McDonald's Corporation (MCD) CEO Discusses Q2 2013 Results - Earnings Call Transcript

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David Tarantino - Robert W. Baird & Co., Inc.

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McDonald's Corporation (MCD) Q2 2013 Earnings Conference Call July 22, 2013 11:00 AM ET

Operator

Hello and welcome to McDonald's July 22, 2013 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'd now like to turn the call over to Ms. Kathy Martin, Vice President of Investor Relations for McDonald's Corporation. Ms. Martin, you may begin.

Kathy Martin

Good morning everyone, and thanks for joining us. With me on the call are President and Chief Executive Officer, Don Thompson; and Chief Financial Officer, Pete Bensen. In addition, Chief Operating Officer, Tim Fenton is here Q&A. Today's conference call is being webcast live and recorded for replay via the phone, webcast and podcast.

And before I turn it over to Don, I want to remind everyone that, as always, the forward-looking statements in our earnings release and 8-K filing also apply to our comments. Both documents are available at our website www.investor.mcdonalds.com, as a reconciliations of any non-GAAP financial measures mentioned on today's call with their corresponding GAAP measures.

And now, I'd like to turn it over to Don.

Don Thompson

Thank you, Kathy, and good morning everyone. I'd like to begin by briefly framing our performance using three lenses. The past, the present, and the future.

First the past, because it provides perspective and guides our present and future. Throughout McDonald's history, we respectively grown both the top and the bottom lines to varying degrees across a variety of economic and competitive cycles. We have an iconic brand an outstanding system of owner-operators, suppliers and employees and superb real estate locations in nearly every market around the world. This provides a solid foundation from which we operate.

Second, the present. In second quarter we grew revenues, operating income and earnings per share, despite the ongoing impact of the challenging environment. This is truly a testament to the fortitude and resilience of our system, our sustainable competitive advantages, and the collective focus on execution at our restaurants.

And third the future. We expect the dynamics of this cycle should persist in the near-term, namely flat to declining informal eating out markets, increasingly less ability to take price, cost pressures throughout our P&L and heightened competitive activity.

Our second quarter results tells story consistent with these lenses. Global comparable sales were up 1%, operating income was up 3% and constant currencies and earnings per share was $1.38, a 6% increase in constant currencies. And as we begin the third quarter, global comparable sales are expected to be relatively flat in July. Based on our recent sales trends, our results for the rest of the year are expected to remain challenged.

We remain committed to the plan to winning our three global growth priorities to optimize our menu, modernize the customer experience, and to broaden accessibility to brand McDonald's around the world. This customer centric plan enables us to deliver an appealing experience by offering great tasting, affordable food and beverages, and clean and modern restaurants.

At the same time, we are diligently implementing thoughtful adjustments to our proven strategies and solutions when and where needed. This flexibility has enabled us to maintain or grow market share in most of our major markets around the world.

Let's review ours results in every geographic business units, starting with the United States, where comparable sales for the quarter were up 1% and operating income was flat. We continue to appeal to our customers with an increased emphasis on new news across our menu, and an ongoing focus on everyday affordable value.

The Dollar Menu remains a foundational component of our strategy to consistently deliver value across the menu, rather than implementing aggressive short-term discounting tactics. At the same time, our focus on enhancing core classics and offering additional premium products, continues to provide customers with even more variety and choices across day parts and price points.

This quarter we introduce new items across all four key growth categories, chicken, beef, breakfast and beverages. Premium McWraps launched in April, the Blueberry Pomegranate Smoothie and Egg White Delight debuted in May and last month we added fresh new taste to our Quarter Pounder Burgers with three new flavorful recipes, Bacon Habanero Ranch, Lettuce Tomato Deluxe and Bacon & Cheese.

From a comparable sales standpoint, these new menu additions individually met or exceeded targeted performance levels. However, softer IEO environment and comparisons against prior-year promotion with chicken and beverage activity offset the sales driven by the new menu news. And while June comparable sales were slightly negative in the U.S., we continued to outpace the competitive set.

In June, I met with our leadership franchisees while they were in Oak Brook for one of their regularly scheduled meetings. While the challenges of operating a small business today are many, it is clear that we're aligned and focused on what's most important and that's the customer. It's that commitment to remaining customer centric, along with the assertive plans and vision we have in place, that enables all three legs of the McDonald's system to grow sales and profitability for the long-term.

Let's shift to Europe where comparable sales were down 10 basis points for the quarter and operating income was up 5% in constant currencies. The U.K. and Russia continued to deliver positive results, while weak performance in Germany and France persist. The U.K.'s business remains solid. Second-quarter results and continued market share growth were driven by a balanced focus across value core new products and promotional offers.

The U.K. launch blended ice beverages in June, just in time to satisfy customers craving for something cool and refreshing during the summer months. The lineup includes two delicious fruit smoothies, strawberry and banana and mango and pineapple, and a line of frappes including Carmel and Iced Mocha.

Inspired by the U.S., these new products expand the overall beverage lineup and further validate blended ice as a proven system solution that can be deployed across markets worldwide. Russia also delivered positive performance for the quarter on top of last year's strong results. In addition to a focus on the Big Mac, two seasonal premium offerings, The Royal Cheeseburger and The Big Tasty with Bacon, contributed to Russia's performance and demonstrated the strong ongoing appeal of our brand in this growth market. We expect the lower inflationary environment in Russia to continue dampening our pricing power, pressuring near-term sales momentum compared to last year.

Moving over to France, comparable sales and guest count performance remained negative as the recession continues to pressure the informal eating out industry. However, we're growing market share by balancing value and premium products across the menu. For example, France recently added two new recipes to the popular Casse-Croute entrée and drink combo. They contributed to market share growth during the lunch day part. This value offer was complemented by a strong focus on two premium beef burgers, Le M and Le 280.

In Germany, negative comparable sales and traffic trends persist. Our traffic has declined at a faster rate than the IEO industry, which also continues to contract. It's critical that our initiatives resonate with consumers in this environment and in this marketplace. So to re-establish our momentum, we are leveraging recent consumer insights and continuing to adjust our plans.

Let's shift to Asia Pacific, Middle East, and Africa or APMEA. Comparable sales were down 30 basis points for the quarter and operating income increased 3% in constant currencies. Although market share improved in China, Australia, and Japan, comparable sales were negative for our big three markets. Positive performance in other markets like South Africa, Singapore, and South Korea partially mitigated the overall segment's decline.

Markets across APMEA are taking a holistic approach to stimulating demand. Across day parts, they are offering limited time and innovative products alongside established price value platforms. In Australia, we continued to grow market share by balancing our focus on the core with new product introductions and promotional activities. Strong performance in 2012 including the launch of our Loose Change menu along with external pressures in 2013 from lower levels of consumer spending and heightened competitive activity have contributed to weaker performance.

In Japan, consumers remain extremely price sensitive. Comparable sales have been positive the last two months, and we continue to grow share by leveraging limited time offerings like the Chicken Teritama and sharing options such as the Mega Potato to keep customers coming back to our restaurants and to build our average check.

In China, comparable sales were down 6.1% for the second quarter reflecting the negative impact from avian influenza, which continues to dissipate. We remain focused on leveraging promotional activities to showcase the diversity of our menu beyond chicken and strengthening our connection with customers through our ongoing brand trust campaign that focuses on the quality and the safety of our food.

We remain confident in our ability to drive future performance in China. Going forward, comprehensive plans for our key growth areas, particularly beverages, the family business, and the late night day part remain our top priorities.

Around the world and across our system, we are focused on ensuring our strategies and tactics resonate with customers. That's the key, the key to our performance today and for the long term. As I mentioned earlier, our market teams continue to strategically and thoughtfully adjust their plans in response to local consumer dynamics and growth opportunities.

At the same time, we remain committed to prudently investing our capital and resources in those initiatives that will further differentiate us from the competition for the long term. We're broadening accessibility by adding new restaurants, we're modernizing our existing restaurants with reimages and remodels, and we continue to deploy technology and convenience initiatives.

As our predominantly franchised business model continues to generate significant levels of cash, our priorities regarding the use of cash have not changed. After investing in our business, we're committed to returning all free cash flow to shareholders over the long term, first through dividends and then through share repurchases. For the second quarter, we returned $1.2 billion to shareholders through a combination of dividends and share repurchases.

In closing I want to reiterate my confidence in our business and in the growth opportunities that exist. We are diligently focused on executing the proven strategies within our plan to win. We have a resilient business model, an aligned and talented system, and an experienced management team.

We're leveraging these strengths and making deliberate, continued progress toward winning this battle for market share and fortifying our position as our customers' favorite place and way to eat and drink.

With that, I'll turn it over to Pete.

Peter J. Bensen

Thanks Don, and hello everyone. McDonald's continued to grow revenues and net income in second quarter within the challenging global environment. The system remains focused on executing our strategies to become even more relevant to the 69 million customers we serve every day.

We continue to adjust our tactics where prudent and are committed to optimizing those factors within our control. Our financial results for the second quarter reflect these efforts to strengthen near-term performance while continuing to build our business for the long term.

For the six months ended June, system-wide sales increased 3% in constant currencies due to expansion. Combined operating margin declined 30 basis points to 30.3% over that same period, primarily due to lower restaurant margin percentages.

We are primarily a franchisor with 81% of our global restaurants operated by local businessmen and women. Consolidated franchise margins contribute approximately 70% of our restaurant profits. This stable, predictable income stream benefits from comparable sales growth and is more insulated from inflationary and other cost pressures.

For the quarter, each area of the world contributed to franchise margin dollars growing 4% in constant currencies to more than $1.9 billion. The margin percent declined 40 basis points to 82.8% as positive comparable sales were more than offset by higher occupancy expenses.

Global company-operated margin dollars declined 1% in constant currencies to $842 million for the quarter. The margin percent decreased 50 basis points to 17.7% as higher labor, commodity, and other costs more than offset slightly positive comparable sales. The margin pressures for the quarter were most acute in the U.S. and APMEA while Europe grew its McOpCo margin.

In the U.S., second quarter company-operated margins declined 110 basis points to 18.7% due to higher labor occupancy and other operating costs. The McDonald's system is effectively managing commodity expenses with cost up about 1% in second quarter. The full year outlook for the increase in our U.S. grocery basket remains at 1.5% to 2.5%.

The U.S. has been deliberate regarding pricing seeking to remain below the food-away-from-home inflation index of

2.2%. Another relevant data point is Food At Home index which is up only 0.9%, somewhat limiting our pricing power. At the end of June, our U.S. price increase was 1.5% which is about 120 basis points less than one year ago.

As we move through the second half of the year, we will consider future price increases balancing our desire to grow traffic and market share amidst the reality of higher input costs. In addition to pricing, we're employing more suggestive selling strategies at the order point to encourage trials, new products and add-on purchases. As Don mentioned, it's a market share battle so we're employing a variety of strategies and tactics to grow traffic and increase relevance to our consumers.

Turning now to Europe, company-operated margins were probably the biggest positive of the quarter as they increased 10 basis points to 19.4%. Europe's McOpCo margins benefited from the significant contribution from the UK and Russia, our two strongest performing markets in the region who contribute nearly half of the segments company-operated margin dollars.

In addition, France and other markets realized labor productivity gains as part of their overall efforts to control costs and enhance efficiencies within the restaurants. Commodities increased about 2% for the quarter and for the full year, Europe's projected increase is now slightly lower at 2% to 3%.

