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McDonald's Corp. (MCD)

Q4 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Hello and welcome to McDonald's Fourth Quarter 2020 Investor Conference Call. At the request of McDonald's Corporation, this conference is being recorded. Following today's presentation, there will be a question-and-answer session for investors. [Operator Instructions]

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

Mike Cieplak

Corporate Vice President-Investor Relations Officer, McDonald's Corp.

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

I want to remind everyone that the forward-looking statements in our earnings release and 8-K filing also apply to our comments on the call today. Both of those documents are available on our website, as are reconciliations of any non-GAAP financial measures mentioned on today's call with their corresponding GAAP measures.

Following the prepared remarks this morning, we will open the queue for your questions. I ask that you please limit yourself to one question. And if you have more than one, please ask your most pressing question first and then re-enter the queue. Today's conference call is being webcast and is also being recorded for replay via our website.

Now, I'll turn it over to Chris.

Chris Kempczinski

President, Chief Executive Officer & Director, McDonald's Corp.

Thanks, Mike, and good morning, everyone. At our Investor Update in November, I talked about the start of something new for McDonald's. It was a moment in which we proudly embraced both what we were going to do to write the next chapter of McDonald's growth and how we were going to do it.

We shared our new growth strategy, Accelerating the Arches, and articulated a clear vision of where we intend to make a difference in a world in need of community and connection. We also acknowledged that between a once in a century pandemic, a record economic downturn and profound societal challenges, it was the most difficult year McDonald's has seen.

While a new year brings new hope, the issues and uncertainty that emerged last year persist. As I reflect on all that has happened even since November, I come back to something Ray Kroc once said. Adversity can strengthen you if you have the will to grind it out. Through all the adversity of the last year, we have seen and done important things that reinforce why we are on the right path.

We have seen the incredible courage and resilience of our McFamily. We know how to run great restaurants. Our long legacy of execution prowess comes from the talent of our teams. From franchisees to supply chain partners and employees, I don't think it's an exaggeration to say that 2020 will be remembered as one of the most challenging, yet inspiring, moments in the long history of this great brand. By making safety and service a priority,

by implementing the largest and fastest rollout of new safety protocols in McDonald's history and partnering with the Mayo Clinic to review and refine our approach, by maintaining supply without interruption, by simplifying our menu, and by continuing to put our customers and people first, all three legs of our stool embodied our values in the best possible way, by living them every day.

And our customers have noticed. Global brand scores for consumer confidence in eating at McDonald's have risen significantly since the start of the pandemic. We've seen the love people have for McDonald's and our food. Even while the pandemic forced lockdowns and prevented customers from dining in most of our restaurants, we achieved over \$90 billion of systemwide sales last year. Tens of millions of people every day continue to choose McDonald's for our drive-thru, contactless delivery, takeaway and curbside pickup, with more and more customers using our app. And that commitment showed. Despite resurgences of the virus and restrictions on restaurants in the fourth quarter, we continue to see sequential improvement as we delivered our strongest quarter of the year, recovering nearly 99% of 2019 global comp sales.

Global comp sales for the full year were down 7.7%. While there were challenges across markets, some of our larger markets achieved positive comp sales for the full year, including the US, Japan and Australia, and that was on top of strong momentum coming into 2020. US delivered its sixth consecutive year of positive comps. The average US franchisee restaurant operating cash flow reached an all-time high in 2020, up nearly \$40,000 over 2019, and up about \$100,000 over the last three years. Japan has achieved five consecutive years of positive comp sales. And Australia posted its seventh consecutive year of positive comps. We have seen the ability that McDonald's has to survive hard times and to do so while consistently investing to support both the short and long-term.

One thing I admire most about our system is that, no matter how difficult times get, we never stop thinking about what's next. The impacts of COVID on our industry have been significant. It's been tough. We were sober and realistic from early on, while remaining committed to helping every operator and partner survive this crisis. We took prudent, quick action designed to prevent not a single Owner/Operator from failing due to the pandemic, why we bolstered our cash position early in the year to provide nearly \$1 billion in financial liquidity to support franchisees.

We also maintained our view on the long-term as we invested \$1.6 billion of CapEx to open nearly 1,000 new restaurants globally and modernize another 900 in the US, provided \$200 million incremental marketing support to accelerate the recovery. And together with our franchisees, we invested over \$1 billion in technology in digital initiatives, all of which will help drive our next chapter of growth.

We've also seen our commitment to feed and foster communities take on new meaning this past year. There are so many incredible stories about how the McDonald's System has stepped up to be there for our neighbors and communities this past year. To name a few, together with our franchisees, we provided more than 12 million thank you meals to First Responders and health care workers in the US. We donated extra food within our supply chain to communities in need around the world. We gave millions of surgical masks to communities to help protect first responders. And in November, we announced our commitment to donate \$100 million over five years to help families with sick children through Ronald McDonald House Charities.

We were on the ground, working to help local communities solve problems while also looking for ways to use our size and scale to make an even bigger impact. It was an important reminder that brands like ours can help provide stability, and even hope, during difficult times.

Today, brands are working through many societal issues that directly impact our businesses and the economy. And we have a unique role to play in ensuring these issues get addressed. That's true of COVID. Hard to imagine that it was just a year ago last week that the first case of the coronavirus was confirmed in the US. Even while we celebrate a vaccine created in record time, we know that COVID is at its worst right now in many parts of the world, that so many of the communities we serve are experiencing record-high infection rates. We all must play a role as part of the solution.

