

27-Oct-2021

# McDonald's Corp. (MCD)

Q3 2021 Earnings Call

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Hello and welcome to McDonald's Third Quarter 2021 Investor 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.

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### Mike Cieplak

*Senior Vice President, Treasurer & Investor Relations Officer, McDonald's Corp.*

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

As a reminder, the forward-looking statements in our earnings release and 8-K filing also apply to our comments on the call today. Both of those documents are available on our website, as are reconciliations of any non-GAAP financial measures mentioned on today's call, along with their corresponding GAAP measures. Following prepared remarks this morning, we'll take your questions. Please limit yourself to one question and then reenter queue for any additional questions.

Today's conference call being webcast and is also being recorded for replay via our website.

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

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### Christopher J. Kempczinski

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

Thanks, Mike, and good morning, everyone. As the largest restaurant business in the world, our size and scale are a competitive advantage that we've built and nurtured for over six decades. Our 40,000 restaurants in over 100 countries are predominantly run by local Owner/Operators, connecting the business to the 40,000 communities in which we operate.

These local connections embed a level of agility that complement our size and scale, enabling local teams to adapt and adjust to operating conditions that vary by country, community, and even restaurant, in real-time. It's what makes McDonald's special. It's also how we're able to use scale and agility, how we can be both big and nimble, to achieve something truly unique.

And thanks to the resilience across all three legs of our stool, franchisees, suppliers, and the company, and the scale and agility that we deploy collectively, I'm confident in our ability to meet whatever challenges may confront us, from restrictions driven by new COVID variants, to supply chain pressures and labor shortages across industries, to any other unknown unknowns.

We're approaching the one-year anniversary of Accelerating the Arches, which took shape in response to changing customer needs early in the pandemic. Rooted in the inherent strengths of the McDonald's System and brand, it's proving to be the right strategy with the right focus at the right time.

We're evolving the customer experience in ways, both large and small, to meet changing customer needs and maintain our market leadership. Our three growth pillars, known as our M, C, Ds, marketing, core menu, and the three Ds of digital, delivery, and drive-thru, guide our business. This includes amplifying contactless channels like delivery and drive-thru and creating digital experiences that are seamless, personalized, and easy to use.

We've continued to make excellent progress this past quarter, and I want to thank the McDonald's people all over the world who are performing under trying conditions.

Let me turn it over to Kevin to walk through our top line results.

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## Kevin M. Ozan

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

Thanks, Chris. Our third quarter top line results represent a continuation of our broad-based business momentum around the world, with global comp sales up nearly 13% or 10% on a two-year basis. Our International Operated Markets have continued to recover, accelerating two-year comp trends in the third quarter to nearly 9%, as most markets operated with fewer government restrictions.

There's still varied performance across the big five markets within the IOM segment, ranging from strong double-digit two-year growth in the UK and Canada, to low single-digit two-year growth in Australia, Germany, and France, as those countries have been slower to recover from the pandemic.

The UK continued to lead the segment in the third quarter, driven by growth in delivery and digital channels as well as strong menu and marketing promotions like MONOPOLY. In Canada, the strong two-year comp momentum was driven by successful marketing activity, including core extensions like the Grand Mac and Spicy Nuggets and growth in the three Ds of drive-thru, delivery, and digital, even as dine-in restrictions have lifted.

In France and Germany, comp sales exceeded 2019 levels for the first time in the third quarter. Germany's positive performance was supported by expanded deployment of delivery, the national launch of our loyalty program, MyMcDonald's Rewards, and a Taste of McDonald's promotion featuring value offerings like McChicken.

France benefited from continued strength in delivery and strong menu and marketing promotions with a focus on family. Market conditions are challenging with the adoption of vaccine pass restrictions for both customers and crew in France and several other countries.

Performance in Australia was impacted by significant stay at home restrictions, affecting over half of the restaurants for nearly the entire quarter. While comp sales were relatively flat for the quarter, the market was positive on a two-year basis and continued to grow its delivery channel, achieving record delivery sales for the quarter.

As we look ahead to the fourth quarter, we expect the IOM segment to maintain a relatively similar two-year comp trend as Q3.

In the US, we maintained our momentum with Q3 comp sales up nearly 10% or 14.6% on a two-year basis. We continued to see positive comps across all dayparts on a two-year basis, with sustained double-digit comps at dinner and breakfast. At the same time, franchisees continue to achieve record high restaurant cash flow.

Our US franchisees have never been better positioned to weather the labor and inflation pressures while still investing in growth.

Performance in the US remains driven by strong average check growth, reflecting larger order sizes and menu price increases. The big bets we've made during the pandemic are paying dividends across the business and enabling us to maintain our QSR leadership. Menu and marketing efforts with products like the Crispy Chicken Sandwich and successful Famous Orders like the Saweetie Meal have elevated our brand and helped drive underlying sales growth across the business.

The launch of our loyalty program in the US has exceeded expectations and is driving increased digital adoption. In just a few short months, we already have over 21 million members enrolled, with over 15 million active loyalty members earning rewards. And we expect that number to continue to grow. Chris will share more loyalty headlines in a few minutes.

We've reopened nearly 80% of our dining rooms in the US. Roughly 3,000 dining rooms remain closed in high-risk COVID areas as we continue to prioritize the health and safety of our customers and crew. In restaurants where we have reopened dining rooms, front counter and kiosk sales remain below pre-pandemic levels, but we're seeing that even modest increases in these channels help to relieve operational pressure in the drive-thru.

The strong performance in the US has continued into October. We're currently seeing low double-digit comps on a two-year basis and we expect that to continue through the rest of the fourth quarter.

Turning the International Developmental Licensed segment, comp sales were up nearly 17% for the quarter or about 5% on a two-year basis. Performance was largely driven by positive results in Japan and Latin America, partly offset by negative comps in China. Japan maintained momentum in Q3 with comps up 13%, achieving an impressive six consecutive years of quarterly comp sales growth, despite restaurants operating with government restrictions.

