sure that we get that customer back into the restaurants.

A - Scott Meader {BIO 1707438 <GO>}

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

Q - John Ivankoe {BIO 1556651 <GO>}

Hi. The question is on value, and I want to position it in a way that, in certain cases, McDonald's has talked about kind of one global solution to certain platforms. I mean, I think about the McCrispy, which is a global product. But value was something that was expressed within countries and even within a country in a lot of cases actually dependent on the app to communicate value on a personalized level to customers. Now, tell me if I'm wrong, but I do sense a shift that value will kind of be communicated more on a global basis with items under a certain price point and combos, what have you? And that does seem to be a fairly significant shift back to what we were talking about in the past one to two -- two years ago. So I guess just relative to your expectations, what really did change from a value perspective that we're kind of thinking about more global solutions at this point and can we get to a point when the app is really the driver of the value in the future or is that something that is just going to take a little bit more time to come? Thank you.

A - Chris Kempczinski {BIO 18660246 <GO>}

Hi, John, it's Chris. Thanks for the question. It gives me an opportunity to just clarify. I can tell you absolutely categorically positively, value is done at the market level. We do not come up with global value solutions that then get top-down out to the market. It's something that's very core to this business, which is value, as you pointed out is inherently a local decision because of the local competitive set, things going on in that country. So this has been and will continue to be something that is driven at the market level. I think maybe what you're seeing is we are getting better at sharing frameworks and strategies that are working. And when we find something that's working in one market, certainly it would be -- we'd be remiss if we didn't share that learning and opportunity with other markets to pick up on. And so that's where you've seen things like McSmart, that's been picked up by a number of different markets, but with the execution varying underneath that. So I think the way I would look at it is we have a global framework on how we think about value and there's a number of different ways to deliver value. We talked about you need to have a strong EDAP platform, which means entry-level price points that can bring the consumer into the restaurant. You also need to have meal deal programs that would be like the $5 meal deal that you saw in the -- that you're seeing currently in the US. And then you can overlay on top of that in-app offers, promotions, other things like that. So that would sort of be the general framework of how we think about value and what we have learned through all of our experience on what works, but how that gets applied is very much left at the market level.

A - Ian Borden {BIO 15826305 <GO>}

And maybe just to build John to Chris' points, which I think just because you talked about digital. I mean, digital certainly continues to grow in importance, but it's still a minority of our customers. And obviously, over the mid- to long-term, digital will become a much bigger part and then we'll obviously bring value to life at an individual level with a lot of data and insights, which allow us to really effectively target value that's most relevant for that individual consumer. But I think it's still going to be quite a while where front counter value, so to speak, is going to continue to be important. And obviously, right now, that's the area of greatest opportunity and why we're focused on getting that right, as Chris talked to.

A - Scott Meader {BIO 1707438 <GO>}

Our next question is from Dennis Geiger with UBS.

Q - Dennis Geiger {BIO 19694619 <GO>}

Great. Thanks, guys. I just wanted to come back to any additional insights on the public health situation. I know you mentioned that you're not expecting it to have a material impact on the business. Just if anything, either kind of on latest trajectory, anything on expectations going forward, if I interpreted that comment correctly or any other financial implications to call out here? Thank you.

A - Ian Borden {BIO 15826305 <GO>}

Yeah, good morning, Dennis. It's Ian. Let me deal with that one. And I think it's a good question and obviously one that I think is important to answer. So just bear with me for a couple of minutes because I just want to give some upfront context and then I'll get back to specifically what you asked. I mean, I think, our US business has done a really nice job of kind of responding to the heightened expectations from customers around value and affordability with the $5 meal. And then as Chris talked about, really combining that with great marketing execution through things like the Collector's Edition or as we saw in early October, LTO events or menu excitement like the Chicken Big Mac, and that's where we kind of get that one plus one equal to three outcome, which is more customers visiting and more of those customers spending more in those visits drive-in, check-in and obviously profitability.