Europe is a collection of 39 markets, so our price increases vary by market with Russia at the higher end due to its inflation albeit a little less than a year ago and all other markets averaging about 1.5% year-over-year. Similar to the U.S. we have less pricing power in 2013 versus a year ago.

In addition, given the economic environment in nearly all of our markets we're balancing a stronger emphasis on value with compelling premium products to effectively manage average check and margins. We have a strong underlying business in Europe and we believe we are making the right strategic decisions and value investments to protect and grow the band over the long term.

In Asia-Pacific, Middle East and Africa, company-operated margins for the quarter decreased 100 basis points to 14.3% due to new restaurant openings mainly in China along with higher labor costs throughout the segment. To a lesser extent, avian influenza impacted our sales and margins in second quarter, but our team work hard to manage expenses and other controllables to mitigate some of the negative impact.

G&A discipline remains an area of focus. We seek to grow sales and revenues faster than our G&A spend. Year-to-date, G&A as a percent of revenues was 8.8% versus 9% a year ago, which included our biennial Worldwide Convention. For the full-year, as part of our ongoing efforts we have reduced our G&A spend and now expect it to be relatively flat versus the prior-year due in part to lower incentive compensation and efficiencies we have identified.

The growth in revenues and operating income within our franchise business model translates into significant generation of cash. As Don reiterated, our first priority for this cash remains reinvesting in our business to drive future growth and returns. In light of the current environment we have trimmed our 2013 capital expenditure forecast by $100 million to about $3.1 billion. Although we will open about 50 fewer sites, we believe this is prudent given the short-term pressures. More importantly it will not undermine our long-term growth potential and the quality and returns of our new restaurants remain very solid.

The remainder of our capital is being invested in existing restaurants, in part through reimaging more than 1,600 location's, we're making steady progress in our efforts to modernize our brand with about 50% of our exteriors and about 60% of our interiors on a global basis reflecting the current contemporary look. In the U.S. this year we will touch about 10% of our traditional brief standing portfolio through a combination of reimaging, rebuild and new restaurants, this will put us close to the 50% mark. Within the next year a U.S. customer more often than us will experience our brand in a more modern and relevant manner than before. We're excited about the potential that this brings to our largest market.

Lastly, let me touch on foreign currency translation which negatively impacted second quarter results by $0.02 more than originally forecasted as several currencies weakened against the U.S. dollar during the quarter. At current exchange rates we expect a negative impact of $0.01 to $0.02 on third quarter EPS with a full-year negative impact of $0.07 to $0.09. As usual though, please take this as directional guidance only because rates will continue to change as we progress throughout the second half of the year.

Despite flat to declining and formal eating out markets around the world McDonald's grew revenue operating income and earnings per share in second quarter. Our results underscore the solid performance, the solid platform from which we are operating. A unique franchise business model that harnesses the entrepreneurial spirit of local businessmen and women will operate approximately 28,000 of our nearly 35,000 restaurants around the world. The powerful alignment of our system around the strategies and key growth priorities that have allowed us to maintain or grow our industry leading market share in most of our major markets and a strong financial foundation that allows us to invest for the future while making prudent decisions to deliver near term performance. We remain confident in our brand and the competitive advantages of our system which we believe will continue to drive positive results over the long-term. Thanks.

Now, I'll turn it over to Kathy to begin our Q&A.

Question-and-Answer Session

Kathy Martin

Thanks, Pete. I am going to open the call now for analyst and investor questions. (Operator Instructions) Our first question is from Joe Buckley from Bank of America Merrill Lynch.

Joseph Buckley - Bank of America Merrill Lynch

Thank you. I'd like to ask a question, maybe a multiple-part question on U.S. sales. So you commented on the U.S. second quarter performance being better than the QSR sector as a whole. Could you quantify what you think the QSR sector did for the quarter and was that also true in the month of June for U.S. performance versus IEO, and maybe in conjunction with that, just talk about pulling monopoly forward, kicking it off this week, just the rationale behind that decision?

Don Thompson

Hi Joe, this is Dan. Thanks so much for the question, and I'll try to address some of the points that you made, and you can -- if there's anything we missed, you let us know, but -- if we look overall in the U.S., it looks like and I'll speak from an informal eating out perspective. It appears that we gained about 10 basis points in the informal eating out category relative to traffic. So, we know that the things that we've put in place are definitely having some impact and it also speaks to some of the things that took place relative to our focus on new products. And so, again looking at the U.S., we know that this year we were lapping some of the implementations of some of the beverage strategies from last year which launched a little bit earlier, Cherry Berry Chiller. We also know there was a frappe launch earlier in the year. We also had 20 piece nuggets that were launched last year. The great thing for us is that the products that we've implemented in the chicken, breakfast, beverages, and beef category being Egg White Delight, Blueberry Pomegranate, the wraps, the Quarter Pounders, those things have performed well and met or exceeded the targeted sales, but again some of the offsets that Pete and I mentioned are some of the reasons that sales are softer aside from the fact that the informal eating out category is projected to be down about 50 basis points. So we know that, we put things in place to address that in the U.S. and we have outperformed the competition. We do know that we've outperformed them on a year-to-date basis from a comparable sales performance by a little bit over 1%.

Kathy Martin

All right. Our next question is from Jason West from Deutsche.

Jason West - Deutsche Bank Securities, Inc.

Yeah, thanks. I guess just one that you guys didn't touch on there was around the Monopoly pull forward, if you could touch on that and then just bigger picture, the comments in the press release and in your prepared remarks about a challenging environment over the rest of the year, I don't think you guys normally talk about the forward outlook quite this much, so I am just wondering what are your thoughts, kind of what's changed since the April call, and would we be considering kind of challenges, meaning kind of flat comps continuing over the next several months, is that the kind of message that you're trying to send? Thanks.

Don Thompson

Thanks, Jason. As you know, we don't give -- we're not giving out guidance, that's not our practice. We do expect the remainder of 2013 to remain challenged based on existing top and bottom line pressures. We know we're seeing ongoing global economic headwinds. We're seeing flatter declining IEO markets and ongoing competition chasing fewer guest counts as a result of a less and discretionary spending. We also know that this is a more price sensitive timeframe based on these economies, and we still have ongoing P&L pressures including higher labor and commodity costs, and we have less ability to take that price. So, relative to those things, that's kind of the -- if you would, the framework around the comments that we made, we continue to believe the long-term, the average annual financial targets that we put in place are achievable and appropriate. We do know, however, in the near term that we're going to face some tough economies around the world and the informal eating out industry is softer around the world, and a matter of fact, 7 out of -- 11 out of our top markets we're seeing contraction from an IEO perspective.

Peter J. Bensen

And Jason, regarding Monopoly, that was a decision last fall when the U.S. was looking at their calendar and looking at the product launch lineup thinking about, how do we follow-up the introduction of these great new products with a way to continue the momentum and we know that Monopoly is always a great transaction driver, and these new products are prominently featured in the Monopoly promotions, so following those product launches up with Monopoly, it seemed like a very prudent thing to do.

Kathy Martin

Our next question is from John Glass from Morgan Stanley.

John Glass - Morgan Stanley & Co.

Hi, thanks very much. Following up on the U.S., Don when you see the IEO market in the U.S., what definition do you use for that? It seems to me, I recall that you use a broader definition than just a quick service hamburger market; and if that's the case, could any of the weakness be described by or explained by some of your near-end competitors doing better? And secondly, what is the dynamic in the U.S.? Is the low-end customer still there, but the high end maybe moved off and maybe they're not taking you up on some of the higher end offers, what's the dynamic underneath the weakness in comps?

Don Thompson

All right, and thanks for the question John. First of all, the definition we use is really more of a protocol, is CREST. CREST is the information that we use relative to our informal eating out data, and they are fairly broad data base to your point. So we look at the overall informal eating out industry, that is what helps us whether it would be identifying opportunities or looking at who may or may not be doing as well in the industry at that point in time. So, it really is a good barometer of the overall marketplace that QSR segment is a little bit – it's a little bit more, I don't want to call it myopic, but it's a much smaller view of the overall marketplace. So as we've looked at that that's how we know that the overall marketplace was going to drop by about 50 basis points. Now the interesting thing about IEO is that QSR makes up the vast majority of IEO. And so, when you hear us talk about IEO, we are talking in a large part also about the QSR industry. As we look forward and if you look at who's winning, who's not winning in the marketplace, we do know that we've gained market share, we know there are a couple of other players that have gained market share. And what we do is we continue to look at our performance relative to the categories of growth which I mentioned earlier which were chicken, beverages, breakfast, and then we also look at the premium beef category which is why you saw it implement the Quarter Pounder line with the three different recipes which is why you've seen us leverage our beverage strategy, which we still have some opportunities to leverage that to an even greater extent. And so, we're going to continue to do that. But when you look across our product implementations this year, they have hit each of the growth categories, and so we feel fairly good. Those products have met or exceeded the expectations we had. As I mentioned, we did see some offset based upon last year's promotional activity particularly around 20 Piece Nuggets and in some of our beverage strategies.

Kathy Martin

Okay. Our next question is from Keith Siegner from Credit Suisse.

Keith Siegner - Credit Suisse Securities LLC

Thanks. If I could just ask another U.S. question kind of more broadly thinking about the IEO market, it seems like a lot of the disappointment say versus our expectations at least on this side have come from IEO market disappointment. If you think through the fact that you've got food at home now running significantly below total food away from home, even though you're running below food away from home in terms of pricing, I guess what I'm asking is, is the setup that the food away from home industry might be pricing a little too aggressively in a low inflation environment? How do you think about the relative share trends across IEO versus food at home? Thanks.

Don Thompson

Hi, Keith. I'm going to let Pete talk a little bit about what's taking place and relative to our own pricing. What I would tell you and I mentioned it in my comments, one thing we do see in the broader industry is we're seeing a lot of discounting, price discounting rather than consistent value platforms which we have around the globe and we've put in place, and we're going to maintain that consistency because it's important to consumers. We know that, but we have seen a lot of, I'll say, sporadic price discounting across the marketplace. But relative to what we've done and how we've seen pricing, I'll ask Pete to make some comments.

Peter J. Bensen

Yeah, Keith, one of the things I mentioned, we're up about 1.5 in pricing in the U.S. on a trailing 12-month basis. That's 120 basis points below where we were a year ago. It's clearly one of the factors that is contributing to comps maybe being not as strong as some would think. When we look at the dynamics at food away from home, it's up 2.5%; food at home up only 0.9%. That's on a trailing 12-month basis through June, so comparable to our 1.5% price increase. But for the full year both food away from home and food at home are currently projected to be up 2.5% to 3.5% each. So what will be interesting we will definitely be looking at those as we move throughout the year and making decisions about what we're going to do with price for the remainder of the year, but as you point out to the extent that food at home continues to be at a significantly lower growth rate the grocery store is a competitor and that does impact the industry's ability to pass on price.

Kathy Martin

Okay. Our next question is from Brian Bittner from Oppenheimer.

Brian Bittner - Oppenheimer Securities

Thank you. A bright spot in the quarter was the profit growth in Europe. You had a slightly negative comp and you're able to somewhat increase the McOpCo margins there. So can you explain how that's possible? How did that happen? And is that sustainable if we have continued weak flattish type comps over in Europe going forward?