The market's performance is being driven by a continued commitment to serve customers safely and conveniently through our drive-thru and digital channels, as well as strong marketing and limited-time promotions.

China continues to be impacted by both COVID resurgences, which restarted in June and lasted throughout the quarter, and a softening economy. While comps for the quarter were negative, the market continues to build its digital presence, as they now have over 100 million active digital members.

In addition, we've accelerated new restaurant growth in China. With over 500 new restaurants already opened this year, we now expect to open roughly 650 restaurants for the year, exceeding our original plan.

China remains a critically important market for us and one where we have confidence in the long-term opportunity. So we plan to get even more aggressive in opening new restaurants in this market.

With our strong overall sales performance for the first three quarters of the year, we now expect Systemwide sales to be up in the high teens in constant currencies for the full year.

Now, I'll turn it back to Chris to talk more about M, C, D growth pillars driving our global business.

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**Christopher J. Kempczinski**

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

Thanks, Kevin. Our results are a testament to the focus of our teams on driving growth through our M, C, and Ds, and we're confident that momentum will continue.

After playing a pivotal role in building out our Fan True strategy in the US, Morgan Flatley is transitioning into the role of Global Chief Marketing Officer. Following the instantly iconic global campaign Morgan developed with BTS, Famous Orders again crossed borders with both Russia and Spain launching successful campaigns with local celebrities in the third quarter.

These markets leaned into the idea that truly no matter how big or famous you are or where you are in the world, everyone has their go-to McDonald's order. As Morgan elevates to the global role, we're excited to welcome Tariq Hassan to the McFamily as Chief Marketing and Digital Customer Experience Officer for McDonald's USA. I've known Tariq for many years and I'm confident Tariq will maintain our marketing momentum in the US.

Behind our marketing success is McDonald's craveable core menu. In the US, Crispy Chicken Sandwich sales continue to exceed expectations. This translated into significant growth in QSR chicken market share as we continue to support the Crispy Chicken Sandwich platform with culturally relevant marketing.

In the UK, we launched our McSpicy Sandwich, which generated the market's best chicken promotional results on record. And in Canada, our Spicy McNuggets promotion had a halo effect on McNugget sales.

This quarter, we introduced the McPlant sandwich in Austria and the Netherlands as a limited-time offer. And both the UK and Ireland launched the McPlant in a limited number of restaurants, with the goal to roll out nationwide in January. McPlant is available for other markets to pull down based on customer demand. As always, we'll do what McDonald's does best, listen to our customers. When people are ready for the McPlant, we'll be ready for them.

Being customer-driven is about more than just menu items. It's also about delivering feel-good experiences when and where our customers want McDonald's, so we can bring the Golden Arches to as many customers as possible. That means continuing to increase our engagement across drive-thru, digital, and delivery. As we do that, we're seeing an increase in sales mix across these channels. In our top six markets, over 20% of sales, or about \$13 billion year-to-date, came through digital channels, whether it was through our app, kiosks in our restaurants, or delivery.

Our loyalty program has been an instant fan favorite and delivers great value to our most loyal customers. It also creates another touch point to increase engagement and take our relationship with customers to more responsive, more personalized places. We're already seeing increased customer satisfaction and higher frequency among digital customers compared to non-digital.

In September, we launched our loyalty program in Germany, quickly amassing millions of active Reward customers. And we're on track to bring MyMcDonald's Rewards to Canada by the end of the year, and the UK and Australia in the first half of 2022, which means that by mid-2022, loyalty programs will be in our top six markets, inclusive of France, which has had a strong loyalty program for many years.

Delivery is another bet we made long before COVID and one that we believe will continue to be a staple for consumers for years to come. Over the past five years, our delivery footprint has grown from just 3,000 of our restaurants to more than 32,000 restaurants across 100 countries. As the needs of our customers have continued to change, delivery has enabled us to increase our reach and grow sales around the world.

We're actively engaged in discussions with our largest delivery providers to support the extraordinary growth in our delivery business. We look forward to sharing more information on these global partnerships soon, but this is yet another example of where our scale confers upon us competitive advantages.

Lastly, our drive-thrus. With a drive-thru presence that is second to none, our drive-thru sales across our top six markets continue to stay elevated versus pre-pandemic levels, even as dining rooms reopen. We previously shared that we have been testing automated order taking in the drive-thru at several restaurants in the US. This was enabled by our acquisition of Apprente, now known as McD Tech Labs, in 2019. These tests have shown substantial benefits to customers and the crew experience.

To enable development and scale deployment of this program, McDonald's has now entered into a strategic relationship with IBM. In my mind, IBM is the ideal partner for McDonald's, given their expertise in building AI powered customer care solutions and voice recognition. IBM will now acquire McD Tech Labs to further accelerate the development of automated order taking.

We're in a strong position today focused on executing our plan, running great restaurants, and taking advantage of our unique size and scale to feed and foster communities.

For more on our Q3 financials and our outlook moving forward, I'll turn it back over to Kevin.

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### Kevin M. Ozan

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

Thanks, Chris. Our strong performance for the quarter resulted in adjusted earnings per share of \$2.76, which excludes the gain as we completed the partial divestiture of our ownership in McDonald's Japan. Our strong sales generated an increase in restaurant margins of about \$500 million for the quarter.

G&A increased about 20% in constant currencies for the quarter, driven by higher incentive-based compensation expense as a result of company performance exceeding our plan this year. We still expect G&A to be about 2.4% of Systemwide sales for the full year.

Year-to-date adjusted operating margin was 44.3%, reflecting the improved restaurant margins across all segments and higher other operating income compared to last year.

Foreign currency translation benefited Q3 results by \$0.04 per share. Based on current exchange rates, we expect currency to have a minimal impact on fourth quarter EPS, with an estimated full year benefit of \$0.21 to \$0.23. As usual, this is directional guidance only, as rates will likely change as we move through the rest of the year.