There's a lot of uncertainty ahead for us as individuals and for this industry, and neither may change for some time. We look forward to joining with other business leaders and working with the Biden Administration and Congressional leadership, as we have with every US President throughout our 66-year history, to address the challenges the country faces.

As we work to hopefully return to some version of normal, the needs of our customers have changed. They're dining in less and taking out more, visiting less in the morning and much more for lunch and dinner and interacting with other people and brands less in-person and more through digital. Just as the investments and choices we've made have driven broad-based strength, Accelerating the Arches will enable us to grow even more sustainably with a bottom-up approach to our growth pillars, our MCDs.

M stands for maximizing our marketing, so our significant marketing investment remains a true growth driver. We're improving creative effectiveness and leaning into social and digital to drive customer engagement. Teams remain focused on the right balance of sales activation with brand building as we work to optimize marketing returns.

We made an immediate impression in the closing weeks of 2020 with the launch of our Serving Here campaign in the US, celebrating the myriad ways we feed and foster communities. At the same time, many markets drove performance in the fourth quarter with successful sales-building promotions like 30 Deals in 30 Days in Australia, and Monopoly in Australia, France and Canada, featuring customer's core favorites. These are great examples of using our marketing muscle to drive sales without adding complexity to our kitchens.

C stands for our commitment to the core menu. Our delicious core is something people rely on and return to again and again. Our core classics comprise roughly 70% of our food sales across our top markets. They drive growth and profitability and we saw that this past year.

Developing a reputation for great chicken represents one of our highest ambitions. That's why markets are activating multi-tiered strategy and holistic approaches that integrate great products, strong and sustained marketing, and operations excellence. We're building on the strength of core equities like Chicken McNuggets and McChicken sandwiches, which have seen significant growth, as we continue to focus on improving our large chicken sandwich offerings around the world. In the US, we're excited about the return of Spicy Chicken McNuggets and the launch of the new Crispy Chicken Sandwich at the end of February.

Markets are also making our delicious and popular 100% all-beef burgers even better with improved cooking procedures and new buns. Russia was the latest major market to roll out these changes in Q4, driving meaningful lifts in hamburgers sold.

We've also continued to create menu excitement that keeps customers engaged by bringing back limited-time promotions like McRib, and introducing new items like our bakery line in the US and the premium McBaguette and Signature Recipe in France.

What's important is that our approach to our menu is thoughtful and judicious. We've seen significant benefits with our streamlined menus and reduced complexity. New items must earn their place on the menu.

Lastly, D stands for doubling-down on digital, delivery and drive-thru. They were the difference-maker when the pandemic hit and are at the heart of our combined efforts to create a faster, easier, better customer experience. Digital sales exceeded \$10 billion or nearly 20% of systemwide sales in 2020 across our top six markets. We're moving aggressively to bring My McDonald's with mobile ordering, payments, delivery, rewards and fun promotions like digital calendars to our customers as soon as possible. We're on track to have elements of My McDonald's across our top six markets by the end of 2021, featuring loyalty programs in several of those markets, including a US loyalty launch later in 2021.

We have big ambitions. We've already shown we know how to meet big goals, as we've proven with delivery. The past four years, McDonald's has expanded the number of restaurants offering delivery to nearly 30,000. And COVID has underscored how meaningful our efforts have been to our customers. Many markets, including Australia, Canada and the US, have doubled their delivery sales mix over the past year.

We continue to build out our delivery advantage, much like we're expanding our competitive advantage on drive-thru. With over 25,000 drive-thrus around the world, we've made smart investments to bolster foundational elements like staffing, positioning and order assembly. We've reduced service times each of the past two years, even as a greater percentage of customers went through our drive-thrus during 2020.

While each pillar will further extend our leadership, what's especially powerful is the exponential impact when all three pillars come together. Famous Orders platform in the US is a prime example. In the fourth quarter, we featured favorite menu items of Latin music icon, J Balvin, and classic holiday characters, including Santa Claus and the Grinch. With exclusive deals on our app, customers rediscovered iconic core menu items like Big Macs and Egg McMuffins, and tried new items like cinnamon rolls. And we drove digital adoption, including significant lifts in app registrations and use. That's our sweet spot. That's how M,C, and D come together to drive demand, sales, and growth without creating additional complexity.

Our ability to navigate the past year would not have been possible without the incredible commitment of our franchisees, our supply chain and agency partners and our employees, who have continued to focus and execute during this extraordinary past year. When I think about everything our restaurant teams around the world have done to provide an essential service at the front lines, serving our customers safely every step of the way, I can't help but believe that this amazing system is proving every day, this isn't just a job. To them, and to us, it's something bigger. It's our chance to make a difference for our customers and our communities.

I'll now turn it over to Kevin to talk in more detail about our financial results. Kevin?

Kevin M. Ozan

Chief Financial Officer & Executive Vice President, McDonald's Corp.

Thanks, Chris. Chris talked a bit about our full year results, but let me spend a few minutes talking about the quarter.

Global comparable sales were down 1.3% in Q4. Comp sales were positive in October, as I mentioned on our Q3 call, but they returned negative in November and December as a result of the widespread resurgences and the return of government restrictions, particularly across the International Operated Markets.

In the US, comp sales increased 5.5% for the quarter, ending the year with six consecutive months of positive comps. Sales grew in all major dayparts, including breakfast, and this is on top of prior-year growth across these dayparts. Our strategic investments, including incremental marketing spend, fueled our momentum with strong national promotions like McRib, buy one get one for \$1, our new bakery line and two separate offerings of Famous Orders. Dinner continued to be our leading daypart, with strong sales of core items as customers keep coming back for familiar favorites.