Don Thompson

Hi, Brian. This is Don. I'm going to ask Tim to make some comments about Europe and productivity. I know he's made quite a few business to the marketplace there relative to what we're doing in McOpCo and how we're focused on our margins there and the profitability and productivity aspects of the business. Tim?

Tim Fenton

Brian, first of all as Pete mentioned the UK and Russia have been two of our best performing countries in Europe which represent almost 50% of our company-operated margins. But in spite of – along with that, the team has really done a great job of fine-tuning their P&L efficiencies particularly in labor scheduling and food cost controls, so they've done a very good job on scheduling efficiencies and just working those through the P&L, so we're very happy with the progress they've made.

Kathy Martin

All right. Our next question is from Matt DiFrisco from Lazard.

Matt DiFrisco - Lazard Capital Markets LLC

Thank you. I guess just looking at the guidance and the end of the 8K there, you talk about G&A. It looks like it's a little bit of a change from previous where you were 2% to 3% constant currency growth, now you're flat. I was wondering what came out of that? Is it simply just a lower outlook brings about lower compensation or is there – some of the technology spend that you did last year that you thought was going to continue at the same pace, have you been able to save money or you're deferring that to '14? Thanks.

Peter J. Bensen

Matt, it's really a combination of factors. Obviously the technology spend we think is an important long-term differentiator for us and a lot of that is in the restaurants. So we're appropriately pacing that. There's other areas that we look at for efficiencies in terms of spending. And then finally as you mentioned, lower performance will yield lower incentive comp and so there's a lower outlook for that as well. So it's a combination of all of those.

Kathy Martin

All right. Our next question is from Jeff Bernstein from Barclays.

Jeff Bernstein - Barclays Capital, Inc.

Great. Thank you. Just two quick follow-ups. First, as we look at the European business, seems like economists are getting a little bit more bullish on the European economy and like people are calling for bottoming in the middle of '13 and recovery starting late in '13. So being that you get to service all those markets across Europe, I'm just wondering on the trends you see within the data, how would you size up the pace or do you feel confident, a likelihood of recovery seem like France and Germany would need to improve before perhaps the UK and or Russia slows, I'm just wondering how you'd size it up based on the data you're seeing? And the follow-up is just – I mean the quality of comments you guys gave for the rest of the – the remainder of the year being challenged. I'm just wondering because you said fairly. A couple of times I know you mentioned that you still grew revenues, operating income and earnings in the second quarter and in the first quarter as well. I'm just wondering if that's a reasonable assumption for the back half of the year or would that dynamic change? Thanks.

Don Thompson

Hi, Jeff. Just a little bit maybe on the European economy and then as we talk about challenges for the rest of the year. First of the all European economy, I can give you a perspective. All of us travel quite a bit to our markets. I don't know – the economists may be a bit ahead of themselves. That's my personal perspective but it's based upon the fact that if you look at GDP growth even quarter one versus year ago or even as you roll into quarter two, France is still in a recession two quarters now that we've seen negative GDP growth. We had Germany, which is negative in GDP growth. Spain is still suffering. From an unemployment perspective, you've got much higher unemployment than the norm across Europe. Youth unemployment is something that is somewhat alarming whether it be in France at 26%, Spain at 57%. You've got markets – I was recently in Portugal and Ireland, you got markets, some markets may have bottomed out. I would tell you some of the larger markets are still having some challenges. So we're looking forward to the bottom out, so to speak, and then a resurgence. At times you'll see a resurgence in some of the markets. Europe for us means 39 different areas and countries that we're working in, but it is a – it's still a challenged environment. The wonderful thing for us and I call it a wonderful thing because if we weren't focused on having implemented the value platforms when we did about a year ago, we would've lost more traffic. At this stage of the game, we are continuing to gain market share across the majority of European countries and that is the position we wanted to be in. Solidify market share, solidify customer visits, those things then we know lead to – with business you can get sales, with sales you can get profitability, but you have to have the sales coming in the front door. And so for us right now Europe is still a big challenge. As we look across the rest of the year, the notion – when we made the comment about challenge, it is similar to the second quarter. So as we see third and fourth quarters, we see them similar to the second quarter where we still see the ability for us to continue to move the business forward, however they are challenging environments, and you know we don't give guidance but we're just really being as transparent as we've always been relative to what we see in the market places.

Kathy Martin

All right. Next question is from David Tarantino from Baird.

David Tarantino - Robert W. Baird & Co., Inc.

Hi, good morning. My question is on the CapEx guidance revision and I just wonder philosophically why the need to turn the CapEx for this year and you mentioned that you wanted to be conservative with that even though the returns on those investments look good. So, I'm just wondering what is going on, on that line and what you might be seeing that's giving you a pause there?

Peter J. Bensen

David, it's really only about 50 openings that we trim from the guidance. So, to your point, new restaurant openings are our highest returning investments and the new openings over the last 12 months are no exception to that, they have generally being performing well. With the exception probably of China where, with the chicken issues in China and the slower economic growth there, that is the biggest of all of the markets contributing to the 50 store decline. So they took a hard look at their inventory, some of the sites they're pushing off to the future are open. And if you think about our opening cycle there is 12 to 24 months from the time we identify a site until we go to ground break, so that's a lot of time for the market dynamics to shift around a little bit. So we're just fine tuning around the edges, some of the inventory and not making any dramatic changes to our outlook for our new restaurant openings or our overall CapEx spend.

Kathy Martin

Next question is from Mitch Speiser from Buckingham.

Mitch Speiser - Buckingham Research Group, Inc.

Great. Thanks very much, and considering the U.S. the Company operated margin decline of 110 bips. Can you perhaps try and parse that out between cost pressures and promotional activity?

Peter J. Bensen

Yeah, Mitch. Pricing – being down 120 basis points in pricing is probably the single biggest contributor to the margin weakness there, but we had pressure across a lot of the lines in the P&L. So without that extra pricing, wage rates, little lower efficiency, we threw a lot of new products at the restaurants this quarter. So our efficiency per crew hour was down a little bit. We had additional depreciation from reimages that continue, and we had the increased additional advertising and promotional cost from the new product. So we had, on the cost side these incremental pressures that were not overcome by a stronger comp.

Kathy Martin

Our next question is from Michael Kelter from Goldman.

Michael Kelter - Goldman Sachs & Co.

Yeah, I guess with all respect throughout the economy being tough, ultimately between the focus on value messaging and the new products that you're saying you're all hitting targets, realistically it's just not moving the needle for you in this environment. So, I guess my question is; what do you need to do to adjust? Essentially other than the economy getting better, what are you going to do differently to get more people in the doors in the next 6 to 12 months?

Don Thompson

Hi, Michael, this is Don. First point and I want to reiterate it. We're winning in the market place. When we look at market share across our major markets, we are gaining market share and that's an important factor here. So, if you ask what do we need to do to adjust? I think we need to continue to adjust. We've been adjusting now for about the last couple of years relative to making sure we had solid value platforms. We've ensured that we have a good mix of value and premium based products, so we can gain as much margin as possible. What we don't have and Pete just mentioned it, is we don't have as much pricing power. And as long as inflationary rates are lower and as long as GDP growth and consumer discretionary spending is softer we're not going to move forward and take a lot of price because we know that it would mean guest count erosion longer term. So we'll be mindful of the price increases that we take. We'll continue to make sure that our value platforms are installed and strong. We'll make sure that we have a very solid menu pipeline which has helped us to as you see in the U.S. to outperform the competition in mass, and so when we look at what we're doing now, we think those are the right things to do. Pete mentioned growing the business and developing new sites. Our new sites are performing relatively well and so we're going to continue to invest capital there. The returns on reimage sites when you have less comparable sales that gets a little bit tight and we'll continue to monitor that, to Pete's point is we always do from a financially responsible perspective, but good pipelines, good value, good marketing campaigns, those things will continue. As I mentioned, we'll continue to invest in technology and we think we do still have some room to grow relative to some of the things we can offer our consumers from an engagement perspective there, and we'll continue to make sure we have good marketing spend, good awareness relative to our advertising. So, we're going to continue doing those things and implement those solidly. We'll continue focusing on the growth strategies we've talked about. There is room to grow in beverages, and in chicken, and in breakfast, and we're moving breakfast around the globe. So all of these pieces are the things that for us we still have a lot of work to do at McDonald's and we'll continue to focus on those areas.

Kathy Martin

Next question is from Jeff Farmer, Wells Fargo.

Jeff Farmer - Wells Fargo Advisors

Don, I just want to get a better read on your view of the U.S. consumer. It looks like obviously both quick service and casual dining consumers in the U.S. are pulling back on spending pretty dramatically in June and July. So from what you're seeing with your own customers, what are some of the key economic drivers on the more conservative behavior and what I mean is just more specially the last couple of months, it seems like a line has been drawn in the sand, consumers have definitely stayed away from pretty much all forms of restaurants or at least cut down on their occasions, I mean again just curious what your view is on what's going on?

Don Thompson

Hi, Jeff, a great question and the way you positioned it is accurate as we've seen it. We have not drawn a direct correlation as if yet, the sequestration or other I'll say tactical executions that have occurred in the U.S. what we do know is that there was a pullback to some extent, and it does seem to be impacting the informal eating out industry a little bit more or so than broader retail. So, again what we have to do is make sure that we institute and continue to have solid value and we have to do that by balancing and also with some innovative new news, this is going to be absolutely critical for us as we move forward. We have to continue to invest in the business appropriately, but make sure we're mindful of the returns. I don't foresee this changing in the next couple of months which is why we spoke of the rest of the year being challenging. And what we see in the United States is not unlike what we see in some of the other markets that are out there. Having said that, we feel pretty solid about the fact that we can continue to gain market share and that our focus. And if we can do that, we'll gain additional guest counts, we'll gain additional sales and we'll gain additional profitability. The pricing piece that Pete mentioned again is going to be tougher through the rest of the year in terms of taking price. So, we'll be monitoring that and measuring that relative to our margins. But again the market place itself is a little bit -- it is a little bit tighter than we've seen. But one thing we've never done at McDonald's, we don't cry or whine over market conditions, because all of us are in the same market conditions. So we just have to stay focused on what we do best which is move the business in the way as we've discussed today.

Kathy Martin

Next question is from Andy Barish, Jefferies.

Andy Barish - Jefferies

Hey, guys, one quick follow-up and then one new area. Just in terms of the monopoly shift does that open up the October window for a new product platform potentially here, and then just on the new front, on franchise margins they continue to slip a little bit; is that purely a function of getting comp back into solidly positive territory to see return or should we expect some of the higher D&A and occupancy to continue to weigh at least near term on franchise margins?

Don Thompson

Hey, Andy I'm going to let Tim make a comment relative to monopoly. I think he'll make a pretty solid point about whether or not it opens up another opportunity, clearly we can speak to specifics but he just finished one of the reviews with the U.S. business, so he can give you a couple of headlines as to some of the things I discussed. Relative to franchise margins we'll have Pete make a comment on that after Tim.

Tim Fenton

Okay, well Andy I can't say specifically on what products we have coming in, but we have a pretty robust fourth quarter -- third and fourth quarter coming down the pike. And as far as monopoly we moved it in as everyone has stated already and really take advantage of the food traffic that we do have in our third quarter. So, product's coming, can't get specific on it.