And finally, in September, our board of directors approved a 7% dividend increase to the equivalent of \$5.52 annually. This marked 45 years of increasing our dividend for shareholders, further reinforcing our confidence in Accelerating the Arches.

We also announced the resumption of our share repurchase program. As a reminder, we had suspended share buybacks at the beginning of the pandemic as we took on additional debt to provide liquidity support to the McDonald's System. Since then, we've been focused on returning to pre-COVID debt ratios that support our strong investment grade credit rating.



Going forward, we're confident that our operating performance will continue to fuel growth in our already strong free cash flow profile. As a result, we're committed to our historical capital allocation priorities. First, to invest in new restaurants, existing restaurants, and opportunities to grow the business. Then, we expect to return all free cash flow to shareholders through a combination of dividends and share repurchases over time.

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

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## Christopher J. Kempczinski

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

Thanks, Kevin. We've accomplished so much the past 20 months, and even though the pandemic has greatly altered so much in our business and our world, it hasn't changed the simple fact that we're better together than we are apart. For a long time, we had to bridge physical separation with technology and new ways of working, but as vaccines have reached critical mass of people in the US and some places around the world, we're beginning to see a different future taking shape. Finally, we're coming together again in our communities and cities around the world are beginning to open up and get back to a new normal.

The same is true for our global McFamily. After being closed for over a year-and-a-half, the McDonald's headquarters reopened on October 11 and it was inspiring to see teams collaborating again in person. To protect the health and safety of our staff, we required all US-based corporate employees to get vaccinated. And we're continuing to monitor local data and seek guidance from public health officials.

Even though we've only been back for a few short weeks, we have found that working in the office together spurs a level of collaboration, creativity, and connectedness that simply could not be replicated from behind our screens. And we're going to be doing the same thing with our global system soon.

Next April in Orlando, franchisees, suppliers, and employees will convene for our worldwide convention in person for the first time in four years. It's already shaping up to be an experience unlike any other. Together, we'll showcase McDonald's bright future. We'll demonstrate the power of technology for our restaurants, learn how innovation is enhancing the customer experience, and discuss plans in the pipeline to drive our Accelerating the Arches growth plan.

As I've said before, it's not only important that we grow, it's equally important that we grow sustainably and in ways that positively impact the communities we serve. Driving climate action has been a centerpiece of our long-term strategy for a while now and our focus has sharpened. In fact, in 2014, we established public commitments intended to make our entire system more sustainable by 2020. Among our goals were to sustainably source 100% of key ingredients, including coffee and beef.

Looking back, this was just the beginning of what would become a much bolder agenda that we are pursuing with urgency. As the threats to our planet have grown, we are responding with a more ambitious plan for ourselves and for the entire industry. We achieved many of our 2020 goals ahead of schedule, and we built upon that momentum to set new ambitious targets.

Just this past September, we announced that we would reduce the use of conventional virgin plastics in Happy Meal toys by 90% by 2025. We recently announced our ambition to achieve net zero emissions across global operations by 2050 and we joined the UN Race To Zero. And I look forward to sharing more of our sustainability story with climate delegates at the United Nations Climate Change Conference, known as COP26, in Glasgow next week.



We believe we have both a privilege and a responsibility to help lead on issues that matter most in communities. And there is no issue more globally important and locally impactful than protecting our planet for generations to come. This is why I continue to remain optimistic about what lies ahead for McDonald's. Accelerating the Arches, fortified by our purpose and guided by our values, makes me confident not just in the future successes of our business, but also for the future of the communities that we serve.

With that, we'll begin Q&A.

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## QUESTION AND ANSWER SECTION

**Operator:** Thank you. [Operator Instructions]

**Mike Cieplak**

*Senior Vice President, Treasurer & Investor Relations Officer, McDonald's Corp.*

Our first question is from Andrew Charles with Cowen.

**Andrew Charles**

*Analyst, Cowen and Company*

Thank you. Chris or Kevin, just wanted to ask about the staffing environment. You touched on it a little bit, but to the degree that it was a headwind in 3Q to your very strong US same-store sales, I'd be curious. From what we're hearing, it seems to be a bigger issue as the quarter progressed. And you talked about how there's going to be low double-digit same-store sales in 4Q. You're seeing that October obviously very strong but does suggest a bit of deceleration from the very strong sales you saw in the quarter.

So curious if you can help with any numbers to kind of help parse that out a little bit more, given it's a challenge for everybody. And I would think that McDonald's is better positioned, but not immune. Thanks.

**Christopher J. Kempczinski**

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

Sure, I'll start, and then let Kevin fill in any other points on this. But certainly, it's a very challenging staffing environment in the US. A little bit less so in Europe, but still challenging in Europe.

In the US, for us, we are seeing, as I've mentioned a few calls ago, that there is wage inflation. Our franchisees are increasing wages. They're over a 10% wage inflation year-to-date that we're seeing in our McOpCo restaurants. We're up over 15% on wages. And that is having some helpful benefit. Certainly, the higher wages that you pay, it allows you to stay competitive.

But we're also seeing that just it's very challenging right now in the market to find the level of talent that you need. And so for us, it is putting some pressure on things like operating hours, where we might be dialing back late night, for example, from what we would ordinarily be doing. It's also putting some pressure around speed of service, where we are down a little bit on speed of service over the last kind of year-to-date and even in the last quarter. That's also a function of not being able to have the restaurants fully staffed.

But I would tell you that it's not unsolvable either. And we're seeing in our McOpCo restaurants that a really strong focus on the shift manager and providing the training for the shift managers to keep engaged with the crew, to keep the crew motivated, that that can make a difference. But certainly, I was hoping and expecting that we were

going to see the situation improve maybe a little bit more quickly than what's materialized. And I think it is going to continue to be a difficult environment for the next several quarters.