In the IOM segment, comp sales were down 7.4% in Q4. And while performance varied across the countries, nearly all of our major markets grew traffic share. Strong positive comps in Australia and the UK were more than offset by negative double-digit comps in France, Germany, Italy and Spain.

Beginning at the end of October, additional government restrictions went into effect across many of our markets, including limited sales channels, reduced operating hours and dining room closures. Australia benefited from strong menu and marketing news in the quarter, including the successful launch of a new chicken line with McSpicy at its center, another example of great ideas and products traveling across our markets, as McSpicy has been a customer favorite in China and several other markets in Asia for a while. Since the start of the pandemic, Australia has also doubled their delivery sales.

The UK has achieved comp sales growth every month since August, despite increased restrictions reintroduced in early November. The quarter benefited from a focus on core menu as well as phenomenal growth in delivery. And finally, comp sales in the International Developmental Licensed segment were down 3.6% for the quarter, reflecting significant improvement for most markets over Q3.

Japan once again delivered strong positive comp sales for the quarter and for the year, as Chris mentioned. The market is meeting customer's changing needs, growing delivery in mobile ordering, along with running successful LTO promotions, all while further strengthening trust in our brand.

And in China, results have improved quarter-over-quarter since Q1. Recovery continued on a steady pace, with a marketing plan focused on delivery and digital along with new chicken offerings. And despite the challenging year, nearly 500 new restaurants were opened across the market in 2020.

Turning to January trends, in the US, sales comps continue to be strong and are expected to be up high single digits, with continued growth across all dayparts and assisted by consumers receiving government stimulus checks. IOM comp sales are projected to be down low double-digits, given the government restrictions that remain in place in most markets. Continued momentum in Australia is being more than offset by double-digit negative comps in France, Germany, Italy and Spain. And we expect this trend to likely continue until dine-in resumes.

Adjusted earnings per share in Q4 was \$1.70, after excluding gains on the sale of an additional 3% of our ownership in McDonald's Japan. While global restaurant margins were down as a result of the pressure on sales, the US grew both franchised and company-operated margins up over \$70 million for the quarter.

Consistent with the guidance we gave in our third quarter remarks, G&A increases for Q4 were primarily driven by some one-time investments we made in renewed brand activity, including the launch of our Serving Here campaign and our commitment to donate \$100 million to Ronald McDonald House Charities, as Chris mentioned earlier.

Turning to our outlook for 2021, as Chris talked about, there's still a lot of uncertainty both today and as we look ahead. We're confident in our ability to manage through this uncertainty, and that our Accelerating the Arches strategy will continue to drive growth in the business. We expect 2021 systemwide sales growth of low double digits in constant currencies versus 2020, with new unit expansion contributing about 1%. This reiterates the mid-single-digit growth rate off of 2019 that we mentioned in November.

We ultimately measure overall financial efficiency by our operating margin, as it serves as the most comprehensive gauge of our operating performance. We expect our operating margin percent to be in the low-to-mid 40s for 2021. In the US, we expect higher depreciation expense of about \$60 million versus 2020 in franchise margins related to our modernization efforts. Depreciation will continue to be a P&L headwind for the next few years, even though it will have no impact on future cash flows.

In the IOM segment, while we expect improvement in our company-operated margin percent over the course of the year, we don't expect to get back to pre-COVID levels in 2021, as a result of near-term sales and cost pressures.

Turning to G&A, as we've become more efficient with G&A required to run the business, we're able to make strategic investments in areas like digital and technology to drive growth. Looking ahead, we expect 2021 G&A to decrease about 2% to 4% in constant currencies over 2020, which reiterates our expectation that G&A will be about 2.3% of systemwide sales.

Looking at other operating income and expense, we expect our equity pickup to be slightly higher for 2021 due to improved results versus 2020, partially offset by our reduced ownership in Japan. Gains on restaurant sales last year were suppressed due to COVID, so we expect gains this year to be about double that of 2020.

And finally, in 2020, we had some one-time items included in the asset dispositions line related to store closings and bad debts. For 2021, we expect that line to get back to a more normal level of expense of roughly \$100 million. We're projecting our 2021 effective tax rate in the range of 21% to 23%.

And finally, turning to FX, based on current exchange rates, foreign currency translation would benefit EPS by about \$0.06 to \$0.08 in the first quarter and \$0.27 to \$0.29 for the full year. As usual, this is directional guidance only as rates will likely change as we move throughout the year.

Moving to capital expenditures, as we indicated in November, we expect to spend roughly \$2.3 billion of capital in 2021. New restaurant development is an important driver of our growth as we see significant expansion opportunity, especially in the IOM segment. These markets have driven strong growth over the past several years and deliver strong returns on new restaurants.

This year, we plan to open over 1,300 new restaurants globally. Of the \$2.3 billion of capital, we'll spend roughly half of that to open nearly 500 restaurants in the US and IOM segments. The remaining 800-plus new restaurant openings are across the IDL markets, including nearly 500 in China. As a reminder, our strategic partners in these markets provide the capital for restaurant openings.

The remaining half of CapEx spend will go towards reinvestment back into our US and IOM restaurants, including about \$500 million to modernize approximately 1,200 restaurants in the US. We're nearing completion of our US modernization efforts and expect over 90% of projects to be complete by the end of the year.