Peter J. Bensen

Andy, you point out the franchise margins they are compared in the capital margins. They're even more sensitive to the comp because the base of cost is more fixed. So the depreciation and the rents are really – we really need a stronger comp to start to get that percentage to move upwards.

Don Thompson

Andy too, and I know we've talked about this and we've tried to relate on the call, the new products that we've implemented have resonated with consumers. And I want to make sure that everyone understands that IEO is relatively flat and declining in many of the markets around the world. So we're not going to change that menu pipeline execution strategy. It is absolutely working. However, we are facing some headwinds and so we'll continue to execute that, continue to make our target to outperform in the marketplace as a whole. But I think you are quite clairvoyant to the fact that there may be something that does come up in the latter part of the year relative to new products.

Kathy Martin

All right. Next question is from Bryan Elliot, Raymond James.

Bryan Elliot - Raymond James

Thank you. I'd like to talk about competitive environment outside of the U.S. So the informal eating out market particularly in Europe has been soft for some time. Are you seeing evidence yet of some shrinkage in supply and also thinking about China, which has been through a meaningful short-term contraction, if there's been any shakeout of competition, particularly thinking of maybe of local type, non-deep pocket type competition and if you're seeing any benefit potentially down the road from some of that?

Don Thompson

Hi, Bryan. Outside of the U.S., some of the competitive sets are different. I'll ask Tim to speak a little bit to some of the things that he's seeing out there. But keep this in mind. The U.S. is – there are a couple of markets that are similar to the U.S. and not quite to the U.S. level relative to the competitive density of competitors as we know them. In many of these cases you have more as we would define them smaller chains, mom and pop type organizations. So we do see consolidation in some of those smaller ones when you get into recessionary periods or macroeconomic conditions like these, but relative to whether or not we've seen larger chains that are consolidating that's not something that I have seen. But Tim, I don't know what else we've seen out there in your travels.

Tim Fenton

Bryan, a lot of couponing and vouchering going on, but we're seeing a rise in the non-traditional competitors that we've faced in the past, particularly cafes, convenience stores, bakeries and supermarkets coming up with ready-to-eat meals. So that's been a resurgence for them, particularly in Europe. On China, the overall chicken market is kind of taking a step backwards as it pertains to the IEO. It's starting to dissipate now and coming back but particularly I would say in Western QSR has probably taken the biggest decline.

Kathy Martin

All right. Our next question's from John Ivankoe, JPMorgan.

John Ivankoe - JPMorgan Securities LLC

Hi. Thank you. It seemed in the last release, in the April release and on that conference call, you were a little bit more protective about profitability in the U.S. and I wonder if there is a change if I'm right in sensing that, there is a change relative – how we're thinking about the business now? And of course I ask that in the context of the franchisees, which I think make more money per store level than – I know make more money per store level than any other major franchisee group if they've really signed on to I think what you're asking them is less pricing, continue with the Dollar Menu, focus on driving traffic even if it doesn't necessarily come to an extent of increasing their near-term store level cash flow?

Don Thompson

Hi, John. Thanks for the question. I would tell you the franchisees have done I think a stellar job in this environment and if you think about it from their perspective, several things. One is they've definitely been aligned relative to the things that we have asked of them focusing on the customer, ensuring that we continue to invest in the business, whether it be reimages or whether it be with new products and the new product introductions. We have really accelerated some of those introductions and getting those to the marketplace because it's very important to have new news and exciting news as well as to execute value. They have been very, very aligned on the value campaign and platform. Having said that, they've given a lot of feedback relative to what does the Dollar Menu look like today and how we need to maintain that and what things we might need to look at in terms of any modifications at any point in time. So I think the franchisees have done a really, really solid job. They've continued to invest in the business and we along with them in the business, they are one of the greatest assets to this overall McDonald's family has. I'd also add along with that, our suppliers because they are in an interesting commodity and legislative environment as well as the franchisees and small business owners. And they also have supported our system relative to how we want to be able to manage through these macroeconomic issues around the world. And so I can't say anything but be complementary about what our franchisees have done relative to the cash flow investments, their focus on the business, their focus on the customers, their focus on their employees and they're focused on a broader alignment around the McDonald system.

Kathy Martin

Next question is from R.J. Hottovy from Morningstar.

R.J. Hottovy - Morningstar Research

Thanks. Good morning. I wanted to keep it in the U.S. for a minute. You talked about the new products, innovations meeting or exceeding expectations. I was hoping to get some color on the Dollar Menu, just in particular your thoughts about the recent Dollar Menu performance and how that compares to your expectations especially with so much promotional activity in the environment? Thanks.

Don Thompson

Hi, R.J. The Dollar Menu itself still represents about 13% to 14% of sales, which is still in that same range it's been in. What has benefited us has been the fact that it is a consistent execution and it still has tremendous alignment across the franchises and the McOpCo restaurants that we have. So it is the value platform of choice. Now we've done a couple of things to try to add some new news to that which also help us to be a little bit more margin accretive, things like the Grilled Onion Cheddar Sandwich, Hot 'n Spicy McChicken limited time offer selections that we placed into the Dollar Menu. Even having done those, we still remain at 13% to 14% of sales based upon the Dollar Menu. So it is a solid platform for us. The last thing I'll mention is, early on we talked about the fact that there are – Tim mentioned we see a lot of discounting in the broader marketplace. We know that one of the most important things that customers look for is consistency in terms of the value platform. They want to know that they can depend on McDonald's to continue to deliver value every day all day and the platform for us is more than about short-term discounts. It's about establishing customer loyalty versus being aggressive for one or two months. We need long-term loyalty. We want a strong customer base. We want to make sure we drive business frequency and we want to support the introduction also of higher margin products, so build the base so that when we implement new products, those products have more awareness relative to our consumer base. So we've established these branded affordability platforms around the world now and they are performing to the levels that we would like. We have a couple of markets, R.J., that we still need to do a little bit of work and Tim is focused on some of those markets. But by and large, we're in a pretty solid place relative to the value platforms around the world.

Kathy Martin

Next question is Peter Saleh from Telsey Advisor Group.

Peter Saleh - Telsey Advisory Group LLC

Great, thank you. I know it's still early but maybe you could give us a little bit of a preview on your outlook for commodities for 2014. We've seen the grain prices coming down and I remember last summer, we had gain prices really shooting up because of the drought and your team in the U.S. at least was able to do a pretty good job in terms of your exposure for this year. So any thoughts on '14 would be pretty helpful?

Peter J. Bensen

Yeah, Peter, it's premature for us to give any numerical guidance but you can imagine as you point out that our team is constantly looking at how do we best deliver that stable, predictable price to the restaurants. While we're not trying to be market timers, we obviously do look at the markets to see when conditions might be better to layer on some coverage and you can imagine that we are working with our suppliers and our suppliers are putting hedges on, going into next year to provide us some of that stability. Probably at the Analyst Meeting in November it's when we'll start to give some numerical texture on 2014.

Kathy Martin

Your next question is Nicole Miller from Piper Jaffray.

Nicole Miller Regan - Piper Jaffray & Co.

Thanks. You've talked about new news and I'm wondering if it's fair to kind of assess that as evolutions of current platforms and I am asking because it seemed like you bought a lot of customization of these platforms to the menu and I'm wondering how you feel about that being a key driver of sales and profits versus your peer group?

Don Thompson

Hi, Nicole. I think you see both. You'll see some areas that are customization, if you would, and I assume you're talking about things like the Quarter Pounder line, which will also see some new platforms like you're seeing with McWraps. You will see us also do limited time offers. So relative to beverages or whether it be the other products that we'd implement. I think Tim gave some insight as to other thing that we might see in the U.S., but this is consistent also Tim around the world.

Tim Fenton

Yeah and in the U.S. Egg White Delight being able to put that different muffins and different carriers. But as we move into the platform deployment of made for you, you're seeing more customization.

Kathy Martin

All right. We have time for one last question. Paul Westra from Stifel.

Paul Westra - Stifel, Nicolaus & Company Inc.

Great. Thank you. I was wondering if we get an update on the value menu efforts in France, particularly maybe Australia a bit. I know you [indiscernible] menu there and given a softness economically, I was curious to give as much color as we can about the mix, the value effort there and may be the percentage of add-on sales within that menu that helps pay for it, is that progressing as planned? And I guess a related question to the loose menu effort in Australia. I'm just somewhat surprised about the overall comp going negative with the great success of the loose menu, seems would have prepared you well for this year's economic softness, and curious maybe about market share changes in Australia as well?

Don Thompson

Hi, Paul. I will – I can speak to the end of that with Australian market share changes and then I will ask Tim to talk about the other part of your question, which was France and France's value piece. Relative to Australia, Australia is another one of those markets that at this point in time we see from their perspective you're seeing some softer – clearly a softer economy, youth unemployment in Australia is about 25.5%. So they're facing some thing, unemployment for them has risen. Having said that, Australia is also one of the markets that we've had some solid share gains in and continue to have share gains in Australia. The – so the broader marketplace we've seen some – we see some tough economy, but we've also seen some share gain and we've seen our business meeting forward there. And again, I think the franchisees and the folks, the Company employees and suppliers have done a good job there. So, Tim anything on France?

Tim Fenton

Yeah Paul, France if you remember us talking about Casse-Croute, which is a Baguette Sandwich and a drink for under €5 has done extremely well for us, particularly in the lunch day part. France is gaining market share in a declining IEO environment. The thing that we're working on to address is looking at some erosion at the dinner time and the folks have done a really good job of putting some products in test to address that, but it's a tough environment there. They're gaining share at the expense of the rest of the IEO players.

Kathy Martin

All right. Thanks everyone. We got some final remarks from Don.

Don Thompson

First of all, thank you all again for being on today's call and participating. And as we wrap up the call, I want to make sure that you all understand that while we recognize that this is a challenging environment, we've been through challenging environments before as McDonald's. Our confidence in our brand and the competitive advantages of our system, truly are strength and a reflection of our ability to build on and learn from the past, having went through cycles before, these are different when you see them in the broad nature of these around the globe. But we've been purposeful and we've been agile, very flexible in our local markets about how we address some of the challenges there.

We are going to be and continue to be strategic relative to the way that we plan and evolve based upon customers spending habits, their discretionary opportunities, and the fact that we want to be their favorite place and wait to eat. So we look to evolving with our customers, evolving in these marketplaces and leveraging our history to make sure we mitigate through these challenges. Thanks so much for all of your support and your questions and have a great day.

Operator

This does conclude today's call. At this time you may disconnect your line.

Executives

Don Thompson - President and CEO

Tim Fenton - COO

Peter J. Bensen - EVP and CFO

Kathy Martin - VP, IR

Analysts

Joseph Buckley - Bank of America Merrill Lynch

Jason West - Deutsche Bank Securities, Inc.

John Glass - Morgan Stanley & Co.

Keith Siegner - Credit Suisse Securities LLC

Brian Bittner - Oppenheimer Securities

Matt DiFrisco - Lazard Capital Markets LLC

Jeff Bernstein - Barclays Capital, Inc.

David Tarantino - Robert W. Baird & Co., Inc.

Mitch Speiser - Buckingham Research Group, Inc.

Michael Kelter - Goldman Sachs & Co.