Kevin, I don't know if you have anything you want to add.

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**Kevin M. Ozan**

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

A

Just to touch on your point about Q4 two-year comps for the US and I guess the fact that they're decelerating a little bit from second and third quarter, couple things there I guess I'd say. One would be I think we're pretty pleased to see two-year comps in low double digits. That's certainly higher than our historical levels. And if we're able to sustain that for a long period of time, I think we'd be pretty happy with that.

Certainly, there have been some changes that have gone on related to more of the full-service restaurants reopening, stimulus benefits, unemployment benefits rolling off. And so we weren't sure how much that would impact our results and are pretty pleased that we're still able to achieve the double-digit comps. And so, I think we feel pretty good about going into fourth quarter right now in the US.

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**Mike Cieplak**

*Senior Vice President, Treasurer & Investor Relations Officer, McDonald's Corp.*

A

Our next question is from Eric Gonzalez with KeyBanc.

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**Eric Gonzalez**

*Analyst, KeyBanc Capital Markets, Inc.*

Q

My question's on pricing. I'm just wondering if you can comment on the current level of pricing in the US system and maybe discuss what you think is the appropriate level in the current environment and whether you're seeing any consumer pushback.

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**Kevin M. Ozan**

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

A

Yeah, thanks for the question, Eric. Certainly pricing and cost pressures are a bigger focus over the last few quarters than they had been previously. Last quarter, I think I talked about how we were seeing roughly a 6% increase year-over-year in the US. We're still seeing that and that's pretty much the level we expect for the full year 2021 over 2020, right around that 6%.

And that's really to cover both labor cost pressures and commodity cost pressures that we're seeing. If we step back for a second, obviously, we're all seeing the environment out there on a global basis, which is some pressure on commodities, certainly some pressure on labor availability and costs, supply chain disruptions, et cetera, that are all putting some pressure. We haven't seen, I'll say, any more resistance to our price increases than we've seen historically, so that the 6% have been pretty well received by customers.

We do certainly have a very big focus to make sure that we are balancing cost pressures and being able to cover those with making sure that our value perception by customers continue to be favorable. And we are continuing to see those surveys and scores from a value favorability perspective still positive from customers. So we'll continue to keep an eye on it.

From a commodity perspective, commodities were up roughly 2% or so through the first nine months, but we expect for the full year for those to be up roughly 3.5% to 4%, which will put a little bit of additional pressure on

the fourth quarter, obviously. And then, going into next year, from a food and paper cost perspective, we would expect our cost to be up relatively in line with the industry. Right now, that expectation is roughly mid-single digits. And so, we will continue to keep an eye both on the cost side and the pricing side.

Both we and our franchisees over the last couple years have been using a third party for pricing advisory services, if you will, using a pretty deep consumer-based research approach. And so, we have, I think, more science built into our pricing decisions that take into account market conditions, competitive factors, et cetera.

So like I said, we'll keep a close eye on costs and pricing, but right now so far it's been received okay by customers.

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**Mike Cieplak**

*Senior Vice President, Treasurer & Investor Relations Officer, McDonald's Corp.*

A

Our next question is from Jared Garber with Goldman Sachs.

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**Jared Garber**

*Analyst, Goldman Sachs & Co. LLC*

Q

Great. Thanks so much for the question. I wanted to shift the topic a little bit over to the unit growth side of the equation. And if you can give us an update on what you're seeing in terms of unit opens and the availability of both labor and equipment and construction and permitting across both the US and international segments. I think the IOM segment came in a bit light in terms of unit opens this quarter, but you also increased the net unit growth for the year. So just any color on framing out some of the puts and takes there would be really helpful.

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**Kevin M. Ozan**

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

A

Yeah, thanks, Jared, for the question. I'll take that. I think it is fair to say, again, just thinking about the global environment, there are certainly supply chain challenges across the world on various things related to kitchen equipment, technology equipment, I'll say pandemic-related disruptions, slower permitting times. All the things that you mentioned are making it a bigger challenge, I'll say, to get restaurants open than historically.

For this year, we still expect roughly in our IOM and US markets, it's down a little bit from where we were previously. There will be a few that will spill over now into 2022. That's more of a timing issue than anything else. And so, because of things taking a little bit longer, some of the openings that we thought we may be able to get done this year will spill into beginning of 2022.

Going forward, I think we're still bullish on openings. We still expect our openings to increase both in our wholly-owned markets as well as our Developmental Licensed Markets next year. The increase that you saw right now for 2021 is being primarily driven by China and a few other Developmental Licensed Markets. So that's why the overall openings is up this year.

But I'd say, overall, it's a bigger challenge than it has been, but our supply chain does a phenomenal job of kind of just managing the whole process, making sure that we've got contingency plans. We're in touch extremely frequently with all of our suppliers. And I feel pretty good about where we are compared to where others may be, just because of the strength of our supply chain. But I think it is fair to say that it's a bigger challenge than it's been historically.

**Mike Cieplak**

*Senior Vice President, Treasurer & Investor Relations Officer, McDonald's Corp.*

Our next question is from Jeff Bernstein with Barclays.

A

**Jeffrey A. Bernstein**

*Analyst, Barclays Capital, Inc.*

Great. Thank you very much. Just a question on the IOM markets. It sounds like you mentioned the recovery is somewhat staggered. Just wondering kind of your bigger picture thoughts in terms of whether you expect the comp recovery, in I believe you said Australia, Germany, and France, whether you think those markets will ultimately accelerate to the UK and Canada levels, maybe providing the next leg of comp growth or, on the flip side, maybe there are reasons why you think those markets will continue to lag, whether structural or otherwise. Any thoughts there would be great. Thank you.

