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McDonald's Corp. (MCD)

Q4 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Hello, and welcome to McDonald's Fourth Quarter 2021 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

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

Hello, 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 filings also apply to our comments on the call today. Both of those documents are available on our website, as are reconciliations of any non-GAAP financial measures mentioned on today's call along with their corresponding GAAP measures. Following prepared remarks this morning, we will take your questions. Please limit yourself to one question and reenter the queue for any additional questions. Today's conference call is being webcast and is also being recorded for replay via our website.

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

Christopher J. Kempczinski

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

Thanks, Mike, and good morning everyone. A little more than a year ago, I said that we were witnessing the beginning of the next great chapter at McDonald's, and it's clear that there has never been a better time to be part of Brand McDonald's than right now. The past 12 months continue to demonstrate what makes McDonald's different: the strength of our people, the might of our scale and supply chain, the agility of our system, the importance of local ownership, operating in the communities we serve and the power of the McDonald's brand. Despite the many disruptions caused by COVID, it's clear from our performance that when the going gets tough, McDonald's gets going and our system's inherent strengths become even more apparent.

2021 was a record-setting year for McDonald's on many dimensions, and we used this momentum to lean into our competitive strengths and build further advantage. Guided by our strategic plan, Accelerating the Arches, we made significant investments behind our brand purpose to feed and foster communities while envisioning new ways for us to serve our customers, leveraging our growing digital capabilities.

As a system, we are laser focused on our MCD growth pillars. In the first full year of the Accelerating the Arches strategy, we made great strides as we maximized our marketing, committed to our core menu and doubled down on the three Ds of digital, drive-thru and delivery to create seamless, memorable experiences for our customers. Our focus on the MCDs has driven broad-based growth in 2021. While we expect that 2022 will be a year of continued progress, we also anticipate that many of the challenges we experienced in 2021 will endure. A surge in COVID-19 cases and a return of restrictions in many of our markets are creating uncertainty around the world, exacerbating labor shortages and supply chain delays. Additionally, rising consumer inflation levels are putting pressure on restaurant economics. Focusing on our foundational operations, expanding our growing digital advantages and continuing to put the health and safety of our customers and crew first will remain critical to executing on Accelerating the Arches this year.

And with strong average unit volumes and restaurant cash flows, the company and our franchisees are well positioned to withstand the pressures ahead. In fact, franchisee cash flows hit all-time highs in most of our top markets including the US, UK, Canada, Germany and Japan. I've said it repeatedly over the past two years and I'll say it again, I have never been more proud of the commitment and leadership of our restaurant managers and crews. Through even the most difficult moments, they have continued to be strong, keeping our restaurants running while providing hope and inspiration and extraordinary service to our customers and our communities every hour of every day.

Because of our unparalleled scale and dedication of our entire system, our employees, franchisees and suppliers, 2021 was a banner year for McDonald's despite the continued disruptions caused by COVID. In addition to the franchisee cash flow performance I mentioned, we hit all-time highs for global system-wide sales of $112 billion, comparable sales growth in the US of 13.8% which represents over $5 billion of system-wide sales growth and operating income of more than $10 billion.

To expand on how Accelerating the Arches drove success, let me pass it over to Kevin.

Kevin M. Ozan

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

Thanks, Chris. As we've talked about before, the customer-focused actions we've taken over the past couple of years continue to drive strong topline momentum. Our global comp sales were up over 12% in the fourth quarter or nearly 11% on a two-year basis. As a result of these actions, we've gained QSR traffic share across most of our major markets since 2019. This is particularly evident within the International Operated Markets, where off-premise channels remain a significant competitive advantage in this fluid COVID environment. Our IOM comp sales for the fourth quarter were nearly 17% or just over 8% on a two-year basis, with strong two-year double-digit growth in the UK and Canada and high-single-digit growth in Australia. Later in the quarter, we had stops and starts in markets like Germany and France, where elevated COVID trends and heightened government restrictions interrupted recovery.