Jeff Farmer - Wells Fargo Advisors

Andy Barish - Jefferies

Bryan Elliot - Raymond James

John Ivankoe - JPMorgan Securities LLC

R.J. Hottovy - Morningstar Research

Peter Saleh - Telsey Advisory Group LLC

Nicole Miller Regan - Piper Jaffray & Co.

Paul Westra - Stifel, Nicolaus & Company Inc.

McDonald's Corporation (MCD) Q2 2013 Earnings Conference Call July 22, 2013 11:00 AM ET

Operator

Hello and welcome to McDonald's July 22, 2013 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'd now like to turn the call over to Ms. Kathy Martin, Vice President of Investor Relations for McDonald's Corporation. Ms. Martin, you may begin.

Kathy Martin - VP, IR

Good morning everyone, and thanks for joining us. With me on the call are President and Chief Executive Officer, Don Thompson; and Chief Financial Officer, Pete Bensen. In addition, Chief Operating Officer, Tim Fenton is here Q&A. Today's conference call is being webcast live and recorded for replay via the phone, webcast and podcast.

And before I turn it over to Don, I want to remind everyone that, as always, the forward-looking statements in our earnings release and 8-K filing also apply to our comments. Both documents are available at our website www.investor.mcdonalds.com, as a reconciliations of any non-GAAP financial measures mentioned on today's call with their corresponding GAAP measures.

And now, I'd like to turn it over to Don.

Don Thompson - President and CEO

Thank you, Kathy, and good morning everyone. I'd like to begin by briefly framing our performance using three lenses. The past, the present, and the future.

First the past, because it provides perspective and guides our present and future. Throughout McDonald's history, we respectively grown both the top and the bottom lines to varying degrees across a variety of economic and competitive cycles. We have an iconic brand an outstanding system of owner-operators, suppliers and employees and superb real estate locations in nearly every market around the world. This provides a solid foundation from which we operate.

Second, the present. In second quarter we grew revenues, operating income and earnings per share, despite the ongoing impact of the challenging environment. This is truly a testament to the fortitude and resilience of our system, our sustainable competitive advantages, and the collective focus on execution at our restaurants.

And third the future. We expect the dynamics of this cycle should persist in the near-term, namely flat to declining informal eating out markets, increasingly less ability to take price, cost pressures throughout our P&L and heightened competitive activity.

Our second quarter results tells story consistent with these lenses. Global comparable sales were up 1%, operating income was up 3% and constant currencies and earnings per share was $1.38, a 6% increase in constant currencies. And as we begin the third quarter, global comparable sales are expected to be relatively flat in July. Based on our recent sales trends, our results for the rest of the year are expected to remain challenged.

We remain committed to the plan to winning our three global growth priorities to optimize our menu, modernize the customer experience, and to broaden accessibility to brand McDonald's around the world. This customer centric plan enables us to deliver an appealing experience by offering great tasting, affordable food and beverages, and clean and modern restaurants.

At the same time, we are diligently implementing thoughtful adjustments to our proven strategies and solutions when and where needed. This flexibility has enabled us to maintain or grow market share in most of our major markets around the world.

Let's review ours results in every geographic business units, starting with the United States, where comparable sales for the quarter were up 1% and operating income was flat. We continue to appeal to our customers with an increased emphasis on new news across our menu, and an ongoing focus on everyday affordable value.

The Dollar Menu remains a foundational component of our strategy to consistently deliver value across the menu, rather than implementing aggressive short-term discounting tactics. At the same time, our focus on enhancing core classics and offering additional premium products, continues to provide customers with even more variety and choices across day parts and price points.

This quarter we introduce new items across all four key growth categories, chicken, beef, breakfast and beverages. Premium McWraps launched in April, the Blueberry Pomegranate Smoothie and Egg White Delight debuted in May and last month we added fresh new taste to our Quarter Pounder Burgers with three new flavorful recipes, Bacon Habanero Ranch, Lettuce Tomato Deluxe and Bacon & Cheese.

From a comparable sales standpoint, these new menu additions individually met or exceeded targeted performance levels. However, softer IEO environment and comparisons against prior-year promotion with chicken and beverage activity offset the sales driven by the new menu news. And while June comparable sales were slightly negative in the U.S., we continued to outpace the competitive set.

In June, I met with our leadership franchisees while they were in Oak Brook for one of their regularly scheduled meetings. While the challenges of operating a small business today are many, it is clear that we're aligned and focused on what's most important and that's the customer. It's that commitment to remaining customer centric, along with the assertive plans and vision we have in place, that enables all three legs of the McDonald's system to grow sales and profitability for the long-term.

Let's shift to Europe where comparable sales were down 10 basis points for the quarter and operating income was up 5% in constant currencies. The U.K. and Russia continued to deliver positive results, while weak performance in Germany and France persist. The U.K.'s business remains solid. Second-quarter results and continued market share growth were driven by a balanced focus across value core new products and promotional offers.

The U.K. launch blended ice beverages in June, just in time to satisfy customers craving for something cool and refreshing during the summer months. The lineup includes two delicious fruit smoothies, strawberry and banana and mango and pineapple, and a line of frappes including Carmel and Iced Mocha.

Inspired by the U.S., these new products expand the overall beverage lineup and further validate blended ice as a proven system solution that can be deployed across markets worldwide. Russia also delivered positive performance for the quarter on top of last year's strong results. In addition to a focus on the Big Mac, two seasonal premium offerings, The Royal Cheeseburger and The Big Tasty with Bacon, contributed to Russia's performance and demonstrated the strong ongoing appeal of our brand in this growth market. We expect the lower inflationary environment in Russia to continue dampening our pricing power, pressuring near-term sales momentum compared to last year.

Moving over to France, comparable sales and guest count performance remained negative as the recession continues to pressure the informal eating out industry. However, we're growing market share by balancing value and premium products across the menu. For example, France recently added two new recipes to the popular Casse-Croute entrée and drink combo. They contributed to market share growth during the lunch day part. This value offer was complemented by a strong focus on two premium beef burgers, Le M and Le 280.

In Germany, negative comparable sales and traffic trends persist. Our traffic has declined at a faster rate than the IEO industry, which also continues to contract. It's critical that our initiatives resonate with consumers in this environment and in this marketplace. So to re-establish our momentum, we are leveraging recent consumer insights and continuing to adjust our plans.

Let's shift to Asia Pacific, Middle East, and Africa or APMEA. Comparable sales were down 30 basis points for the quarter and operating income increased 3% in constant currencies. Although market share improved in China, Australia, and Japan, comparable sales were negative for our big three markets. Positive performance in other markets like South Africa, Singapore, and South Korea partially mitigated the overall segment's decline.

Markets across APMEA are taking a holistic approach to stimulating demand. Across day parts, they are offering limited time and innovative products alongside established price value platforms. In Australia, we continued to grow market share by balancing our focus on the core with new product introductions and promotional activities. Strong performance in 2012 including the launch of our Loose Change menu along with external pressures in 2013 from lower levels of consumer spending and heightened competitive activity have contributed to weaker performance.

In Japan, consumers remain extremely price sensitive. Comparable sales have been positive the last two months, and we continue to grow share by leveraging limited time offerings like the Chicken Teritama and sharing options such as the Mega Potato to keep customers coming back to our restaurants and to build our average check.

In China, comparable sales were down 6.1% for the second quarter reflecting the negative impact from avian influenza, which continues to dissipate. We remain focused on leveraging promotional activities to showcase the diversity of our menu beyond chicken and strengthening our connection with customers through our ongoing brand trust campaign that focuses on the quality and the safety of our food.

We remain confident in our ability to drive future performance in China. Going forward, comprehensive plans for our key growth areas, particularly beverages, the family business, and the late night day part remain our top priorities.

Around the world and across our system, we are focused on ensuring our strategies and tactics resonate with customers. That's the key, the key to our performance today and for the long term. As I mentioned earlier, our market teams continue to strategically and thoughtfully adjust their plans in response to local consumer dynamics and growth opportunities.

At the same time, we remain committed to prudently investing our capital and resources in those initiatives that will further differentiate us from the competition for the long term. We're broadening accessibility by adding new restaurants, we're modernizing our existing restaurants with reimages and remodels, and we continue to deploy technology and convenience initiatives.

As our predominantly franchised business model continues to generate significant levels of cash, our priorities regarding the use of cash have not changed. After investing in our business, we're committed to returning all free cash flow to shareholders over the long term, first through dividends and then through share repurchases. For the second quarter, we returned $1.2 billion to shareholders through a combination of dividends and share repurchases.

In closing I want to reiterate my confidence in our business and in the growth opportunities that exist. We are diligently focused on executing the proven strategies within our plan to win. We have a resilient business model, an aligned and talented system, and an experienced management team.

We're leveraging these strengths and making deliberate, continued progress toward winning this battle for market share and fortifying our position as our customers' favorite place and way to eat and drink.

With that, I'll turn it over to Pete.

Peter J. Bensen - EVP and CFO

Thanks Don, and hello everyone. McDonald's continued to grow revenues and net income in second quarter within the challenging global environment. The system remains focused on executing our strategies to become even more relevant to the 69 million customers we serve every day.

We continue to adjust our tactics where prudent and are committed to optimizing those factors within our control. Our financial results for the second quarter reflect these efforts to strengthen near-term performance while continuing to build our business for the long term.

For the six months ended June, system-wide sales increased 3% in constant currencies due to expansion. Combined operating margin declined 30 basis points to 30.3% over that same period, primarily due to lower restaurant margin percentages.

We are primarily a franchisor with 81% of our global restaurants operated by local businessmen and women.

Consolidated franchise margins contribute approximately 70% of our restaurant profits. This stable, predictable income stream benefits from comparable sales growth and is more insulated from inflationary and other cost pressures.

For the quarter, each area of the world contributed to franchise margin dollars growing 4% in constant currencies to more than $1.9 billion. The margin percent declined 40 basis points to 82.8% as positive comparable sales were more than offset by higher occupancy expenses.

Global company-operated margin dollars declined 1% in constant currencies to $842 million for the quarter. The margin percent decreased 50 basis points to 17.7% as higher labor, commodity, and other costs more than offset slightly positive comparable sales. The margin pressures for the quarter were most acute in the U.S. and APMEA while Europe grew its McOpCo margin.

In the U.S., second quarter company-operated margins declined 110 basis points to 18.7% due to higher labor occupancy and other operating costs. The McDonald's system is effectively managing commodity expenses with cost up about 1% in second quarter. The full year outlook for the increase in our U.S. grocery basket remains at 1.5% to 2.5%.

The U.S. has been deliberate regarding pricing seeking to remain below the food-away-from-home inflation index of 2.2%. Another relevant data point is Food At Home index which is up only 0.9%, somewhat limiting our pricing power. At the end of June, our U.S. price increase was 1.5% which is about 120 basis points less than one year ago.

As we move through the second half of the year, we will consider future price increases balancing our desire to grow traffic and market share amidst the reality of higher input costs. In addition to pricing, we're employing more suggestive selling strategies at the order point to encourage trials, new products and add-on purchases. As Don mentioned, it's a market share battle so we're employing a variety of strategies and tactics to grow traffic and increase relevance to our consumers.

Turning now to Europe, company-operated margins were probably the biggest positive of the quarter as they increased 10 basis points to 19.4%. Europe's McOpCo margins benefited from the significant contribution from the UK and Russia, our two strongest performing markets in the region who contribute nearly half of the segments company-operated margin dollars.