And finally, I want to conclude with our free cash flow profile. With the improvements made to our business operating model over the last several years, and the consistent strength of our global business, our free cash flow grew significantly through 2019. In 2020, even with significant disruption, we generated free cash flow of over \$4.5 billion. And free cash flow conversion, which measures our ability to convert bottom line earnings to free cash flow, was nearly 100%. In 2021, we expect to convert more than 90% of our net earnings to free cash flow and to generate free cash flow near 2019 levels, or about \$5.5 billion to \$6 billion.

Our capital allocation priorities remain the same. First, investing in the business to drive growth. This includes both capital expenditures as well as investments in technology and digital. Second, prioritizing dividends to our shareholders. After that, most of our remaining free cash flow for 2021 will go towards paying down debt to get back to pre-COVID leverage ratios by the end of the year.

As we start the new year, I'm confident that the plans we have in place will position us to continue to deliver sustained, long-term profitable growth for our system and shareholders.

Now, I'll turn it back to Chris to close.

Chris Kempczinski

President, Chief Executive Officer & Director, McDonald's Corp.

Thank you, Kevin. Despite the uncertainties we continue to face, one thing is clear. McDonald's is well-positioned to emerge from this moment with competitive strength and we're confident we can keep capturing market share as we look to the future.

We're confident because we were growing share in most markets before COVID. We're confident because we've continued growing market share during COVID. And we're especially confident because we've gained important insights which will bolster the strategic vision we set with Accelerating the Arches.

This clarity of purpose and strategy is the reason that in October we increased our annual dividend to shareholders. Not only did it mark 40-plus consecutive years of increases, it reinforced to our shareholders our confidence in the long-term strategy. It's also the reason we continued directing investments where they make the most strategic sense and build on our strengths. We'll uphold McDonald's commitment and legacy as a responsible and reliable choice for trusted delicious food, and we'll do so while feeding and fostering community and continuing to create delicious feel-good moments for everyone.

This is the mission that has always, and will always, [ph] animate our work, because

(28:26) when it comes to our customers, our employees, our franchisees and our suppliers, it doesn't just matter what we do. It matters how we do it.

And now, we'll begin Q&A.

QUESTION AND ANSWER SECTION

Mike Cieplak

Corporate Vice President-Investor Relations Officer, McDonald's Corp.

A

All right, thank you. [Operator Instructions] Our first question, to get us started, is from John Glass with Morgan Stanley.

John Glass

Analyst, Morgan Stanley & Co. LLC

Q

Thanks. Good morning, everyone. Chris and Kevin, can you talk a little bit more about the IOM markets and the tactics you're using to drive sales? I understand that dine-in is more important. There's less drive-thrus structurally, but what are you doing to help sort of bridge this gap to get to easier comparisons in the reopening? Is this a market, for example, you might try launching the My McDonald's Rewards earlier? Can you talk about maybe the role of delivery and what you're doing to delivery, some things that can help obviously bridge this gap when you've got such restrictions in place?

Chris Kempczinski

President, Chief Executive Officer & Director, McDonald's Corp.

A

Hey, John, this is Chris. Thanks for the question. And you know, in the IOM market, as you know, it is – those markets tend to be more of a dine-in business. And so, the biggest thing that we're doing with many of these markets having dine-in closed, is we are trying to do as much as we can to drive our drive-thru, delivery, our digital businesses and we're having good success with that.

Some of it, though, is, frankly, limited because in many markets, there are hour or operating hour restrictions, 6:00 PM, 8:00 PM, et cetera. So I think part of what we are trying to do is, with our franchisees, so long as we are dealing with government restrictions around what you can open, how long you can be open, it's about supporting the franchisees, as we said in the opening remarks here, making sure that all of our franchisees have the liquidity that they need to get through it.

As you come through, though, I think the plan that we laid out, which is focused on driving core menu in the 3 Ds, that's the way that we really come out of this I think in a very strong position. And we've seen, as we've gone through this, one of the things for us, we've discovered capacity that we didn't even realize we've had. We – think in the last year, we've moved something like 300 million additional cars through our drive-thrus. And if you'd asked me a few years ago, I was thinking that we were pretty maxed out on drive-thru. So I think our guys are setup well to get after this, but as we're continuing to deal with some of the short-term restrictions, it is challenging.

Kevin M. Ozan

Chief Financial Officer & Executive Vice President, McDonald's Corp.

A

The only thing I'd add, John, is, as Chris mentioned, obviously we're seeing both digital and delivery growing significantly in those IOM markets. In the UK, for example, over 20% of their sales in Q4 were delivery sales, so we are seeing some significant growth both in delivery and digital.

The other thing I would point out is this is nothing structural. This is a temporary issue. And the reason I think we're confident in saying that is if we look back at even as recently as October, we were relatively flat in IOM in

October, but as the new restrictions come back, that's when we see kind of comps going down again. So as soon as the markets start opening up again and easing restrictions, I think we're pretty confident customers come back pretty quickly, and we'll be setup well.

Mike Cieplak

Corporate Vice President-Investor Relations Officer, McDonald's Corp.

A

Our next question is from Eric Gonzalez with KeyBanc.

Eric Gonzalez

Analyst, KeyBanc Capital Markets, Inc.

Q

Hey. Thanks for the question and good morning. I was wondering how you think fast food chains like yourself might fare as the world gets through the vaccine recovery phase? And clearly, there's been a high demand for contactless and home meal solutions during the pandemic, as evidenced by the increased average check, but Australia, which seems to be a strong performer as of late, might be one area where it seems like consumers are closer to normal relative to the rest of the world. So if you could speak to how the traffic ticket dynamics have evolved in that country, perhaps that might give us some clues about how you might perform in some other countries post-vaccine rollout. Thanks.