Our UK performance was driven by continued growth in our delivery business and strong marketing featuring core menu items such as the Double Big Mac. Canada also saw increased delivery momentum, with October being the strongest month of delivery sale to-date. And a highly successful launch of MyMcDonald's Rewards Loyalty Program drove significant digital engagement. Australian consumers began to emerge from stay-at-home restrictions throughout the quarter. Our 30 Days, 30 Deals value platform was a strong contributor to comp growth for the quarter and drove app usage as we prepare for our loyalty launch in the first half of this year.

As I mentioned, there are still challenging operating conditions in Germany and France, but we remain confident about our market share opportunities. Germany continued to benefit from a strong third quarter rollout of Loyalty as well as a digital advent calendar in December, accelerating both app adoption and digital sales in the market. And in France, we highlighted our core menu with the launch of our new premium chicken line featuring wraps and the chicken McBaguette.

In the US, we finished the year strong with comp sales up 7.5% for the quarter and over 13% on a two-year basis. We saw positive comps across all dayparts, which are still benefiting from average check growth, driven primarily by strategic menu price increases. Our MCD pillars continue to drive US comps, as strong marketing efforts behind McRib and the Crispy Chicken Sandwich were complemented with digital adoption by our customers.

Digital growth remains a key driver of success in the US. Our loyalty program continues to build, with digital sales growing month over month. Chris will share additional headlines on our digital strategy and success in a few minutes. All of this top line growth has also fueled franchisee cash flows to record highs in the US, with average growth in 2021 of around $125,000 per restaurant, putting our franchisees in a strong position to weather the inflationary pressures Chris talked about earlier.

Turning to the International Developmental Licensed segment, momentum accelerated in Q4 with comp sales up over 14% or 10% 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 achieved its 25th consecutive quarter of comp sales growth with strength across our delivery and digital channels, while our dinner daypart benefited from compelling value programs and the introduction of new menu items. Recovery in China, however, continues to be impacted by COVID-related government restrictions, which significantly disrupted the restaurant industry in the fourth quarter. While comps were negative for the quarter, we expanded our digital presence with the successful year-end festival for app members, and we opened over 650 restaurants for the year.

Turning to the P&L, company-operated margins, particularly in the US, were pressured for the quarter as a result of higher labor and commodity costs. G&A for the quarter increased 9% in constant currencies. As I've mentioned before, the increase was primarily driven by higher incentive-based compensation expense as a result of company performance significantly exceeding our plan for the year.

Foreign currency translation negatively impacted fourth quarter results by $0.03 per share, and after a tax rate of over 22%, which included some one-time items, adjusted earnings per share was $2.23 for the quarter. For the full year, adjusted operating margin was 43.4%, reflecting higher restaurant margins across all segments and higher other operating income. Despite some of the P&L pressures I mentioned, topline results generated restaurant margins of over $12 billion for the year, an increase of over $2.5 billion.

Before I hand it back to Chris, I want to touch on CapEx and our free cash flow profile. Our overall capital spend for 2021 was a little over $2 billion, slightly lower than our original expectations, primarily due to the timing of projects. With the improvements we've made to our business model over the last several years and the consistent strength of our global business, our free cash flow grew to $7.1 billion in 2021, an increase of nearly 25% over 2019, and free cash flow conversion was 94% for the year.

With that, I'll pass it back to Chris.

Christopher J. Kempczinski

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

Thanks, Kevin. At McDonald's, we've long prided ourselves on the relationships we build with our customers. For decades, they relied on us to provide hot, delicious food with service that's fast, friendly and reliable. That promise is what keeps them coming back. And it's why we see every guest interaction as an opportunity to drive customer loyalty, whether through digital channels like our app, in person at our restaurants and drive-thrus, or off-premise through delivery.