Q

**Christopher J. Kempczinski**

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

Yeah, sure. I'll start off, and then, again, Kevin can pick up anything that I miss here. But I think, overall, we remain very optimistic about our international portfolio. In the markets where we're seeing restrictions relaxed, those businesses are bouncing back and bouncing back in a very healthy way. The markets that you mentioned, like an Australia, like a France, they have certainly have had to navigate a more restrictive COVID environment.

We did get a peek earlier in the year, when things appeared to be getting better before the Delta variant, that those markets were poised to spring back. So from our expectation, as soon as the conditions in those markets start to become more favorable in terms of being able to return to normal operating conditions, we expect those markets are going to perform in a very healthy way because that's how they were performing pre-pandemic. So there's nothing structural that would make us concerned about their ability to bounce back.

A

**Kevin M. Ozan**

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

The only other thing I'd add is there are a couple of countries, the Spains and a little bit of France also, where they are more reliant on tourism. So as tourism starts getting back and returning a lot, that should help those countries, too. But some of the slower countries to come back are some of the more tourist-heavy countries as well as having some of these vaccine passports that just adds some logistical challenges with kind of checking customers coming in. But, as Chris said, there isn't anything structural that prevent all those countries from coming back strong.

A

**Mike Cieplak**

*Senior Vice President, Treasurer & Investor Relations Officer, McDonald's Corp.*

Our next question is from Brian Bittner with Oppenheimer.

A

**Brian Bittner**

*Analyst, Oppenheimer & Co., Inc.*

Good morning. Thank you. You had a breakout operating margin performance in 3Q and your consolidated EBIT margins year-to-date are now above 44%. And so the question is, how do you want us to think about the EBIT margin opportunity in a post 2021 world? Is there an opportunity to keep expanding from this elevated EBIT margin level? I know there's more opportunity to leverage G&A [ph] and (34:15) leverage D&A, but there's also a lot of inflation out there. So any color would be helpful.

Q

**Kevin M. Ozan**

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

A

Yeah, thanks for the question, Brian. Relating to our operating margins, I think at our Investor Update last year, we talked about for 2021 and 2022, we thought operating margins would be pretty much in the mid to low 40s. I think that's still our thinking right now. There will be some near-term moderation potentially of restaurant margins as some of the labor costs and commodity costs kick in, but we also expect to get leverage as sales are improving.

We're currently in the midst of working through our 2022 plan, so I don't have exactly specifics, but I think generally that mid to low 40s is the way we've been thinking about it, both for this year and for next year.

**Mike Cieplak**

*Senior Vice President, Treasurer & 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. I was hoping that you would elaborate a little bit more on the loyalty program and what you're seeing there in the early stages and just in terms of kind of what it's doing to the business currently. And then also, if you could give some perspective on how you're collecting data and what you're planning to use or to do with the data that you're collecting as we move into the next few years. Thanks.

**Christopher J. Kempczinski**

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

A

Sure. Well, we're really pleased with how loyalty is starting off in the US. We're seeing a similar very nice start to it in Germany and Canada. So we are – the more we learn about loyalty, the more optimistic that we get about loyalty.

I think for us, in terms of what that means for the business long-term, certainly the benefit you get with a loyalty program is the ability to increase frequency. And in the markets where we operate, roughly 80% of the population visits a McDonald's once a year. So it's not that we have a reach opportunity. It's about driving frequency in this business. And we've seen in the places where we have deployed loyalty, that it absolutely does increase customer frequency. So for us, that's really encouraging.

I think to the broader point of what do you do with the data, we had set out earlier an aspiration where we wanted to have 40% of our customers be known customers. Today, that number is probably only about 5% of the customers where we actually know who is the customer, what do they buy, what did they buy previously. You can imagine all sorts of things that you're able to learn about customers and their preferences when you're able to get more and more of your transactions where you know who the customer is. And loyalty is certainly the way that you get that customer to engage and share information with you.

So for us, I think we're just getting started on it, but very optimistic about what loyalty can do to this business. And by mid-next year, we're going to have loyalty in our top six markets, so I think the ability to give you a better idea of what exactly it's doing for the business I think once we have that kind of scale and rollout, we'll be able to talk with even more specificity about it.

**Mike Cieplak**

*Senior Vice President, Treasurer & Investor Relations Officer, McDonald's Corp.*

Our next question is from Dennis Geiger with UBS.

**Dennis Geiger**

*Analyst, UBS Securities LLC*

Thank you. Chris, just wondering if you could speak a bit more to the strong momentum that you got in the US and roughly how you maintain that momentum and the market share gains going forward.

I know you've been asked this question coming into the year and throughout the year and I think you've consistently suggested the momentum would continue despite having to lap some of the strong results that you've gone up against and you folks have done just that. So just kind of curious if you have any additional thoughts from here about how to think about that US momentum going into 2022, just perhaps framing up some of the key existing initiatives that maybe you've already touched on and, at a high level, any kind of upcoming things that will help support that momentum as you go into next year? Thank you.

**Christopher J. Kempczinski**

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

Sure. Well, I think a shout-out to the US team and our Owner/Operators for doing a great job of sustaining that momentum, as you mentioned, through what continues to be a challenging environment for all the reasons that have come up on this call, labor challenges, commodity inflation, et cetera.

I think the momentum that we're seeing in the US business is not something that just came about in the last couple years. This was something that started several years ago with the foundation that we put in place in the US. And the foundation was around modernizing our estate, improving the food, making investments in digital and delivery. And I think the fact that we were able to get all those things sort of embedded in the business back in, call it, 2017, 2018, set us up really well for what none of us could have predicted, which is what we've now experienced through COVID.

So I think for us, what I feel good about with the US is we've got sort of the foundational elements in place for this business to outperform or perform quite well for extended period of time.

As to how you do that, it's going to be back to the strategy that we have with Accelerating the Arches. It's a focus on great marketing, driving core menu, and outperforming on the three Ds, delivery, drive-thru, and digital. And so for us, a message that I'm talking about to the teams internally is we have the right strategy. It's all about execution. And we've got to execute at a really high level. If we do that on those three dimensions, then I'm confident. But we also can't get complacent, and I think there's a good healthy level of dialogue going on in the US right now about just keeping that hunger, keeping that momentum going. And once you've got it, you don't want to give it up. And that's the mindset right now.