We talked about in the opening remarks that the US has significantly outperformed the QSR industry with comp, guest count, and traffic gaps at their highest point since the beginning of '23. And then we also talked about that $5 meal doing exactly what we had kind of set out to have it achieve. Two of those things that I think are really important is for the first time in over a year, we gained share with lower-income consumers. And we also saw that customers that were buying that $5 meal were also visiting us more frequently. So if you think about us getting back to guest count-led growth, I think certainly those things were starting to come to life. We ended the third quarter on an upward trajectory in the US business. And then obviously, we started our Chicken Big Mac LTO on the 10th of October.

And I would say if you looked at just the first three weeks of October in the US business, we had comp sales of close to mid-single-digit positive and comp guest counts positive, just a little bit below that. So a really strong start to -- a really strong finish to the end of the third quarter, a really strong start to the fourth quarter. When you consider that we were still operating in a very challenging broader industry context. I mean, I think, of course, as you would expect, there's been an impact in the US business as a result of the food-safety incident and that positive momentum that I just talked about, we saw that shift to kind of having daily negative sales and guest count results since the beginning of the food safety incident.

I mean, I think as Chris talked about, our focus has been on obviously moving swiftly and decisively, working closely with all the relevant health authorities to protect consumers, getting to a clear understanding of the root cause, and obviously trying to bring clarity for everyone as quickly as we could. And certainly, now that's been addressed, as you heard Chris talk about, we're working to kind of get quarter pounders back on our menus and all of the limited number of restaurants that were impacted. I think what I would say is we certainly believe the most significant events are behind us and the work to do right now is focused on restoring consumer confidence, getting our US business back to that strong momentum that I just talked about. I think we're really confident in our ability to do that.

A - Scott Meader {BIO 1707438 <GO>}

Our next question is from David Tarantino with Baird. Go ahead.

Q - David Tarantino {BIO 15144105 <GO>}

Hi, good morning. Just maybe to follow-on the last comments, Ian, and maybe Chris can comment on this. With respect to the advertising message that you're thinking about over the next three to six months, a lot of it's been focused on value and you've had success there and some great initiatives. But I'm wondering if you think some of those dollars are going to need to be allocated towards a message about the brand and restoring sort of the confidence in the brand fundamentals as opposed to being so focused on value and product initiatives, at least in the near term?

A - Chris Kempczinski {BIO 18660246 <GO>}

Yeah, thanks, David. We're going to do what we need to do to get the growth back into the business. And certainly, if there's an aspect of that, which is around reassuring the public, we're prepared to do that. I think I don't view it as an or, I view it as an and. I think we can do both. I think we can make sure that we're communicating the steps that we've taken and if there is lingering unease out there to be able to address that. At the same time, I think we can also continue to be driving value and I think we can be driving marketing news. And so one of the things about McDonald's is we have, I think, ample resources to address whatever the business opportunity is, and we're prepared to do that. I know the US team right now is actually over the next couple of days, engaging with our franchisees, thinking about what our plans need to look like and I'm sure this will be a topic of conversation. But we're going to do what we need to do to make sure we've got to get the momentum back in the business.

A - Scott Meader {BIO 1707438 <GO>}

Our next question is from Brian Harbour with Morgan Stanley.

Q - Brian Harbour {BIO 19285890 <GO>}

Yeah. Thank you. Good morning, guys. Ian, I appreciate the comments just kind of on the US, recently. I guess some of the other pieces in 4Q, and I know you're kind of sticking to the overall annual guidance for the most part. Do you -- should we infer though that there is -- you are seeing kind of some traction in IOM and IDL and you think that there can be some sales momentum there as we go into the fourth quarter? Do you think that SG&A is still kind of similarly favorable as we saw in 3Q? And just any other kind of key moving parts as we think about the last quarter of the year?

A - Ian Borden {BIO 15826305 <GO>}

Yeah. Thanks, Brian. So I think a couple of things. I mean, I think on, in the IOM markets, as you heard us talk about in our upfront remarks, I mean the industry environment remains challenging. There's no doubt about that. I mean, I think consumers are under pressure. The industry is contracting in a number of our largest IOM markets. And in fact, that contraction worsened in the third quarter in several of those markets. Obviously, as a result of that, I think consumers continue to be discerning with where, with whom they're spending money and some of those consumers are certainly choosing to eat out more often.