While each pillar of our Accelerating the Arches strategy is formidable on its own, the real power is when the M, C and D come together in combination with the customer at the center. That's what enabling us to continue to make customer recognized progress as we did once again this quarter. For starters, McDonald's continues to set a new standard for marketing in our industry. We're focused on taste, affordability, family and brand trust, and we've raised the bar on creative excellence with one of the most talented marketing teams in the world. Behind our marketing success is McDonald's iconic core menu. This quarter, we saw strong performance that resulted in market share gains for both beef and chicken. Our core classics aren't just the heart of our business, they're also a central part of our growth strategy. Iconic favorites like the Big Mac, Chicken McNuggets and our world-famous French fries drive almost 60% of our total business and about 75% of our food business. And we continue to make them better.

We've implemented enhanced cooking procedures and new buns in over 20 markets including Australia, Canada and Russia that result in hotter, fresher-tasting burgers. Customers have told us that they noticed improved taste and quality, and we're excited to deploy these standards in most markets across the globe over the next couple of years.

To complement our leadership in beef, we're also focusing on growing our market share in chicken by leaning into the strength of core equities like Chicken McNuggets as well as creating the core classics of tomorrow. We've begun to make progress with new chicken sandwiches in the US and many of our international markets. We've gained IEO market share in chicken in every single one of our top 11 markets since 2019. And after a successful pilot of McPlant in 250 restaurants in the UK, we're excited that McPlant is now available across all of our restaurants in the UK and Ireland.

Of course, being customer-driven is about more than just menu items. Our investments in technology and digital are paying off, as our digital engine continues to make the customer experience more seamless and fuels growth in the process. Our top six markets saw more than a quarter of their system-wide sales or $18 billion come from digital channels in 2021, a 60% increase over 2020.

We now have loyalty programs in more than 40 markets including the US, Germany and Canada, each of which launched in 2021. In the first half of 2022, we're excited to bring MyMcDonald's Rewards to consumers in the UK and Australia. We're well on our way to building the world's largest loyalty program. Loyalty is the single biggest driver of digital adoption, and MyMcDonald's Rewards has exceeded expectations in terms of enrollment and participation. After just six months in the US, there are over 30 million loyalty members enrolled and 21 million active members earning rewards.

I mentioned earlier the importance of customer relationships. With Loyalty, we're building on a strong legacy of meaningful customer relationships and driving greater customer engagement and re-engagement. And in the first few months of our Loyalty launch, we're seeing an increase in digital customer frequency of over 10%.

Moreover, strategic partnerships have been fundamental to our digital growth strategy. Dynamic Yield has been instrumental in bringing our drive-thrus and self-order kiosks into a new era for customer engagement. Last month, we announced that Mastercard will acquire Dynamic Yield. As part of our broader strategy to better scale our assets, our collaboration with Mastercard will help us expedite and integrate capabilities across ordering channels and across the globe to continue providing an even more personalized customer experience.

Delivery is a bet we made long before COVID and continues to be a staple for consumers. Our delivery footprint has expanded to more than 33,000 restaurants in 100 countries, and in the fourth quarter, our momentum continued with double-digit comps over strong growth in 2020. We've entered into new long-term strategic partnerships with two of our largest global delivery providers – Uber Eats and DoorDash. These multiyear deals are mutually beneficial and unlock tremendous value for our customers and franchisees, helping to ensure the long-term profitable growth of delivery. And as we integrate McDelivery into our app, we'll enable an even more seamless and personal customer experience.

Even as our digital and delivery engagement rises, the drive-thrus remain an essential channel, especially as customers seek safe, contactless access to McDonald's. We continue to see a higher percentage of sales in the drive-thru compared to pre-pandemic levels. While average drive-thru service times have improved since 2019 across our top markets, service times slowed in 2021 in the US and many markets compared to 2020. With industry-wide labor availability challenges, our market teams are focused on the foundational elements to maximize throughput, from staffing and positioning to new technology. Collectively the investments we've made in our MCDs paid off in 2021, and we're confident they will drive even greater growth across the system in 2022 and beyond.