**Mike Cieplak**

*Senior Vice President, Treasurer & Investor Relations Officer, McDonald's Corp.*

The next question is from John Glass with Morgan Stanley.

**John Glass**

*Analyst, Morgan Stanley & Co. LLC*



Thanks very much. First, on delivery, can you just update – I know you gave the total digital mix – what delivery makes up of that? And maybe quickly since just post COVID, there's been acceleration in that, kind of where it stands now versus prior?

You also, Chris, talked about maybe being more strategic in your partner – picking your partners in delivery. I just wondered if you could expand on that.

And just finally, Kevin, I just want to make sure I understand if you're selling the Tech Labs or transferring it to IBM, is there anything material we should know about, either G&A or anything that would impact the financials through that transaction?

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**Kevin M. Ozan**

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

I'm trying to get all the parts of that question.

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**Christopher J. Kempczinski**

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

Yeah. Well, I'll do the delivery question while Kevin is going through his notes on the other parts of this.

But so we don't share a specific breakout on delivery, but, suffice to say, delivery for us continues to be a really important driver for us. The business has grown by billions and billions, I think it's fair to share, over the last several years. And we're continuing to see, even as markets reopen and things start to get back to normal in places where they're able to get the dining room, et cetera, back open, delivery remains elevated. And so for us, I think what has become apparent is delivery was meeting a customer need that I don't think any of us fully appreciated, even maybe a few years ago. So it's here to stay.

What we're trying to do with our partners, the way that we had approached some of our delivery conversations previously with our 3PO partners, in many cases those were discussions that were happening at the market level. And when you are a company the size and scale of McDonald's, we certainly have, we believe, a great proposition for 3PO partners on a global basis. And so, what we're trying to do through these conversations is leverage the fact that we are the largest restaurant company in the world, that we have an ability to drive traffic onto 3PO apps that we think is second to none and that that should be reflected in the rates that we're paying with our 3PO partners.

So those conversations are proceeding, but I'd say there's a good recognition on both sides that we need each other. And I'm optimistic that we'll be able to get to a good resolution on that in the next couple months.

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**Kevin M. Ozan**

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

And then, just to follow-up on your question related to the – our transaction with IBM and the potential impact of that, there shouldn't be much of a financial statement impact of that. We had generally – I forget, maybe about – less than 100 people I think that were associated with that business. And so, those folks will now go work with IBM.

Really the reason we're doing this with IBM is to be able to have someone that can take how far we've gotten right now with the solution and be able to kind of finish the development and then help us deploy this at scale. And so,



we're going to use their expertise, certainly in AI and everything that they've learned from Watson, et cetera. But it isn't a big financial statement impact, plus or minus, I'll say, going forward from that.

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**Mike Cieplak**

*Senior Vice President, Treasurer & Investor Relations Officer, McDonald's Corp.*

Our next question is from Chris Carril with RBC.

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**Christopher Carril**

*Analyst, RBC Capital Markets LLC*

Hi. Good morning. Thanks for the question. So just following up on the US business, you noted the benefit to average check from larger order sizes and menu pricing, which you gave us some detail on a little while ago. Can you comment on your view of the sustainability of recent average check drivers? It seems like some of the recent guest behaviors are remaining consistent around group ordering, maybe perhaps longer than expected. So curious as to your thoughts around your ability or focus on maintaining check growth and perhaps how digital helps drive this going forward.

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**Kevin M. Ozan**

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

Yeah, I'll try, and I'll let Chris add on to this one. It's a good question because you're right. I think early on in the pandemic, I think we believed that the average check would decline quicker than it certainly has. And I think the reason, right now at least, is because the channels that much of our sales are going through, which continue to be things like drive-thru, delivery, digital, as you mentioned, people are still going through and ordering for several people. If you're getting delivery, you're getting it for your family or for at least a couple people. A lot of the folks going through drive-thru are getting orders for several people. And so, we are seeing those larger order sizes continue. And I think at least some of that will be stickier than we originally may have thought. So we don't anticipate, certainly in the near-term, average check returning back to the level it was at pre-pandemic.

I think – I lost my train of thought. But I do think we will continue to see the check continue to grow as those channels continue to grow. And like I said, we're not seeing any degradation of that check at this point.

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**Christopher J. Kempczinski**

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

Maybe just to fill in here a few things and I'll go back and quote my CFO from something that he said several quarters ago, which is we're still selling more stuff. We're still selling more sandwiches. We're selling more fries. And so, from a unit standpoint, while we certainly are looking at traffic, the absolute volume of what we're selling is continuing to grow. And for me, that's a really good barometer about the health of this business.

I think as to whether that's sustained, whether these larger parties, larger order sizes sustain, we're going to follow the customer to whichever way they want to go. If the customer starts to come back and split the ticket and we have smaller check, I think so long as we continue to focus on the execution, we'll be just fine on that. But certainly, I think what you're seeing right now and what we're expecting is that some of the benefits that we're seeing around larger check and the mix, the channel mix that goes with that, we're expecting that to continue.

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**Mike Cieplak**

*Senior Vice President, Treasurer & Investor Relations Officer, McDonald's Corp.*

Our next question is from Lauren Silberman with Credit Suisse.

**Lauren Silberman**

*Analyst, Credit Suisse Securities (USA) LLC*

Q

Thank you. I wanted to ask about the McPlant test in the US. Can you talk about what you've heard from consumers with respect to demand for a plant-based option? And then from a franchisee perspective, what's the demand to offer a plant-based option on the menu, particularly given the current operating backdrop? And it looks like the test is being conducted in diverse cities. Is there anything you can share on differences in demand across markets from the perspective of both consumers and franchisees?