Chris Kempczinski

President, Chief Executive Officer & Director, McDonald's Corp.

A

Thanks, Eric. In Australia, as you note, it has been one of the few markets in the world that has – [ph] I don't want to say relatively unscathed (33:06) by coronavirus, as they've done a very nice job of containing the virus. And that market is performing very strongly. Our franchisees in Australia are going to have record cash flow in 2020. The business is doing high single-digit performance. So I think it is, for us, a good indication of what this – the post-COVID opportunity for us can look like.

I think what we are expecting, though, is, and what we've seen as we've gone through COVID and the resurgence of COVID's recovery, is that channels like digital, like delivery, like drive-thru, they do remain elevated. We think that that is going to be kind of one of the more enduring parts of it. Doesn't mean that there still isn't going to be a sizable dine-in business, but I think the takeaway business is going to remain elevated post-COVID, including delivery with that.

And those channels, when you look at whether it's delivery or digital, drive-thru, those tend to be higher order sizes. And so as the mix moves to that, I think this idea of elevated check, we're expecting that that's going to continue, albeit not at the level that you're seeing now, but I think it just – there's going to be a channel mix shift that is going to continue to give benefit to average check going forward, is our expectation.

Mike Cieplak

Corporate Vice President-Investor Relations Officer, McDonald's Corp.

A

Our next question is from David Tarantino with Baird.

David E. Tarantino

Analyst, Robert W. Baird & Co., Inc.

Q

Hi. Good morning. Chris, there's been a lot of media reports about friction between the franchisees in the US and the company. And I was wondering if you could just comment on the current situation and your plan to resolve some of that conflict as you think about the short-term or near-term?

Chris Kempczinski

President, Chief Executive Officer & Director, McDonald's Corp.

A

Sure. Thanks, David. Well, as you know, I know the US market well, having run that for three years, and I'd say there are a few things that I just learned during my time in the US. The first is we have 2,000 Owner/Operators in the US. And it is very difficult to generalize sort of what is the overall sentiment in that market. You have 2,000 CEO's and Presidents of their own businesses with a lot of different opinions and perspectives, so I would just caution to make any generalizations about the market.

The other thing that I would say is the business is a very decentralized, federated type of model. All the action happens at the restaurant level. And at the restaurant level, the US interaction between the company and franchisees remains strong. And I think the evidence of that is just the operating performance that you're seeing out of our restaurants in the US as we're putting up pretty strong comps, which if you look at it on a two-year stack basis, it was I think a 10.1% in Q4 on a two-year stack.

So the business is performing, I think, at a very high-level. We're seeing service times improve, but there is absolutely noise and there absolutely is – are some disagreements that happen right now between the national operator leadership and our US team.

I dealt with those when I was in the US. They flare up from time-to-time. We're certainly in one of those moments now, but I'm confident that Joe Erlinger and the US team, along with Mark Salebra, who leads the operator group at the national level, we always find our way to work through these and I fully expect that that will be the case in the US.

Mike Cieplak

Corporate Vice President-Investor Relations Officer, McDonald's Corp.

A

Our next question is from Dennis Geiger with UBS.

Dennis Geiger

Analyst, UBS Securities LLC

Q

Great. Thanks for the question. Chris, you've outlined I think a bunch of initiatives in the US and marketing plans and overall strategy for the US this year. Just wondering kind of given the strong recent momentum the US has seen, wondering if you could kind of just help frame some of those initiatives for the year that you kind of see as most impactful. I'm sure it's sort of a collective effort, but, in your mind, what's kind of the most impactful this year to help drive sales, to help drive continued market share gains? Is it the marketing plans? Is it some of the new products that you've highlighted, aspects of the 3 Ds? Just hoping you could contextualize some of that for us. Thanks.

Chris Kempczinski

President, Chief Executive Officer & Director, McDonald's Corp.

A

Sure, well, I'll go through kind of the M, C, D framework. I think we've got to have great marketing. The great marketing has to come to life on chicken and the loyalty launch. That's where all three of those come together. And our expectation is that chicken and loyalty, not just for 2021, but, frankly, for a longer-term perspective, those are probably two of the most important things we need to get done in a high-quality manner in 2021, both for that year's performance – or for this year's performance, but also setting us up for the longer-term.

Mike Cieplak

Corporate Vice President-Investor Relations Officer, McDonald's Corp.

A

Our next question is from David Palmer with Evercore.

David Palmer

Analyst, Evercore ISI

Q

Thanks. Another question on the IOM. Just wondering how you're thinking about those International Operated Markets after the vaccine. These markets had most of their sales pre-COVID from on-premise ordering. And some are even city-center locations, perhaps more than the US, where you have a lot of suburban drive-thrus. So obviously, more painful today, but I wonder if you're thinking that market share gains could be even greater because your competition, which is often local, lacks McDonald's unit economics and the drive-thrus that you have, that are obviously helping your profitability during the pandemic. So could you talk about the outlook for market share gains and if there's any sort of difference in the recovery that you foresee in these markets broadly than what we would expect in the US? Thanks.

Kevin M. Ozan

Chief Financial Officer & Executive Vice President, McDonald's Corp.