I'll turn it back over to Kevin to talk about our 2022 outlook. Kevin?

Kevin M. Ozan

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

Thanks. Looking ahead this year, as Chris said, we're confident that our Accelerating the Arches strategy will continue to drive growth against an uncertain macro backdrop. We expect that our 2021 net new restaurant openings of about 2%, along with planned expansion in 2022, will contribute about 1.5% to our system-wide sales growth in constant currency this year. We're focused on increasing our overall operating margin over the long term, as it serves as the most comprehensive gauge of operating performance. In 2022, we anticipate our operating margin percent will continue to be in the low to mid-40s range, as strong topline momentum and minimal other operating income will be hampered by significant commodity and labor inflation in the near term.

We've seen our digital and technology investments over the past few years drive topline growth. As we continue to strategically invest in digital and technology, we're also carefully managing our G&A. In 2022, we expect G&A to be about 2.2% to 2.3% of system-wide sales. Beyond 2022, we expect to gain leverage on both G&A and operating margin through continued sales growth. Based on current interest and foreign currency exchange rates, we're projecting interest expense this year to be relatively flat compared to 2021. And under current tax legislation, we expect our effective tax rate for the year to be between 20% and 22%.

Finally, based on current exchange rates, we anticipate currency translation will negatively impact EPS between $0.05 and $0.07 in the first quarter and between $0.18 and $0.20 for the full year. As usual, this is directional guidance only, as rates will change as we move through the year.

Transitioning to capital expenditures, we anticipate spending between $2.2 billion and $2.4 billion this year. About 40% of this will be allocated to our US business where we expect to have net restaurant unit growth for the first time in a few years. Most of the US spend will go towards reinvestment, including the completion of our restaurant modernization efforts. About half of our total capital spend will be dedicated to new unit openings. Globally, we plan to open over 1,800 restaurants, with more than 500 of these openings in the US and IOM segments. The remaining 1,300 new restaurants, including roughly 800 in China, will be across the IDL markets, where our strategic partners provide the capital for restaurant openings. We anticipate net new restaurant growth of about 3.5% for the year.

We also expect our strong cash flow growth to continue in 2022, and after the CapEx spend I just talked about, we'll continue to convert more than 90% of our net income to free cash flow as we have the last few years. Going forward, our capital allocation priorities remain unchanged. First, to invest in new units and opportunities to grow the business along with reinvesting in existing restaurants. Second, to continue growing our dividend. And third, to repurchase shares. It's during times like this that the strength of the McDonald's system and scale are more beneficial than ever, and I remain confident that our strategy will continue to deliver sustained, long-term profitable growth for our system and shareholders.

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

Christopher J. Kempczinski

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

Ray Kroc built McDonald's as both the most independent and interdependent brand on the planet. From the beginning, Ray wanted the McDonald's franchise model to be a two-way street. In doing so, he unleashed the creative power of franchisees who had ownership in their businesses. Together we have built a brand that is second to none. We see the power of that brand every single day. We see the power of the brand reflected as part of the cultural fabric in communities around the world. We see the power of the brand in the value of restaurant ownership and the strong cash flows that our franchisees are experiencing. Most of all, we see the power of the brand in the ways our thoughtful decisions and investments have resulted in our collective strength today. It enabled us to build an unrivaled customer experience where modern restaurants and innovative digital technology served more than 65 million customers every single day.

Now, as we prepare to come together with our franchisees in April for the first time in four years at our worldwide convention in Orlando, we will celebrate the McDonald's brand and talk about how this generation of system leaders will put their own shine on the arches. The answer will certainly be rooted in how we create a more seamless customer experience that connects the physical restaurant to our digital channels, but it will also be based on one of our founding principles in the model: building a business that is representative of our customers and communities, where equity opportunity is central to our business. We cannot let economic or other barriers stand in the way of bringing the best talent into the system. It's part of our brand's commitment to diversity, equity and inclusion, and we're demonstrating this commitment in various ways throughout our system including a mutual DEI pledge for suppliers, incorporating human capital metrics into annual compensation for senior leaders and a commitment to equal pay for employees.