**Christopher J. Kempczinski**

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

A

Yeah, I think in the US, it's really early to be making any kind of readout on what we're learning. I would point out it's in less than 10 restaurants in the US. It's largely an operations test right now. Now, there are other markets that are further along. The UK is in 250 restaurants and they're going to be planning on doing a full national rollout in the UK in Q1. In that situation, I think we have more evidence that it is filling an unmet need that certainly existed in the UK on their menu. So early results in the UK are very encouraging. A couple other markets as well in Europe have seen success with McPlant and the rollout on that.

So I think this is one where we've said all along, we're going to let the markets decide when is the best time to pull it down, based on what the customer acceptance or interest is in this concept. I think certainly, I can say, at this point, there are definitely a couple European markets where there is customer acceptance for it. Whether that is a broad-based acceptance in the US, I think we'll learn that over the next several quarters.

**Mike Cieplak**

*Senior Vice President, Treasurer & Investor Relations Officer, McDonald's Corp.*

A

Our next question is from Brian Mullan with Deutsche Bank.

**Brian H. Mullan**

*Analyst, Deutsche Bank Securities, Inc.*

Q

Hey, thank you. Just follow-up on the unit growth topic specific to the IOM segment. Putting aside transitory related and timing-related issues, do you see any opportunity to go faster on development there over the next few years versus what you might have previously been planning for prior to the pandemic?

And if you do see increased opportunity, is there any kind of upper limit in terms of the number of gross openings that make sense for that business? Is it just a function of managing the level of CapEx spend you're comfortable with, or are there actual operational constraints to think about, too?

**Kevin M. Ozan**

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

A

Yeah, thanks for the question, Brian. I think to be fair, we had started thinking about accelerating some of the openings internationally even pre-pandemic. Certainly nothing that's happened in the pandemic has changed our thinking at all related to that. And if anything, I think just reinforces our opportunity to continue growing in many of those International Operated Markets.

As far as any constraints, I think the constraints really are from a market perspective, there is kind of a sweet spot of what they can open in terms of building a pipeline, having the right real estate representative, opening in a way that isn't disruptive to the rest of the market. So we do have a lot of tools that we use to determine kind of what the appropriate opening level is for the markets.

I think we do have opportunity to open quicker in many of those markets than we have been. And I think our expectation is that we will continue to grow in many of those International Operated Markets, where we still believe there's a lot of opportunity.

We're just in the midst of going through our plans right now for 2022. So I don't have specifics yet for 2022, but I think it is fair to say that we would expect our openings next year to be higher than they are in 2021 and continue to kind of increase that level for a little while where we will – we've talked about unit growth being about 1.5% to 2% contribution to sales growth. Right now, we're at the lower end of that, more the 1.5%, and likely not a lot above that for 2022 because it really relates to 2021 openings. But as we go on, I would expect that to get closer to that 2% contribution.

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**Mike Cieplak**

*Senior Vice President, Treasurer & Investor Relations Officer, McDonald's Corp.*

A

The next question is from John Ivankoe with JPMorgan.

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**John Ivankoe**

*Analyst, JPMorgan Securities LLC*

Q

Lot about drive-thru, digital and delivery. The question really is on dine-in. And as you've seen various consumers in various markets respond in a post-COVID environment in terms of their behavior, what are you kind of thinking about using dine-in longer-term? And do you have an opportunity to pivot that asset even further to focus more on the off-premise consumer as we think about leveraging all of the asset and not just part of it?

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**Christopher J. Kempczinski**

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

A

That's a great question. And it is one that we're thinking about. It's something that is now on the plate for Manu Steijaert. Manu is, as we announced, I think last quarter it was, that he's the Chief Customer Officer. And one of the things that fits in Manu's portfolio is he has both restaurant design operations as well as the customer experience. And so, thinking about what is going to be the consumer acceptance on a sustaining basis for dine-in coming out of this and then what are the implications of that.

I would add we have a lot of PlayPlaces in our restaurants. What is the implication for the PlayPlace space? So we are just now starting to think about that and think about potential scenarios for how you might reuse the space if dine-in doesn't come back to the level that it was pre-pandemic.

But I think right now, it's still a little bit preliminary just because there's still noise in the dine-in numbers that I don't want to do anything hasty here until we just get a better bead on what does dine-in sustain at. But it's certainly something for us to be thinking about.

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**Kevin M. Ozan**

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

A

The only other thing I'd add is on the international side, certainly in Europe, dine-in is a bigger percentage of our sales and is an important part of that business, and we have seen dine-in return. I mean, kiosk usage is getting back to almost where it was pre-pandemic. And so families are – the family business is very important in Europe. And so, to Chris' point, we've got to be careful about what we do, because it isn't the same around the world as far as dine-in business and how customers view that side of the business.

**Mike Cieplak**

*Senior Vice President, Treasurer & Investor Relations Officer, McDonald's Corp.*

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

**Sara H. Senatore**

*Analyst, BofA Securities, Inc.*

Thank you. I wanted to sort of go back to the technology piece like in particular, on what I would characterize as big data. I know you're partnering with IBM because they have expertise. But as I think about loyalty, one of the things that I think has emerged is that's really about – it's not just the data, it's what you do with it.

Are there opportunities to partner, whether it's with IBM or other tech companies, within loyalty or maybe more broadly that you see where outside expertise would be useful? And maybe more specifically, is this a signal as to how you're thinking about technology in-sourcing versus outsourcing, so where McDonald's should own the technology or really has specific expertise and maybe customer-facing or UI versus some of the sort of behind-the-scenes capabilities? So just anything you can signal about that and longer-term as we think about your technology budget, does this change over time, not just with Apprente, but more broadly? Thanks.