I think the consumers -- I think while there's broad consumer pressure, I think certainly lower-income consumers and families are consumers that are under more acute kind of pressures, I think on disposable income, obviously, two really important parts of our consumer base. I think for all of those reasons, it's why, obviously we have such a heightened focus on value and affordability and making sure we get that right for the context we're in each and every one of our markets.

I think the US results are a really strong data point that when we get that right, get that value and affordability proposition right, we're going to win in the environment we're in and we're going to obviously win better, I think than anyone else is doing and we know we can continue to drive better momentum even in those more difficult contexts.

I think we're certainly seeing what I'll call some early signs of progress in several of our international markets, where we are seeing that our comp -- guest count for comp traffic gap versus our near-end competitive set is positive. But we want to get that in place in every one of our key international markets. We want that to be as strong as we feel the opportunity exists for it to be and we want to make sure that it's consistent.

And so I think there's more work to do on that front. Obviously, we're continuing to move at pace to get that in place. And I think you'll see a few more things coming in over the next quarter or so around that so that we are in a position to be best placed in '25 irregardless of the context around us. And we're going to obviously continue to measure our performance through are we taking share irregardless of that environment.

I think on G&A, look, obviously, when G&A, the metric is as a percentage of sales and you've got pressure on-sales, there's going to be obviously some implied pressure on that G&A metric. I think we are trying to do everything possible. And as you saw, we expect to be able to continue to deliver against our guidance this year. We're doing that obviously because we've got some relief on kind of the incentive-based part of G&A. But we're also being very disciplined in our current year spending in areas like travel, meetings, professional services, all the things that you would expect us to be doing in the current context while continuing to invest obviously in our enterprise transformation efforts and the strategic growth opportunities that we have in areas like digital and technology, which we know are critical to ensure we have a strong growth pipeline as we look forward.

A - Chris Kempczinski {BIO 18660246 <GO>}

Yeah. I would just add, and maybe reiterate what Ian said. We are seeing a tough industry, UK, France, Germany, Australia, those are all markets where the industry traffic is down. That said, we are either gaining share or seeing sequential improvement in all of our major markets, which is encouraging. But I would also tell you, I'm not satisfied with the pace. And I think there's more that we need to do to step up and accelerate, there's a number of adjustments that are being made in each individual market to augment their value programs. And I think we have an opportunity to overlay on top of that some stronger marketing efforts as well. So seeing progress, but I'm not fully satisfied with the pace on international and that's the focus for us as we close out this year is making sure we get off to a fast start in 2025.

A - Scott Meader {BIO 1707438 <GO>}

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

Q - Sara Senatore {BIO 22426028 <GO>}

Thank you. A clarification and a question, please. The clarification is just you talked about the average check at $10 for those checks that have a $5 meal. I think though that might be lower than what your overall your aggregate -- your average, average is, if you will. So as you think -- as you launch this kind of holistic value platform, should I be thinking about perhaps a negative mix headwind for the -- maybe the year ahead just as there's sort of a reset in ordering pattern? Yeah, I mean with the recognition that your traffic gains are certainly the -- should be and are the priority. So that's a clarification.

And then just a question on McOpco, we -- it looks like margins were a bit lower than we expected, maybe because of value, but maybe because of deleverage. Is there anything in this margin dynamics or sales trends that your franchisees are seeing that would change how they think about adding new units as you look to accelerate unit growth? Thanks.

A - Ian Borden {BIO 15826305 <GO>}

Good morning, Sara. Let me start on that and then I'll let Chris weigh in if he wants to add anything. I think on the $5 meal, as you picked up a check north of $10, that is slightly below our overall average check-in the US, but we consider that to be a really strong check when you look at obviously the $5 price point. I think if you go back to what I talked about a little bit earlier, I mean, obviously, what we're trying to do with stronger value and affordability is drive more traffic and more guest counts. And as we bring more traffic and guest counts into the restaurants, we're pairing that with things like the Collector's Edition or the Chicken Big Mac LTO, that's where we're going to get that check growth and profit growth.