A

Yeah. Thanks, David. I'll take a shot at it and Chris can certainly chime in. As you mentioned, certainly our percentage of restaurants with drive-thru in the International Operated Markets is a little bit less than what we have in the US. In Australia and Canada, it's more around 80%, 90%, but in France, Germany, UK, it's roughly two-thirds of their restaurants or so that have drive-thrus. So the percent of sales that run through the drive-thrus pre-COVID in those International Operated Markets was less.

We're certainly seeing, during the pandemic, a higher percentage of sales run through the drive-thru as well as elevated digital and delivery sales. But I think to your point, I think we believe we're well setup post-pandemic, because while the percentage of drive-thrus is less than the US, it's substantially higher than just about any competitor in most of those markets. And so the fact that we're well setup with drive-thrus. We'll continue to open up more drive-thrus.

To your point, there are some city-center tourist travel locations right now that are kind of getting hit harder than certainly most of our US restaurants because of the pandemic, but there's nothing structural in the business that gives us concern that once the markets start opening up, post-pandemic, we feel like we should be in good shape to be able to pick up market share.

There are still a substantial number of restaurants in many of those markets that are closed – not McDonald's restaurants, I'm just saying in the industry. The unknown certainly is how many of those are temporary versus what's permanent, but we think we're pretty well setup to be able to continue gaining market share, which we have done both in 2019 and in 2020 during the pandemic in those IOM markets, to keep gaining market share.

Mike Cieplak

Corporate Vice President-Investor Relations Officer, McDonald's Corp.

A

Our next question is from Jon Tower with Wells Fargo.

Jon Tower

Analyst, Wells Fargo Securities LLC

Q

Awesome, great. Thanks for taking the question. Just first, a clarification and a question. Kevin, on the IOM margin, I just want to make sure I understand that guidance you had talked about. I think you'd said not getting

back to pre-COVID levels in 2021. I assume you're speaking about the full year, not just on a quarterly basis, but a clarification there would be great.

And then secondarily, on the marketing side, you had the \$200 million or so of incremental spend in 2020 across the US and IOM. How should we think about the company lapping this spend in 2021, meaning are you anticipating that franchisee sales recovery will fill the void and therefore your presence in dollar spend will be similar year-over-year? If you could just add a little bit of color there, that would be great.

[indiscernible] (42:24)

Kevin M. Ozan

Chief Financial Officer & Executive Vice President, McDonald's Corp.

A

So, Jon, to your point, what I talked about is, yes, annually, I don't expect yet in 2021 that the IOM segment would get back to the kind of 20% margins that we've all been used to pre-pandemic. Again, there's nothing structural that prevents that from happening longer-term, but we know, for at least in the first quarter certainly, margins are certainly depressed a little bit still because of the sales and the restrictions going on, so we do think as the year progresses, margins will improve over where they were in 2020, but likely not get back for the full year to that 20% kind of level that we were used to prior to the pandemic.

Chris Kempczinski

President, Chief Executive Officer & Director, McDonald's Corp.

A

And then on the marketing question, I'll start maybe just with the math, which is, as you note, we do fund marketing as a percent of revenue. And so, certainly, as the business recovers and grows, we think, at a pretty nice clip in 2021, that there will be a benefit from an investment size that we can go do in marketing, but it's not going to be to the level of \$200 million.

I think the bigger thing that I think about and the bigger benefit is this is a momentum business. And when you have momentum in the business, everything seems to work better, including on your marketing side. So our expectation, part of why we put the \$200 million in in 2020, was to make sure that we could generate some strong momentum coming out of this. And when you've got that momentum, you get an outsized effect from what would be even a normalized marketing level. So that's the bet that we're making and why we're confident on the back half of the year.

Mike Cieplak

Corporate Vice President-Investor Relations Officer, McDonald's Corp.

A

Our next question is from Chris Carril with RBC.

Christopher Carril

Analyst, RBC Capital Markets LLC

Q

Hi. Good morning. And thanks for all the detail provided so far, and appreciate the detail on the most recent trends in January. I did want to ask about the competitive environment in the US, and clearly a lot has been made around the growing competition around chicken, but there also appears to be more of a focus on value as competition continues to ramp for traffic. So curious to hear your perspective on just broader industry competitive dynamics and, in particular, thoughts on breakfast competition and share gain opportunities there. Thanks.

Chris Kempczinski

President, Chief Executive Officer & Director, McDonald's Corp.

A

Sure. Well, thanks, Chris. And it is a competitive market in the US, probably one of the most competitive markets, if not the most competitive market, in the world. Back in November, when we had our Investor Day, part of the M within MCD was that we needed to make sure we had a strong focus on affordability. And you're seeing just as we've entered into 2021, you've seen some of the value deals that are out there from our competitors. We've also had some programs that I think have performed well for us. And that's going to be a trend that continues all through 2021. Our expectation is that you're absolutely going to need to remain competitive on value.

I think we've been able to – back to the momentum point, we've been able to put ourselves through the investments we've made in modernizing our estate, upgrading our brand attributes, I think we're in a better position than we were maybe four or five years ago in terms of just the consumer demand for our brand, so I think that for us gives me confidence that this isn't going to be something that gets – that we're going to have to chase down the rabbit hole, so to speak.

On your question about breakfast, our breakfast business is performing well. In Q4, our breakfast business grew. We saw strong performance out of the bakery line, so our expectation is going forward that breakfast, the daypart, we've been pleased with how we weathered through 2020 on that, even with the introduction of one of our competitors, didn't have a significant impact on our breakfast business. And as we look to 2021, our expectation, we're setup that breakfast for us should be a good performing daypart as people get back to hopefully returning to work and kind of a more regular routine, which certainly benefits traffic in the morning.