In addition, France and other markets realized labor productivity gains as part of their overall efforts to control costs and enhance efficiencies within the restaurants. Commodities increased about 2% for the quarter and for the full year, Europe's projected increase is now slightly lower at 2% to 3%.

Europe is a collection of 39 markets, so our price increases vary by market with Russia at the higher end due to its inflation albeit a little less than a year ago and all other markets averaging about 1.5% year-over-year. Similar to the U.S. we have less pricing power in 2013 versus a year ago.

In addition, given the economic environment in nearly all of our markets we're balancing a stronger emphasis on value with compelling premium products to effectively manage average check and margins. We have a strong underlying business in Europe and we believe we are making the right strategic decisions and value investments to protect and grow the band over the long term.

In Asia-Pacific, Middle East and Africa, company-operated margins for the quarter decreased 100 basis points to 14.3% due to new restaurant openings mainly in China along with higher labor costs throughout the segment. To a lesser extent, avian influenza impacted our sales and margins in second quarter, but our team work hard to manage expenses and other controllables to mitigate some of the negative impact.

G&A discipline remains an area of focus. We seek to grow sales and revenues faster than our G&A spend. Year-to-date, G&A as a percent of revenues was 8.8% versus 9% a year ago, which included our biennial Worldwide Convention. For the full-year, as part of our ongoing efforts we have reduced our G&A spend and now expect it to be relatively flat versus the prior-year due in part to lower incentive compensation and efficiencies we have identified.

The growth in revenues and operating income within our franchise business model translates into significant generation of cash. As Don reiterated, our first priority for this cash remains reinvesting in our business to drive future growth and returns. In light of the current environment we have trimmed our 2013 capital expenditure forecast by $100 million to about $3.1 billion. Although we will open about 50 fewer sites, we believe this is prudent given the short-term pressures. More importantly it will not undermine our long-term growth potential and the quality and returns of our new restaurants remain very solid.

The remainder of our capital is being invested in existing restaurants, in part through reimaging more than 1,600 location's, we're making steady progress in our efforts to modernize our brand with about 50% of our exteriors and about 60% of our interiors on a global basis reflecting the current contemporary look. In the U.S. this year we will touch about 10% of our traditional brief standing portfolio through a combination of reimaging, rebuild and new restaurants, this will put us close to the 50% mark. Within the next year a U.S. customer more often than us will experience our brand in a more modern and relevant manner than before. We're excited about the potential that this brings to our largest market.

Lastly, let me touch on foreign currency translation which negatively impacted second quarter results by $0.02 more than originally forecasted as several currencies weakened against the U.S. dollar during the quarter. At current exchange rates we expect a negative impact of $0.01 to $0.02 on third quarter EPS with a full-year negative impact of $0.07 to $0.09. As usual though, please take this as directional guidance only because rates will continue to change as we progress throughout the second half of the year.

Despite flat to declining and formal eating out markets around the world McDonald's grew revenue operating income and earnings per share in second quarter. Our results underscore the solid performance, the solid platform from which we are operating. A unique franchise business model that harnesses the entrepreneurial spirit of local businessmen and women will operate approximately 28,000 of our nearly 35,000 restaurants around the world. The powerful alignment of our system around the strategies and key growth priorities that have allowed us to maintain or grow our industry leading market share in most of our major markets and a strong financial foundation that allows us to invest for the future while making prudent decisions to deliver near term performance. We remain confident in our brand and the competitive advantages of our system which we believe will continue to drive positive results over the long-term. Thanks.

Now, I'll turn it over to Kathy to begin our Q&A.

Question-and-Answer Session

Kathy Martin - VP, IR

Thanks, Pete. I am going to open the call now for analyst and investor questions. (Operator Instructions) Our first question is from Joe Buckley from Bank of America Merrill Lynch.

Joseph Buckley - Bank of America Merrill Lynch

Thank you. I'd like to ask a question, maybe a multiple-part question on U.S. sales. So you commented on the U.S. second quarter performance being better than the QSR sector as a whole. Could you quantify what you think the QSR sector did for the quarter and was that also true in the month of June for U.S. performance versus IEO, and maybe in conjunction with that, just talk about pulling monopoly forward, kicking it off this week, just the rationale behind that decision?

Don Thompson - President and CEO

Hi Joe, this is Dan. Thanks so much for the question, and I'll try to address some of the points that you made, and you can -- if there's anything we missed, you let us know, but -- if we look overall in the U.S., it looks like and I'll speak from an informal eating out perspective. It appears that we gained about 10 basis points in the informal eating out category relative to traffic. So, we know that the things that we've put in place are definitely having some impact and it also speaks to some of the things that took place relative to our focus on new products. And so, again looking at the U.S., we know that this year we were lapping some of the implementations of some of the beverage strategies from last year which launched a little bit earlier, Cherry Berry Chiller. We also know there was a frappe launch earlier in the year. We also had 20 piece nuggets that were launched last year. The great thing for us is that the products that we've implemented in the chicken, breakfast, beverages, and beef category being Egg White Delight, Blueberry Pomegranate, the wraps, the Quarter Pounders, those things have performed well and met or exceeded the targeted sales, but again some of the offsets that Pete and I mentioned are some of the reasons that sales are softer aside from the fact that the informal eating out category is projected to be down about 50 basis points. So we know that, we put things in place to address that in the U.S. and we have outperformed the competition. We do know that we've outperformed them on a year-to-date basis from a comparable sales performance by a little bit over 1%.

Kathy Martin - VP, IR

All right. Our next question is from Jason West from Deutsche.

Jason West - Deutsche Bank Securities, Inc.

Yeah, thanks. I guess just one that you guys didn't touch on there was around the Monopoly pull forward, if you could touch on that and then just bigger picture, the comments in the press release and in your prepared remarks about a challenging environment over the rest of the year, I don't think you guys normally talk about the forward outlook quite this much, so I am just wondering what are your thoughts, kind of what's changed since the April call, and would we be considering kind of challenges, meaning kind of flat comps continuing over the next several months, is that the kind of message that you're trying to send? Thanks.

Don Thompson - President and CEO

Thanks, Jason. As you know, we don't give -- we're not giving out guidance, that's not our practice. We do expect the remainder of 2013 to remain challenged based on existing top and bottom line pressures. We know we're seeing ongoing global economic headwinds. We're seeing flatter declining IEO markets and ongoing competition chasing fewer guest counts as a result of a less and discretionary spending. We also know that this is a more price sensitive timeframe based on these economies, and we still have ongoing P&L pressures including higher labor and commodity costs, and we have less ability to take that price. So, relative to those things, that's kind of the -- if you would, the framework around the comments that we made, we continue to believe the long-term, the average annual financial targets that we put in place are achievable and appropriate. We do know, however, in the near term that we're going to face some tough economies around the world and the informal eating out industry is softer around the world, and a matter of fact, 7 out of -- 11 out of our top markets we're seeing contraction from an IEO perspective.

Peter J. Bensen - EVP and CFO

And Jason, regarding Monopoly, that was a decision last fall when the U.S. was looking at their calendar and looking at the product launch lineup thinking about, how do we follow-up the introduction of these great new products with a way to continue the momentum and we know that Monopoly is always a great transaction driver, and these new products are prominently featured in the Monopoly promotions, so following those product launches up with Monopoly, it seemed like a very prudent thing to do.

Kathy Martin - VP, IR

Our next question is from John Glass from Morgan Stanley.

John Glass - Morgan Stanley & Co.

Hi, thanks very much. Following up on the U.S., Don when you see the IEO market in the U.S., what definition do you use for that? It seems to me, I recall that you use a broader definition than just a quick service hamburger market; and if that's the case, could any of the weakness be described by or explained by some of your near-end competitors doing better? And secondly, what is the dynamic in the U.S.? Is the low-end customer still there, but the high end maybe moved off and maybe they're not taking you up on some of the higher end offers, what's the dynamic underneath the weakness in comps?

Don Thompson - President and CEO

All right, and thanks for the question John. First of all, the definition we use is really more of a protocol, is CREST. CREST is the information that we use relative to our informal eating out data, and they are fairly broad data base to your point. So we look at the overall informal eating out industry, that is what helps us whether it would be identifying opportunities or looking at who may or may not be doing as well in the industry at that point in time. So, it really is a good barometer of the overall marketplace that QSR segment is a little bit – it's a little bit more, I don't want to call it myopic, but it's a much smaller view of the overall marketplace. So as we've looked at that that's how we know that the overall marketplace was going to drop by about 50 basis points. Now the interesting thing about IEO is that QSR makes up the vast majority of IEO. And so, when you hear us talk about IEO, we are talking in a large part also about the QSR industry. As we look forward and if you look at who's winning, who's not winning in the marketplace, we do know that we've gained market share, we know there are a couple of other players that have gained market share. And what we do is we continue to look at our performance relative to the categories of growth which I mentioned earlier which were chicken, beverages, breakfast, and then we also look at the premium beef category which is why you saw it implement the Quarter Pounder line with the three different recipes which is why you've seen us leverage our beverage strategy, which we still have some opportunities to leverage that to an even greater extent. And so, we're going to continue to do that. But when you look across our product implementations this year, they have hit each of the growth categories, and so we feel fairly good. Those products have met or exceeded the expectations we had. As I mentioned, we did see some offset based upon last year's promotional activity particularly around 20 Piece Nuggets and in some of our beverage strategies.

Kathy Martin - VP, IR

Okay. Our next question is from Keith Siegner from Credit Suisse.

Keith Siegner - Credit Suisse Securities LLC

Thanks. If I could just ask another U.S. question kind of more broadly thinking about the IEO market, it seems like a lot of the disappointment say versus our expectations at least on this side have come from IEO market disappointment. If you think through the fact that you've got food at home now running significantly below total food away from home, even though you're running below food away from home in terms of pricing, I guess what I'm asking is, is the setup that the food away from home industry might be pricing a little too aggressively in a low inflation environment? How do you think about the relative share trends across IEO versus food at home? Thanks.

Don Thompson - President and CEO

Hi, Keith. I'm going to let Pete talk a little bit about what's taking place and relative to our own pricing. What I would tell you and I mentioned it in my comments, one thing we do see in the broader industry is we're seeing a lot of discounting, price discounting rather than consistent value platforms which we have around the globe and we've put in place, and we're going to maintain that consistency because it's important to consumers. We know that, but we have seen a lot of, I'll say, sporadic price discounting across the marketplace. But relative to what we've done and how we've seen pricing, I'll ask Pete to make some comments.

Peter J. Bensen - EVP and CFO

Yeah, Keith, one of the things I mentioned, we're up about 1.5 in pricing in the U.S. on a trailing 12-month basis. That's 120 basis points below where we were a year ago. It's clearly one of the factors that is contributing to comps maybe being not as strong as some would think. When we look at the dynamics at food away from home, it's up 2.5%; food at home up only 0.9%. That's on a trailing 12-month basis through June, so comparable to our 1.5% price increase. But for the full year both food away from home and food at home are currently projected to be up 2.5% to 3.5% each. So what will be interesting we will definitely be looking at those as we move throughout the year and making decisions about what we're going to do with price for the remainder of the year, but as you point out to the extent that food at home continues to be at a significantly lower growth rate the grocery store is a competitor and that does impact the industry's ability to pass on price.

Kathy Martin - VP, IR

Okay. Our next question is from Brian Bittner from Oppenheimer.