So we're not worried about that maybe that, let's call it that value component because at the end of the day, we've got to have that in place, I think, to be competitive and to drive market share progress and we feel really good that if we -- as we execute on marketing -- great marketing, as we execute on great menu news, that's where we're going to get consumers spending more, which will drive obviously the check and profitability as we saw towards the end of the third quarter and as we saw in the start of the fourth quarter, as I talked about earlier. So that's the dynamic there.

On McOpco margin, you're right, they did come in, obviously, it did come in on a percentage basis, a little lower in the third quarter. I think there were a number of things at play there. Obviously, we still have pretty muted top-line growth, which is going to put pressure on margin from a percentage standpoint because we still have cost impacts that are hitting the business. I think if you just use the US as a specific example, we've got just above kind of mid-single-digit wage pressure, which is obviously coming in large part from the more significant increases in California earlier in the year, plus obviously overall wage increases, so you've got that pressure.

You've still got commodity pressure even though this year we expect '24 increase in commodity needs to be in that low single-digit range. We've got some carryover impacts from higher inflation rates in '23 through the first part of the year, and still some increase there. So you've got cost pressures, more muted sales growth.

And then I think for sure, there's a little bit of an impact from I think the affordability positioning. I mean, obviously, that's an investment -- a short-term investment that we think is really important to make because obviously, we grow margins and we grow profitability by growing volume and we want to be in a position to be able to do that. And clearly, that $5 meal is doing exactly what we want in that area. So we feel really confident about our ability to grow margin percent over the mid- and longer-term as we drive that stronger traffic and volume growth in the business.

A - Chris Kempczinski {BIO 18660246 <GO>}

Maybe I'll just clean up the one other thing that you asked about, Sara, which was around development. And right now, we're seeing good returns on our new units. As we look at the US, we're on pace to hit our development goals in the US. It's certainly something that we pay very close attention to. But right now, from our vantage point, we don't see any impact to our development goals. And as you know, as we've talked about on prior calls, this is something that we spent a fair bit of time looking at it and being pretty detailed in our assessment of the opportunity and we make these decisions over a longer time period. There will be ups and downs with the business, but from our vantage point, the long-term development opportunity that we saw in the US that stays intact.

A - Scott Meader {BIO 1707438 <GO>}

Our next question is from Eric Gonzalez with KeyBanc.

Q - Eric Gonzalez {BIO 19845547 <GO>}

Hey, thanks for the question. Just as a follow-up to that with regards to the $5 meal, on the last earnings call, it seemed like the traffic lift was more than offset by the lower mix as the consumers trade down. But as we move through the quarter, I'm guessing those comp dynamics shifted more favorably as it was paired with the Collector's custom more recently the Chicken Big Mac. So if you can comment on that and discuss how that experience is shaping the discussion with your franchisees around the more permanent value contract, and I think you said inflated for the first quarter?

A - Chris Kempczinski {BIO 18660246 <GO>}

Sure. As we talked about, I think what we've seen is, it's a pretty simple formula at the end of the day on what you need to do to get that good balance of traffic and sales growth in the business. You need to at the foundation, have a strong value proposition, and that's been the focus for us in a number of our markets, either strengthening, adding to, adjusting our value programs so that we have that good foundation. You need to then overlay on top of that food news that can excite the customer and you have to have great marketing behind it. And when you do that with news and great marketing, you can get a strong full-margin check that goes along with some of those value programs. And I think that's exactly what we saw in the US. You had the $5 meal deal, but you also had things that were growing margin in check getting added on top of that. So that's the focus for us in all the various markets is strong value programs, great food news and innovation paired with strong marketing. And if we execute and do that well, which by the way is the essence of our Accelerating the Arches strategy when we do that well, the business responds.