Last month, we were proud to announce a franchisee recruitment initiative focused in three areas: recruitment, financing, and ongoing learning and development. Our goal is to create opportunities and increase the number of new franchisees from all backgrounds, including women and historically underrepresented groups in McDonald's operated markets around the world. I'm excited and optimistic about the months and years to come. Together as a system, we will continue to bring Ray Kroc's vision for collaboration to life, while providing customers the food they crave, the experience they treasure and the brand they love. It's this commitment that will accelerate the arches, while helping us feed and foster communities everywhere.

Thank you. And with that, we'll take questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions]

Mike Cieplak
Senior Vice President, Treasurer & Investor Relations Officer, McDonald's Corp.
A

Our first question is from Andrew Charles with Cowen.

Andrew Charles
Analyst, Cowen & Co. LLC
Q

Great. Thanks. Kevin, this quarter is a little different that the formal outlook in the 8-K did not he provide a 2022 system sales outlook. And usually you guys provide some commentary around the forward quarter, around how you see sales and margins progressing. And I recognize that media reports two weeks ago around a 10% reduction in operating hours due to staffing challenges is probably presenting some lack of visibility. But if you can just help level set, what are you seeing out there at the start of January, just given the staffing dynamic and kind of how you see the potential for US sales progressing over the course of 2022, just given the [ph] market share gains (00:24:55) you saw last year as the strategy really is working.

Kevin M. Ozan
Chief Financial Officer & Executive Vice President, McDonald's Corp.
A

Yeah, thanks, Andrew. Let me start with some of the sales commentary, and then I'll let Chris talk about the 10% labor thing that you were talking about because that came out of a discussion that Chris was having. First, I guess, let me say that as things hopefully are starting to stabilize a little bit with some of the stops and starts, I think our thinking is to go back to some of our practices from pre-pandemic and not focus a lot of commentary guidance on current quarter. So we're going to try and go back and not give a lot, kind of, in current month. But what I would say is we're really pleased with our 2021 performance in the US. You heard both in the prepared remarks as well as seeing in the release the US put up its highest annual comp basically in our history. We have really good momentum as we start going into 2022. Our franchisees are very strong financially. Their cash flow has grown over 50% over the last three years. So from a US sales perspective, we feel really good.

The focus in 2022 is going to be in a few specific areas. It's on chicken where we want to continue our market share gains that we've been experiencing. It's on digital and loyalty. You've heard about kind of the beginning of the loyalty program, and we think that still has considerable runway to grow. And it's on operations execution in the restaurants, which is really about kind of our people practices as well as service. So I'd say going into 2022, we feel really bullish on kind of the US momentum in the business where we are right now. Our franchisees are working hard. There are still some challenges from the labor perspective, but the restaurants are running pretty well and we feel good about sales opportunities this year.

Christopher J. Kempczinski
President, Chief Executive Officer & Director, McDonald's Corp.
A

Yeah, I would just add, our franchisees have done a phenomenal job working through what is a really challenging staffing environment. Omicron certainly didn't make that any easier, but as of this week, we are now down to – only about 1% of our restaurants in the US are operating with limited hours. So franchisees have been able to make significant progress in ensuring that they've got the staffing that they need. And we actually are exiting 2021 with our roster size, the average number of people that work in the restaurant. Our roster size at the end of 2021 is greater than where we were entering into the beginning of the year. So franchisees again have done a nice job, but it certainly is challenging. I think we're in a good place, though, in terms of having the vast majority of our restaurants, 99% of them, operating now with normal hours.