**Christopher J. Kempczinski**

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

Yeah, thanks, Sara. And I think this is one where I'd go back to the conversation you and I had, I don't know, it was probably several quarters ago now, on this topic of how do we think about technology, what's insourced, what's outsourced. And my thinking then is the same as my thinking now, which is there are certain times where it may make sense for us to go acquire a technology, so that we can accelerate the development of that, make sure that [ph] it is bespoke to McDonald's' (55:54) needs.

But, at some point, that technology reaches a level of development where I think getting it to a partner who can then blow it out and scale it globally makes more sense. And so, I think what we did with Apprente is very much consistent with that philosophy, which is we've had it for a couple years. I've been really pleased with how the team has progressed the development of that. We're seeing some very encouraging results in the restaurants that we have it. But there's still a lot of work that needs to go into introducing other languages, being able to do it across 14,000 restaurants with all the various menu permutations, et cetera. And that work is beyond the scale of our core competencies, if you will. And so, I think in this case, IBM is a natural partner for us.

I think going forward, it's going to be very much on a case-by-case basis as to when we just – we go from day one with a partner versus one where we might bring something inhouse for a period of time. But the nice thing about being McDonald's is we're everybody's first call when it comes to a partner in the restaurant industry. And so, we have a really good visibility to the various partners out there. And certainly, I think our overall view is we are best on a long-term, sustaining basis to use others externally partnering. But again, there may be time-to-time where there's benefit for us from being able to accelerate and learn how to have it in for a period of time.

**Mike Cieplak**

*Senior Vice President, Treasurer & Investor Relations Officer, McDonald's Corp.*

Our next question is from Jon Tower with Wells Fargo.

**Jon Tower**

*Analyst, Wells Fargo Securities LLC*

Great. Thanks for taking the question. I'm just hoping to tie it into some earlier questions. I was wondering if you could get into how your customer demographics may be shifting in the US. And specifically, it seems like either through product innovation, obviously new mediums in terms of ordering, or even in marketing, you're talking to a younger customer than you've been talking to for years. So I'm wondering if that's actually showing up in the data and if frequency is changing amongst that group, which is obviously a good lead indicator for longer term demand for the business. But if you wouldn't mind expanding, that'd be great.

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**Christopher J. Kempczinski**

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

A

Sure. Well, I think not just in our industry, but across I'd say most consumer industries, the youth and the preferences and desires of the youth drive consumer demand, whether it's in apparel, beverages, restaurant, et cetera. And so, it becomes a very natural demographic to target. That 18 to 35 target is, you know from a media standpoint, probably the most coveted, the most expensive demographic to reach because of the brand preferences that get formed at an early age and that sustain over the lifetime value of that customer.

So I think you're absolutely spot-on in observing that we have made a more demonstrable push against that demographic. And I expect that that's going to continue. And it's one that we believe at McDonald's that we have a brand that can be part of culture. And we probably have not, in my view, we haven't done enough to lean into the stature of our brand and culture and how we can connect to that. And so I think finding properties, finding a message that resonate with youth but also resonate more broadly in culture for us is a big upside opportunity.

And we're seeing other markets, the US started some of this, but we're seeing other markets like Russia, like Spain, pick up on the Famous Orders concept and getting very similar results on that. And it just, to me, it speaks to the ability of this brand and what we can do with it.

I think in terms of how is that changing the mix, it's still early days on this. So I think we are seeing certainly the brand sentiment improving, but we're also having to move a pretty big boat here. And so, we're not yet seeing it show up in terms of a big demographic shift within the business, but, frankly, nor did we. This is something that I think for us is going to sustain over several years and it's, again, it's about making sure that our brand is one that is as powerful in the future as it has been in the past.

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**Mike Cieplak**

*Senior Vice President, Treasurer & Investor Relations Officer, McDonald's Corp.*

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We have time for one last question from David Palmer with Evercore.

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**David Palmer**

*Analyst, Evercore ISI*

Q

Thanks. Thanks for squeezing me in. A quick technical question. Was there a gap between the company and franchise same-store sales growth, particularly in the IOM and especially on two-year? I ask that because I remember you used to have a lot of company stores in urban centers, which I would imagine would be slower to recover.

But my bigger picture question was on free cash flow. Do you anticipate the free cash flow yield moving up over time? I would imagine that over 100% would be achievable given the gap between depreciation and maintenance CapEx on the owned real estate franchise restaurants. And if you agree, when do you think you could get there? And perhaps you can give us a window into how you're thinking about growth CapEx, of course, which would be in that answer. Thanks.

**Kevin M. Ozan**

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

A

Yeah, let me start with your comp question, I guess. For the third quarter at least, both the US and IOM comps were a little bit higher with franchisees than they were with company-operated. That's not dramatically different than historical, I'll say. So for a while, that's generally been the trend. Some of that is driven certainly in the US, depending on the location of where our company-operated stores are versus others, but in general, franchisees are running a little bit ahead of company-operated on a comp basis. And that, that is what we saw, both in the third quarter and on a year-to-date basis, I'll say, this year.

Related to free cash flow, we've said we expect our free cash flow [ph] coverage to (01:02:22) conversion to be greater than 90%, both for this year and going forward. I don't want to surmise of when or if it could get to over 100%. For now, we're going to stay with that over 90%.

I think we are seeing that we have a pretty healthy flow-through in our P&L that converts to free cash flow. The big question right now, and, again, as I mentioned a couple times, we're still in our planning phase to look at capital requirements and what that means related to some of the opening opportunities that I mentioned earlier, et cetera. So we've got to take all those pieces into account to figure out what the free cash flow profile looks for several years.

We do expect free cash flow dollars to continue to grow and I would expect that free cash flow conversion certainly to stay at high levels.

**Mike Cieplak**

*Senior Vice President, Treasurer & Investor Relations Officer, McDonald's Corp.*

Thank you, Chris. Thank you, Kevin. Thanks, everyone, for joining. Have a great day.

**Operator:** Thank you. This does conclude McDonald's Corporation Investor Conference Call. You may now disconnect.

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