A - Ian Borden {BIO 15826305 <GO>}

And maybe just the only kind of build I would make on that is if you just go back to, I think what Chris talked about in his opening remarks. So if you look at food news like the Big Arch that we've had in three pilot international markets for the last several months, where we're seeing really strong results. So again, I think there's certainly demand from consumers for that exciting food news when they visit us, obviously, they still are buying and these promotions or activities when they're done well are resonating really well. I mean, you heard us talk about the Collector's Edition where we ran through that in two weeks because the demand was just so strong. We saw incredibly strong demand in the first couple of weeks of October for Chicken Big Mac. So consumers still want that excitement, they want great ideas and great food news. But obviously, for some of our consumers, they're just really looking for that value and affordability. So we've got to get both of those in place and get them working together, as I talked about before, where we get that one plus one kind of equal to three overall outcome.

A - Chris Kempczinski {BIO 18660246 <GO>}

And I just would add, I think it was a question on a prior call about Big Arch given that it's a higher ticket item in this environment. I think the question was, does a product like that resonate and what we've seen in our three markets so far is, it's doing great. And that's why we've decided we're going to accelerate it into more markets next year. So I think there's -- the consumer still sees it as a good value, albeit at a higher check, but they're also using it -- it's clearly meeting an unmet need and when we have good marketing behind it, that can be a nice add-on and complement to the overall ticket. So those are -- that to me is just a great example of it's not all about the low entry-level price points, when you have good food news and marketing on top of it, you can get that check build that we've been talking about.

A - Scott Meader {BIO 1707438 <GO>}

Our next question is from Lauren Silberman with Deutsche Bank.

Q - Lauren Silberman {BIO 19805519 <GO>}

Thank you. Just a quick follow-up on the sales impact with the food safety incident. Are you seeing the impact more concentrated in the affected areas in the Midwest or is pressure more broad-based? And then just on the US comp, can you just talk about the composition across traffic, price, and mix during the quarter? And any additional commentary on what you're seeing across the low, middle, and high-income cohorts? Thank you.

A - Chris Kempczinski {BIO 18660246 <GO>}

Hi, good morning, Lauren. Well, I think as you would -- as you would expect, for sure, there is a bit more impacted in the concentrated areas where the news and attention has been a little bit more specific, and I think they're obviously just with the broader news and lack of clarity early-on, there's a bit of a broader impact as I talked about earlier. But as I said, you know, I think the most significant events are behind us now, and we certainly are fully focused on getting the US business back to the momentum that we were seeing at working hard to kind of restore confidence of all of our consumers. So I think that's a focus. I think on the -- I guess the dynamics, I won't get into a lot of detail on that. I mean I think we've talked about a fair bit about that already in the call today.

I think as I said, we exited the third quarter with stronger momentum, had a really strong start to the beginning of the fourth quarter. I think the $5 meal obviously continued to work well and I think that continued to resonate even more strongly as we work through the quarter. And then as we were getting that kind of combination with some of the menu news and marketing excitement and execution that we were delivering, we were getting a pretty strong check lift as well at points, particularly kind of towards the end of the quarter and into the fourth quarter. So I think those would be maybe a bit of the texture that I would give you.

A - Scott Meader {BIO 1707438 <GO>}

Our next call is from Jeff Bernstein with Barclays.

Q - Jeffrey Bernstein {BIO 7208345 <GO>}

Great. Thank you very much. Just following up on the US value component. It seems like the $5 value offer response has been encouraging. I'm wondering whether there's any key metrics you can share, whether it's the mix of sales that you see from value more broadly or whether it's the $5 menu in particular, or any detail on that share growth? I think you said for the first time in over a year you've seen share growth with that low-income consumer. So any support around that? And just to clarify, I think you said a more holistic value platform in the first quarter of '25, kind of reminds me of maybe the prior $1, $2, $3 menu where the consumer has options to choose among a variety of items. So any color you can provide in terms of directionally what you're thinking about what that means for a more holistic value platform in the first quarter would be very helpful? Thank you.

A - Chris Kempczinski {BIO 18660246 <GO>}

Sure. Well, first on the elements of what we're seeing. I think Ian hit some of the key criteria that we're looking for. But certainly, when we launched the $5 meal deal, we wanted to see that it would improve value perception with the consumer and we've seen evidence of that. We wanted to see that it could engage the low-income consumer in particular. We've seen evidence of that. We wanted to see that it could drive guest counts. We were seeing strong evidence of that. And then we were getting incremental check on top of that, that allowed us to have a positive lift between -- meaning that we saw comp sales growing faster than GC.