Brian Bittner - Oppenheimer Securities

Thank you. A bright spot in the quarter was the profit growth in Europe. You had a slightly negative comp and you're able to somewhat increase the McOpCo margins there. So can you explain how that's possible? How did that happen? And is that sustainable if we have continued weak flattish type comps over in Europe going forward?

Don Thompson - President and CEO

Hi, Brian. This is Don. I'm going to ask Tim to make some comments about Europe and productivity. I know he's made quite a few business to the marketplace there relative to what we're doing in McOpCo and how we're focused on our margins there and the profitability and productivity aspects of the business. Tim?

Tim Fenton - COO

Brian, first of all as Pete mentioned the UK and Russia have been two of our best performing countries in Europe which represent almost 50% of our company-operated margins. But in spite of – along with that, the team has really done a great job of fine-tuning their P&L efficiencies particularly in labor scheduling and food cost controls, so they've done a very good job on scheduling efficiencies and just working those through the P&L, so we're very happy with the progress they've made.

Kathy Martin - VP, IR

All right. Our next question is from Matt DiFrisco from Lazard.

Matt DiFrisco - Lazard Capital Markets LLC

Thank you. I guess just looking at the guidance and the end of the 8K there, you talk about G&A. It looks like it's a little bit of a change from previous where you were 2% to 3% constant currency growth, now you're flat. I was wondering what came out of that? Is it simply just a lower outlook brings about lower compensation or is there – some of the technology spend that you did last year that you thought was going to continue at the same pace, have you been able to save money or you're deferring that to '14? Thanks.

Peter J. Bensen - EVP and CFO

Matt, it's really a combination of factors. Obviously the technology spend we think is an important long-term differentiator for us and a lot of that is in the restaurants. So we're appropriately pacing that. There's other areas that we look at for efficiencies in terms of spending. And then finally as you mentioned, lower performance will yield lower incentive comp and so there's a lower outlook for that as well. So it's a combination of all of those.

Kathy Martin - VP, IR

All right. Our next question is from Jeff Bernstein from Barclays.

Jeff Bernstein - Barclays Capital, Inc.

Great. Thank you. Just two quick follow-ups. First, as we look at the European business, seems like economists are getting a little bit more bullish on the European economy and like people are calling for bottoming in the middle of '13 and recovery starting late in '13. So being that you get to service all those markets across Europe, I'm just wondering on the trends you see within the data, how would you size up the pace or do you feel confident, a likelihood of recovery seem like France and Germany would need to improve before perhaps the UK and or Russia slows, I'm just wondering how you'd size it up based on the data you're seeing? And the follow-up is just – I mean the quality of comments you guys gave for the rest of the – the remainder of the year being challenged. I'm just wondering because you said fairly. A couple of times I know you mentioned that you still grew revenues, operating income and earnings in the second quarter and in the first quarter as well. I'm just wondering if that's a reasonable assumption for the back half of the year or would that dynamic change? Thanks.

Don Thompson - President and CEO

Hi, Jeff. Just a little bit maybe on the European economy and then as we talk about challenges for the rest of the year. First of the all European economy, I can give you a perspective. All of us travel quite a bit to our markets. I don't know – the economists may be a bit ahead of themselves. That's my personal perspective but it's based upon the fact that if you look at GDP growth even quarter one versus year ago or even as you roll into quarter two, France is still in a recession two quarters now that we've seen negative GDP growth. We had Germany, which is negative in GDP growth. Spain is still suffering. From an unemployment perspective, you've got much higher unemployment than the norm across Europe. Youth unemployment is something that is somewhat alarming whether it be in France at 26%, Spain at 57%. You've got markets – I was recently in Portugal and Ireland, you got markets, some markets may have bottomed out. I would tell you some of the larger markets are still having some challenges. So we're looking forward to the bottom out, so to speak, and then a resurgence. At times you'll see a resurgence in some of the markets. Europe for us means 39 different areas and countries that we're working in, but it is a – it's still a challenged environment. The wonderful thing for us and I call it a wonderful thing because if we weren't focused on having implemented the value platforms when we did about a year ago, we would've lost more traffic. At this stage of the game, we are continuing to gain market share across the majority of European countries and that is the position we wanted to be in. Solidify market share, solidify customer visits, those things then we know lead to – with business you can get sales, with sales you can get profitability, but you have to have the sales coming in the front door. And so for us right now Europe is still a big challenge. As we look across the rest of the year, the notion – when we made the comment about challenge, it is similar to the second quarter. So as we see third and fourth quarters, we see them similar to the second quarter where we still see the ability for us to continue to move the business forward, however they are challenging environments, and you know we don’t give guidance but we’re just really being as transparent as we’ve always been relative to what we see in the market places.

Kathy Martin - VP, IR

All right. Next question is from David Tarantino from Baird.

David Tarantino - Robert W. Baird & Co., Inc.

Hi, good morning. My question is on the CapEx guidance revision and I just wonder philosophically why the need to turn the CapEx for this year and you mentioned that you wanted to be conservative with that even though the returns on those investments look good. So, I'm just wondering what is going on, on that line and what you might be seeing that's giving you a pause there?

Peter J. Bensen - EVP and CFO

David, it's really only about 50 openings that we trim from the guidance. So, to your point, new restaurant openings are our highest returning investments and the new openings over the last 12 months are no exception to that, they have generally being performing well. With the exception probably of China where, with the chicken issues in China and the slower economic growth there, that is the biggest of all of the markets contributing to the 50 store decline. So they took a hard look at their inventory, some of the sites they're pushing off to the future are open. And if you think about our opening cycle there is 12 to 24 months from the time we identify a site until we go to ground break, so that's a lot of time for the market dynamics to shift around a little bit. So we're just fine tuning around the edges, some of the inventory and not making any dramatic changes to our outlook for our new restaurant openings or our overall CapEx spend.

Kathy Martin - VP, IR

Next question is from Mitch Speiser from Buckingham.

Mitch Speiser - Buckingham Research Group, Inc.

Great. Thanks very much, and considering the U.S. the Company operated margin decline of 110 bips. Can you perhaps try and parse that out between cost pressures and promotional activity?

Peter J. Bensen - EVP and CFO

Yeah, Mitch. Pricing – being down 120 basis points in pricing is probably the single biggest contributor to the margin weakness there, but we had pressure across a lot of the lines in the P&L. So without that extra pricing, wage rates, little lower efficiency, we threw a lot of new products at the restaurants this quarter. So our efficiency per crew hour was down a little bit. We had additional depreciation from reimages that continue, and we had the increased additional advertising and promotional cost from the new product. So we had, on the cost side these incremental pressures that were not overcome by a stronger comp.

Kathy Martin - VP, IR

Our next question is from Michael Kelter from Goldman.

Michael Kelter - Goldman Sachs & Co.

Yeah, I guess with all respect throughout the economy being tough, ultimately between the focus on value messaging and the new products that you're saying you're all hitting targets, realistically it's just not moving the needle for you in this environment. So, I guess my question is; what do you need to do to adjust? Essentially other than the economy getting better, what are you going to do differently to get more people in the doors in the next 6 to 12 months?

Don Thompson - President and CEO

Hi, Michael, this is Don. First point and I want to reiterate it. We're winning in the market place. When we look at market share across our major markets, we are gaining market share and that's an important factor here. So, if you ask what do we need to do to adjust? I think we need to continue to adjust. We've been adjusting now for about the last couple of years relative to making sure we had solid value platforms. We've ensured that we have a good mix of value and premium based products, so we can gain as much margin as possible. What we don't have and Pete just mentioned it, is we don't have as much pricing power. And as long as inflationary rates are lower and as long as GDP growth and consumer discretionary spending is softer we're not going to move forward and take a lot of price because we know that it would mean guest count erosion longer term. So we'll be mindful of the price increases that we take. We'll continue to make sure that our value platforms are installed and strong. We'll make sure that we have a very solid menu pipeline which has helped us to as you see in the U.S. to outperform the competition in mass, and so when we look at what we're doing now, we think those are the right things to do. Pete mentioned growing the business and developing new sites. Our new sites are performing relatively well and so we're going to continue to invest capital there. The returns on reimage sites when you have less comparable sales that gets a little bit tight and we'll continue to monitor that, to Pete's point is we always do from a financially responsible perspective, but good pipelines, good value, good marketing campaigns, those things will continue. As I mentioned, we'll continue to invest in technology and we think we do still have some room to grow relative to some of the things we can offer our consumers from an engagement perspective there, and we'll continue to make sure we have good marketing spend, good awareness relative to our advertising. So, we're going to continue doing those things and implement those solidly. We'll continue focusing on the growth strategies we've talked about. There is room to grow in beverages, and in chicken, and in breakfast, and we're moving breakfast around the globe. So all of these pieces are the things that for us we still have a lot of work to do at McDonald's and we'll continue to focus on those areas.

Kathy Martin - VP, IR

Next question is from Jeff Farmer, Wells Fargo.

Jeff Farmer - Wells Fargo Advisors

Don, I just want to get a better read on your view of the U.S. consumer. It looks like obviously both quick service and casual dining consumers in the U.S. are pulling back on spending pretty dramatically in June and July. So from what you're seeing with your own customers, what are some of the key economic drivers on the more conservative behavior and what I mean is just more specially the last couple of months, it seems like a line has been drawn in the sand, consumers have definitely stayed away from pretty much all forms of restaurants or at least cut down on their occasions, I mean again just curious what your view is on what's going on?

Don Thompson - President and CEO

Hi, Jeff, a great question and the way you positioned it is accurate as we've seen it. We have not drawn a direct correlation as if yet, the sequestration or other I'll say tactical executions that have occurred in the U.S. what we do know is that there was a pullback to some extent, and it does seem to be impacting the informal eating out industry a little bit more or so than broader retail. So, again what we have to do is make sure that we institute and continue to have solid value and we have to do that by balancing and also with some innovative new news, this is going to be absolutely critical for us as we move forward. We have to continue to invest in the business appropriately, but make sure we're mindful of the returns. I don't foresee this changing in the next couple of months which is why we spoke of the rest of the year being challenging. And what we see in the United States is not unlike what we see in some of the other markets that are out there. Having said that, we feel pretty solid about the fact that we can continue to gain market share and that our focus. And if we can do that, we'll gain additional guest counts, we'll gain additional sales and we'll gain additional profitability. The pricing piece that Pete mentioned again is going to be tougher through the rest of the year in terms of taking price. So, we'll be monitoring that and measuring that relative to our margins. But again the market place itself is a little bit -- it is a little bit tighter than we've seen. But one thing we've never done at McDonald's, we don't cry or whine over market conditions, because all of us are in the same market conditions. So we just have to stay focused on what we do best which is move the business in the way as we've discussed today.

Kathy Martin - VP, IR

Next question is from Andy Barish, Jefferies.

Andy Barish - Jefferies

Hey, guys, one quick follow-up and then one new area. Just in terms of the monopoly shift does that open up the October window for a new product platform potentially here, and then just on the new front, on franchise margins they continue to slip a little bit; is that purely a function of getting comp back into solidly positive territory to see return or should we expect some of the higher D&A and occupancy to continue to weigh at least near term on franchise margins?