Mike Cieplak

Corporate Vice President-Investor Relations Officer, McDonald's Corp.

A

Our next question is from Jared Garber with Goldman Sachs.

Jared Garber

Analyst, Goldman Sachs & Co. LLC

Q

Hi. Thank you very much. A little bit of a follow-up on the last question, but with maybe a different, little bit of a different spin. Wondering if you could talk about the state of the consumer in the US and how you're seeing things play out from that perspective, obviously given some stimulus benefits, but still high unemployment and challenges related to COVID. And maybe to follow-up on that point, how you're thinking about the balance of value and premium offerings and LTOs throughout 2021. Thanks.

Chris Kempczinski

President, Chief Executive Officer & Director, McDonald's Corp.

A

Sure. Thanks, Jared. I think with the state of the consumer, we do consumer tracking, as you would expect, on a monthly basis. And what we're seeing right now is that concern for economic uncertainty is by far the single most, single biggest concern that exists with our consumers, which again gets back to why we think affordability is going to be one of the things that all of us need to stay focused on in a prudent way in 2021.

Because of the level of stimulus, certainly it is helping right now in the short-term. I think the industry, we're a beneficiary of that, but the stimulus is going to roll off. And I don't think that we yet fully understand or have visibility to as the stimulus rolls off, sort of what is the underlying health of the consumer. Many people have talked about a K-shaped recovery, the divergence between the stock market and the rest of the "real economy." I think that's real, so we are watching closely what happens with the consumer, but we think this concern about the economy, concern about people's sort of financial health, that that is going to be something that persists through the balance of 2021. Was there another part to that?

Kevin M. Ozan

Chief Financial Officer & Executive Vice President, McDonald's Corp.

A

I think it was just the concept of balancing value, premium and LTOs, which is a constant focus for us that we need to balance all of those three, LTOs, value and premium. I think you'll see that continuing both in the US and outside the US because that is our normal. We've got to make sure that we have offerings for all consumers, depending on what they – kind of the change they've got in their pocket at any given time.

Chris Kempczinski

President, Chief Executive Officer & Director, McDonald's Corp.

A

The one thing I guess I would just say on that if you go to the C in our framework, core menu is the primary growth driver for us in 2021 and we think for the next several years. So while there will be some LTO activity, I think all markets, US and our IOM markets in particular, have raised the bar in terms of what an LTO has to do to earn its way out to the menu, so I think you might see, versus maybe what we had pre-pandemic levels, a little bit more moderate pace of LTOs because of this focus on core menu.

Mike Cieplak

Corporate Vice President-Investor Relations Officer, McDonald's Corp.

A

Our next question is from John Ivankoe with JPMorgan.

John Ivankoe

Analyst, JPMorgan Securities LLC

Q

Hi. Thank you. I wanted to follow-up on, I guess, the supply question in IOM, but maybe talk about it specifically by country. Many of us have traveled to these countries with you over the years, Canada, Australia, France, Germany, UK, so we do have a fine appreciation of as you define the informal eating out market that you directly compete against in many of these areas and I guess many of the High Streets, if you will, in particular. So through the market intelligence that you have – and I think you define that market uniquely in terms of using the words IEO, or informal eating out, how much capacity do you think – and, again, this is really looking for your opinion, it's not necessarily a fact, but how much of that capacity do you think has come out permanently?

And I ask this question also in the context of government assistance to restaurants are so different around the world, certainly different than the US, that maybe give a certain amount of survivability or I guess in some cases unsurvivability relative to what's happened, for example, through PPP here.

Kevin M. Ozan

Chief Financial Officer & Executive Vice President, McDonald's Corp.

A

Yeah, all right, I'll take a shot and then again, Chris can always add in. John, as you know, and you mentioned, obviously, each country's a little different, both in terms of demographic, consumer demographics as well as competitive environment. I think, so things like High Streets in the UK, I think right now, is a challenge, certainly much broader than our business, but there's a question of when and even if the High Street in the UK completely returns to kind of pre-pandemic levels.

I think in general, as I mentioned, right now, there's a lot of outlets closed in many of the markets. The unknown is how many of those are temporary versus permanent. I do think certainly in many of those countries where someone has one, maybe two outlets, that's a bigger challenge. And I don't think we'd be surprised to see several of those outlets permanently closed. We're seeing that in several of the countries right now, where it looks like many of those outlets will not be returning, so that I think overall supply in general will shrink a little bit, which

certainly is an opportunity for us to continue gaining market share. That's our expectation. That's what we're going after, and I think we believe that we're well-positioned to gain a lot of that share.

Mike Cieplak

Corporate Vice President-Investor Relations Officer, McDonald's Corp.

A

Okay, our next question is from Andrew Charles with Cowen.

Andrew Charles

Analyst, Cowen and Company

Q

Great. Thank you. Just on the new Crispy Chicken Sandwich that's coming next month, can you talk about the learnings in test markets, particularly looking to what you observed in sales, even if it's qualitative? And also just operationally comparing it to three years ago when Hot Off the Grill was launched, where the performance was a bit subdued because of the longer than expected service times. Thank you.

Chris Kempczinski

President, Chief Executive Officer & Director, McDonald's Corp.

A

Sure. Well, we did have it in test market, and we were encouraged. It's why we're rolling it out. I think our focus in test was much more on the operation side than having it be sort of an advertised type of test. So for us, it was about just getting the operation work through and confident for us in being able to deliver it in a high-quality way. We feel good about that.