So all of those kind of key metrics that we had outlined at the outset of that program, we've seen that deliver. As you think about then what -- what our longer-term value program needs to look like, we're not going to get into the specifics of that on this call. I alluded to that this is something that we're in active conversations right now with our franchisees on. But I think you can anticipate it's going to have a few components. It needs to have this EDAP component that we've talked about. It needs to have a meal deal component, whether that's a $5 meal deal or some other meal deal, that will be something that's included in it, and it needs to be able to incorporate some of the digital offers that we do.

So as you think about what this is going to look like, I think you can look to some of our other markets where we have platforms like either a McSmart or a Saver, where you've got a branded platform that can house all of these various individual value components. And I think that's what you should expect to see from us launching in Q1 of next year.

A - Ian Borden {BIO 15826305 <GO>}

Jeff, I just might add a bit on the first part of your question. I mean, I think as you heard me talk about earlier, I mean, we had a positive comp gap versus the industry on both traffic and sales during the quarter. So that would tell you that what we were doing was resonating with all consumers, obviously, not just lower-income consumers and that goes back, I think, to what we've talked about a couple of times today, which is strong value and affordability positioning and exciting menu news and marketing execution.

So we feel the US did a very nice job during the quarter of resonating broadly with consumers. The specific data points that we've talked about already was just -- obviously, we've gained share with lower-income consumers, which is a really important part of our consumer basis for the first time in over a year. So I think that's a very specific and important proof point.

But I think also buyers of the $5 meal are visiting us more frequently. So we're winning more visits. Some of those visits obviously going towards the $5 meal, but some of those visits going to other things on the menu and that's what you start seeing when you start getting consumers back into the restaurants on a more regular basis. So I think we feel pretty good about the specific outcomes, but also the broader outcomes and those proof points.

A - Scott Meader {BIO 1707438 <GO>}

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

Q - Jon Tower {BIO 22741653 <GO>}

Great. Thanks for taking the question. I guess maybe just following up on Sara's question earlier regarding store margins. I was hopeful that you could maybe provide some color on your thoughts into '25, given the dynamics that have played out this year in the market and some of the plans you have for value. And then on top of that, just broadly speaking, how you're thinking about the brand's pricing power, more so in the US relative to other markets in the world, given the macro backdrop where it seems like we've got a mixed consumer with respect to demand and jobs. And just curious, do you think the brand can kind of price in line with inflation next year? Or is it going to have to kind of track below?

A - Chris Kempczinski {BIO 18660246 <GO>}

Great. Thanks, Jon. Well, look, I think on margins, I would just go back to -- if you think about the momentum that we have been able to drive in the US business through the third quarter and at least to start in October, it's that kind of momentum that's going to be able to drive margin growth, both in percentage and dollars. And I think as you've heard us say today, we feel really confident we can get momentum back restored into the US business to where it was.

And as we do that, we certainly feel confident about our ability to drive margin leverage because at the end of the day, if we've got greater volume, that's what allows us to obviously drive margins over time. So I would say we feel good about our ability to do that as we're able to drive sales. And I think as we look into '25, we certainly feel confident in that.

I think in terms of pricing power, I mean, you've heard us talk a lot about you know the more challenging environment, particularly in our international markets. I mean, consumers are certainly remaining resistant to pricing, but there are obviously different ways to kind of get at pricing. There's obviously taking price increases, but we've also got the ability through great marketing through full kind of margin promotions or menu excitement, things like the Big Arch, where we can get more effective pricing by just obviously influencing our mix. And I think we're going to obviously continue to be thoughtful about incremental pricing action because I think there's a lot of resistance. I think that there's plush pressure as a result of that on flow-through rates. I think we still feel we can get pricing, but I think that is going to be at more conservative levels until we get the right momentum back in the business in each and every one of our markets. And I think that certainly, that opens up more opportunities as we look forward.

A - Scott Meader {BIO 1707438 <GO>}

Okay. That concludes our call. Thank you, Chris. Thank you, Ian. 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.