Don Thompson - President and CEO

Hey, Andy I'm going to let Tim make a comment relative to monopoly. I think he'll make a pretty solid point about whether or not it opens up another opportunity, clearly we can speak to specifics but he just finished one of the reviews with the U.S. business, so he can give you a couple of headlines as to some of the things I discussed. Relative to franchise margins we'll have Pete make a comment on that after Tim.

Tim Fenton - COO

Okay, well Andy I can't say specifically on what products we have coming in, but we have a pretty robust fourth quarter -- third and fourth quarter coming down the pike. And as far as monopoly we moved it in as everyone has stated already and really take advantage of the food traffic that we do have in our third quarter. So, product's coming, can't get specific on it.

Peter J. Bensen - EVP and CFO

Andy, you point out the franchise margins they are compared in the capital margins. They're even more sensitive to the comp because the base of cost is more fixed. So the depreciation and the rents are really – we really need a stronger comp to start to get that percentage to move upwards.

Don Thompson - President and CEO

Andy too, and I know we've talked about this and we've tried to relate on the call, the new products that we've implemented have resonated with consumers. And I want to make sure that everyone understands that IEO is relatively flat and declining in many of the markets around the world. So we're not going to change that menu pipeline execution strategy. It is absolutely working. However, we are facing some headwinds and so we'll continue to execute that, continue to make our target to outperform in the marketplace as a whole. But I think you are quite clairvoyant to the fact that there may be something that does come up in the latter part of the year relative to new products.

Kathy Martin - VP, IR

All right. Next question is from Bryan Elliot, Raymond James.

Bryan Elliot - Raymond James

Thank you. I'd like to talk about competitive environment outside of the U.S. So the informal eating out market particularly in Europe has been soft for some time. Are you seeing evidence yet of some shrinkage in supply and also thinking about China, which has been through a meaningful short-term contraction, if there's been any shakeout of competition, particularly thinking of maybe of local type, non-deep pocket type competition and if you're seeing any benefit potentially down the road from some of that?

Don Thompson - President and CEO

Hi, Bryan. Outside of the U.S., some of the competitive sets are different. I'll ask Tim to speak a little bit to some of the things that he's seeing out there. But keep this in mind. The U.S. is – there are a couple of markets that are similar to the U.S. and not quite to the U.S. level relative to the competitive density of competitors as we know them. In many of these cases you have more as we would define them smaller chains, mom and pop type organizations. So we do see consolidation in some of those smaller ones when you get into recessionary periods or macroeconomic conditions like these, but relative to whether or not we've seen larger chains that are consolidating that's not something that I have seen. But Tim, I don't know what else we've seen out there in your travels.

Tim Fenton - COO

Bryan, a lot of couponing and vouchering going on, but we're seeing a rise in the non-traditional competitors that we've faced in the past, particularly cafes, convenience stores, bakeries and supermarkets coming up with ready-to-eat meals. So that's been a resurgence for them, particularly in Europe. On China, the overall chicken market is kind of taking a step backwards as it pertains to the IEO. It's starting to dissipate now and coming back but particularly I would say in Western QSR has probably taken the biggest decline.

Kathy Martin - VP, IR

All right. Our next question's from John Ivankoe, JPMorgan.

John Ivankoe - JPMorgan Securities LLC

Hi. Thank you. It seemed in the last release, in the April release and on that conference call, you were a little bit more protective about profitability in the U.S. and I wonder if there is a change if I'm right in sensing that, there is a change relative – how we're thinking about the business now? And of course I ask that in the context of the franchisees, which I think make more money per store level than – I know make more money per store level than any other major franchisee group if they've really signed on to I think what you're asking them is less pricing, continue with the Dollar Menu, focus on driving traffic even if it doesn't necessarily come to an extent of increasing their near-term store level cash flow?

Don Thompson - President and CEO

Hi, John. Thanks for the question. I would tell you the franchisees have done I think a stellar job in this environment and if you think about it from their perspective, several things. One is they've definitely been aligned relative to the things that we have asked of them focusing on the customer, ensuring that we continue to invest in the business, whether it be reimages or whether it be with new products and the new product introductions. We have really accelerated some of those introductions and getting those to the marketplace because it's very important to have new news and exciting news as well as to execute value. They have been very, very aligned on the value campaign and platform. Having said that, they've given a lot of feedback relative to what does the Dollar Menu look like today and how we need to maintain that and what things we might need to look at in terms of any modifications at any point in time. So I think the franchisees have done a really, really solid job. They've continued to invest in the business and we along with them in the business, they are one of the greatest assets to this overall McDonald's family has. I'd also add along with that, our suppliers because they are in an interesting commodity and legislative environment as well as the franchisees and small business owners. And they also have supported our system relative to how we want to be able to manage through these macroeconomic issues around the world. And so I can't say anything but be complementary about what our franchisees have done relative to the cash flow investments, their focus on the business, their focus on the customers, their focus on their employees and they're focused on a broader alignment around the McDonald system.

Kathy Martin - VP, IR

Next question is from R.J. Hottovy from Morningstar.

R.J. Hottovy - Morningstar Research

Thanks. Good morning. I wanted to keep it in the U.S. for a minute. You talked about the new products, innovations meeting or exceeding expectations. I was hoping to get some color on the Dollar Menu, just in particular your thoughts about the recent Dollar Menu performance and how that compares to your expectations especially with so much promotional activity in the environment? Thanks.

Don Thompson - President and CEO

Hi, R.J. The Dollar Menu itself still represents about 13% to 14% of sales, which is still in that same range it's been in. What has benefited us has been the fact that it is a consistent execution and it still has tremendous alignment across the franchises and the McOpCo restaurants that we have. So it is the value platform of choice. Now we've done a couple of things to try to add some new news to that which also help us to be a little bit more margin accretive, things like the Grilled Onion Cheddar Sandwich, Hot 'n Spicy McChicken limited time offer selections that we placed into the Dollar Menu. Even having done those, we still remain at 13% to 14% of sales based upon the Dollar Menu. So it is a solid platform for us. The last thing I'll mention is, early on we talked about the fact that there are – Tim mentioned we see a lot of discounting in the broader marketplace. We know that one of the most important things that customers look for is consistency in terms of the value platform. They want to know that they can depend on McDonald's to continue to deliver value every day all day and the platform for us is more than about short-term discounts. It's about establishing customer loyalty versus being aggressive for one or two months. We need long-term loyalty. We want a strong customer base. We want to make sure we drive business frequency and we want to support the introduction also of higher margin products, so build the base so that when we implement new products, those products have more awareness relative to our consumer base. So we've established these branded affordability platforms around the world now and they are performing to the levels that we would like. We have a couple of markets, R.J., that we still need to do a little bit of work and Tim is focused on some of those markets. But by and large, we're in a pretty solid place relative to the value platforms around the world.

Kathy Martin - VP, IR

Next question is Peter Saleh from Telsey Advisor Group.

Peter Saleh - Telsey Advisory Group LLC

Great, thank you. I know it's still early but maybe you could give us a little bit of a preview on your outlook for commodities for 2014. We've seen the grain prices coming down and I remember last summer, we had gain prices really shooting up because of the drought and your team in the U.S. at least was able to do a pretty good job in terms of your exposure for this year. So any thoughts on '14 would be pretty helpful?

Peter J. Bensen - EVP and CFO

Yeah, Peter, it's premature for us to give any numerical guidance but you can imagine as you point out that our team is constantly looking at how do we best deliver that stable, predictable price to the restaurants. While we're not trying to be market timers, we obviously do look at the markets to see when conditions might be better to layer on some coverage and you can imagine that we are working with our suppliers and our suppliers are putting hedges on, going into next year to provide us some of that stability. Probably at the Analyst Meeting in November it's when we'll start to give some numerical texture on 2014.

Kathy Martin - VP, IR

Your next question is Nicole Miller from Piper Jaffray.

Nicole Miller Regan - Piper Jaffray & Co.

Thanks. You've talked about new news and I'm wondering if it's fair to kind of assess that as evolutions of current platforms and I am asking because it seemed like you bought a lot of customization of these platforms to the menu and I'm wondering how you feel about that being a key driver of sales and profits versus your peer group?

Don Thompson - President and CEO

Hi, Nicole. I think you see both. You'll see some areas that are customization, if you would, and I assume you're talking about things like the Quarter Pounder line, which will also see some new platforms like you're seeing with McWraps. You will see us also do limited time offers. So relative to beverages or whether it be the other products that we'd implement. I think Tim gave some insight as to other thing that we might see in the U.S., but this is consistent also Tim around the world.

Tim Fenton - COO

Yeah and in the U.S. Egg White Delight being able to put that different muffins and different carriers. But as we move into the platform deployment of made for you, you're seeing more customization.

Kathy Martin - VP, IR

All right. We have time for one last question. Paul Westra from Stifel.

Paul Westra - Stifel, Nicolaus & Company Inc.

Great. Thank you. I was wondering if we get an update on the value menu efforts in France, particularly maybe Australia a bit. I know you [indiscernible] menu there and given a softness economically, I was curious to give as much color as we can about the mix, the value effort there and may be the percentage of add-on sales within that menu that helps pay for it, is that progressing as planned? And I guess a related question to the loose menu effort in Australia. I'm just somewhat surprised about the overall comp going negative with the great success of the loose menu, seems would have prepared you well for this year's economic softness, and curious maybe about market share changes in Australia as well?

Don Thompson - President and CEO

Hi, Paul. I will – I can speak to the end of that with Australian market share changes and then I will ask Tim to talk about the other part of your question, which was France and France's value piece. Relative to Australia, Australia is another one of those markets that at this point in time we see from their perspective you're seeing some softer – clearly a softer economy, youth unemployment in Australia is about 25.5%. So they're facing some thing, unemployment for them has risen. Having said that, Australia is also one of the markets that we've had some solid share gains in and continue to have share gains in Australia. The – so the broader marketplace we've seen some – we see some tough economy, but we've also seen some share gain and we've seen our business meeting forward there. And again, I think the franchisees and the folks, the Company employees and suppliers have done a good job there. So, Tim anything on France?

Tim Fenton - COO

Yeah Paul, France if you remember us talking about Casse-Croute, which is a Baguette Sandwich and a drink for under €5 has done extremely well for us, particularly in the lunch day part. France is gaining market share in a declining IEO environment. The thing that we're working on to address is looking at some erosion at the dinner time and the folks have done a really good job of putting some products in test to address that, but it's a tough environment there. They're gaining share at the expense of the rest of the IEO players.

Kathy Martin - VP, IR

All right. Thanks everyone. We got some final remarks from Don.

Don Thompson - President and CEO

First of all, thank you all again for being on today's call and participating. And as we wrap up the call, I want to make sure that you all understand that while we recognize that this is a challenging environment, we've been through challenging environments before as McDonald's. Our confidence in our brand and the competitive advantages of our system, truly are strength and a reflection of our ability to build on and learn from the past, having went through cycles before, these are different when you see them in the broad nature of these around the globe. But we've been purposeful and we've been agile, very flexible in our local markets about how we address some of the challenges there.

We are going to be and continue to be strategic relative to the way that we plan and evolve based upon customers spending habits, their discretionary opportunities, and the fact that we want to be their favorite place and wait to eat. So we look to evolving with our customers, evolving in these marketplaces and leveraging our history to make sure we mitigate through these challenges. Thanks so much for all of your support and your questions and have a great day.

Operator

This does conclude today's call. At this time you may disconnect your line.