I know Morgan Flatley and the US marketing team feel good about the campaign that we have, so – and franchisees are excited about it. So we are optimistic as we head into February, despite what was referenced earlier, a lot of activity in this space, but we think we're prepared well to generate demand from consumers on this one and then deliver on that as consumers come into our restaurants.

Mike Cieplak

Corporate Vice President-Investor Relations Officer, McDonald's Corp.

A

Next question is from Jeff Bernstein with Barclays.

Jeffrey A. Bernstein

Analyst, Barclays Capital, Inc.

Q

Great. Thank you very much. Just a question on the labor side of things. And I guess it's more so for franchisees, but you mentioned working closely with the government on different initiatives. It seems like there's a lot of opposing forces, at least for franchisees, where you have the national minimum wage potentially going up, but on the flipside, unemployment high, which would historically imply ample labor. So maybe with that as kind of a backdrop, would love your outlook on labor cost and perhaps labor availability and whether you think the franchisees can offset that pressure, whether it's through cost saves, technology, pricing? How are those conversations going with franchisees regarding dealing with upcoming, ongoing labor cost pressures? Thank you.

Chris Kempczinski

President, Chief Executive Officer & Director, McDonald's Corp.

A

Sure. Well, thanks, Jeff. I think the discussion about the minimum wage and what that means in terms of cost of labor, while it's picked up with the change in the administration at a federal level, I would say that it's been going on at the state level for the last several years. And you've seen a number of states – I forget if it's 24, 25 states have passed some degree of minimum wage legislation. Florida was the most recent one in this past election,

where I think they've introduced a \$15 an hour, a glide path to a \$15 an hour. So we've, as this has been rolling into the states, we have seen and developed quite a bit of experience with how this works out.

I think the positive for us has been so long as it's done in a staged way, and so long as it is done equitably across the entire market without sort of any carve-outs or special exemptions for people, then we do just fine. And we're able to balance between judicious pricing on the menu, as well as just thinking about productivity savings that we can manage through this.

I'll give you another example that gives us confidence. There was a significant increase in the minimum wage that was passed in Canada a couple years back. And that team, working with the franchisees, did a spectacular job of working that through onto the menu through pricing, through productivity. So I think our view is the minimum wage is most likely going to be increasing, whether that's federally or at the state level, as I referenced. And so long as it's done, like I said, in a staged way, and in a way that is equitable for everybody, McDonald's will do just fine through that.

Mike Cieplak

Corporate Vice President-Investor Relations Officer, McDonald's Corp.

A

Our next question is from Lauren Silberman with Credit Suisse.

Lauren Silberman

Analyst, Credit Suisse Securities (USA) LLC

Q

Thanks. I believe back in June, you talked about drive-thru service times improving in the US by about 25 seconds through the pandemic. Assuming that 25 seconds still holds, to what extent do you attribute that to the simplified menu versus other changes? And how is the dynamic of outsized check and larger orders impacting drive-thru times? And then, just for 2021, do you see any other opportunities of further improvement, such as a broader rollout of Apprenté?

Kevin M. Ozan

Chief Financial Officer & Executive Vice President, McDonald's Corp.

A

All right, yeah, I can give a shot to that, Lauren. So yeah, we've continued both in 2019, as you mentioned but as well in 2020. Overall, we reduced drive-thru times by roughly 30 seconds over the past two years in our major markets.

And I think that's a combination of a few things. One is menu simplification and the more limited menu that you indicate, but also, just a big focus on operations around the world, which includes some non-sexy stuff like staffing and positioning of our crew, some certain technology that we put in the restaurants to help the crew monitor the times. And so there's just some basic kind of operating the restaurants efficiently that goes along with the right menu and menu boards.

And so there continues to be a big focus on drive-thru operations, especially because we've seen drive-thru continue to be a bigger percentage of our business. So I would – there's still opportunity to continue reducing those service times, so I wouldn't say that we are now at kind of the top level of what we can achieve. There's still a big focus around the company on continuing to improve those service times.

Mike Cieplak

Corporate Vice President-Investor Relations Officer, McDonald's Corp.

A

Okay. We have time for one more question from Greg Francfort with Bank of America Merrill Lynch.

Gregory R. Francfort

Analyst, Bank of America Merrill Lynch Research



Yeah. Hey, thanks for that. Can you maybe talk a little bit about store level margins in the US and where you see them going kind of over the next few years? And the pandemic has helped kind of push that up quite a bit. And I'm wondering how much those gains you think you can hold on to from an efficiency standpoint. Thanks.

Kevin M. Ozan

Chief Financial Officer & Executive Vice President, McDonald's Corp.



Yeah. Thanks, Greg. Certainly in the US, we've seen the last couple quarters that store level margins are up. I think that's a combination of a few things. We've talked about higher average check, being larger group size orders, et cetera. Again, I think, as Chris mentioned, some of that will stick, maybe not to the level that we are today, so I think we do see some of the US margins probably moderating over the next year.

Conversely, in the IOM, I think they've been hit harder at store level margins because they haven't had the sales levels that we need in order to maintain high margins, so I think IOM, over time, will get back to where they were pre-pandemic. US is probably a little bit higher in the last couple quarters than we should expect ongoing for 2021, at least.

Mike Cieplak

Corporate Vice President-Investor Relations Officer, McDonald's Corp.

Okay. Thank you, Chris and Kevin, and thank you all for joining. Have a great day.

Operator: This concludes McDonald's Corporation Investor Conference Call.

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