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. A couple part question here on the unit growth outlook. One, I just wanted to get more perspective from you on what's driving the big uptrend here in openings and whether there's certain markets you'd call out as particularly strong in terms of the outlook. And then, secondly, Kevin, if you could just explain a little bit why a 3.5% unit growth number for this year would only translate to 1.5% of system sales. And I understand there's some mix impacts on that with respect to IDL, but was curious to sort of understand the dynamics there and what perhaps the run rate contribution to system sales would be from that type of growth. And thank you.

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

A

Yeah. Hope I caught all the parts. Let me try. So I think we've said for 2022 our unit growth will be about 3.5%. And that – it's really if you think about it, it's more – current year sales growth is really driven more by prior year unit growth than current year, but obviously current year has some impact. So we've said last year's about 2% unit growth plus what we're opening this year will give us about 1.5% of sales growth. Part of that is – most of that is mix. I mean, if you think about where we're opening, we said about 800 of those openings are in China. Those are generally open up in a little lower volume certainly than either the US or our European markets, and so that drives the difference between unit growth rate and the contribution of system-wide sales.

Going forward, post 2022, our expectation is of unit growth of about 3.5% to 4%. That will give about 2% contribution to system-wide sales growth. And again, same dynamic where a chunk of those openings will be in China at a little bit lower volume. I would say the other places where we are opening besides accelerating China are in most of our large markets. That's Canada, France, UK, Australia and even the US. We believe there's still significant opportunity to grow units in our major markets, and we earn really good returns on those new openings. So from our perspective, it's a very good use of capital, and so that's what we'll see going forward.

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

A

Our next question is from Eric Gonzales with KeyBanc.

Eric Gonzalez
Analyst, KeyBanc Capital Markets, Inc.

Q

Hey, thanks for the question. I think you mentioned $125K increase in the store-level cash flow in the US, which I think puts you around $500K per unit if I'm not mistaken. So obviously there's overearning that occurred in the early part of the year, and 4Q's run rate was likely seasonally lower given the company-owned margin. So can you talk about how much of that you expect to hold onto in 2022 and what you're seeing right now in terms of commodity and labor inflation and how much pricing is in the system? Thanks.

Kevin M. Ozan
Chief Financial Officer & Executive Vice President, McDonald's Corp.
A

Okay. There's definitely a lot in there between cash flow and commodity and pricing. Let me try and hit a few things there. Let me start with the cash flow perspective because we did say our unit cash flow is up about $125,000 for the year. Again, looking over a three-year period, it's up about 50%. It does get you over $500,000 on a individual restaurant basis. It is fair to say to your point that there is commodity pressure going into 2022. Just to give a perspective, in 2021, in the US, our food and paper costs were up about 4% for the year. If we look forward to 2022, our expectation is that will be about double or in high-single digits increases for 2022. Most of that pressure or more of that pressure will be in the first half of the year, and as the year progresses, we expect that to ease somewhat. On the international side, just to give a similar perspective, we saw about a 3% increase in food and paper costs in 2021, and that increase is supposed to be around double also in 2022. Similarly, more pressure early in the year. So there is some pressure certainly, again more early in the year on margins and therefore on cash flow also. We certainly don't expect it to wipe away what we gained either in 2021 or prior to that. But it certainly will pressure again both margins and cash flow.

From a pricing perspective, our franchisees, I think you know, they obviously decide pricing for their individual restaurants. They're advised by a third-party, and the pricing mechanism or methodology that's used is a consumer-based research approach. We take into account market conditions, economic environment, competitive landscape, et cetera. Generally try and take small increments of pricing at various times versus taking a lot at one time. And really the most important thing that we're trying to balance is cost pressures with making sure that we provide good value to our customers and that our customer ratings on value remain high. We do keep a close eye on that. Our customer ratings have continued to score well on the idea of providing good value for money, and that's a really important metric for us because obviously a lot of our customers are looking to make sure that they're getting value as inflation rises. So that's some of the pricing dynamics that go on.

Mike Cieplak
Senior Vice President, Treasurer & Investor Relations Officer, McDonald's Corp.
A

Our next question is from John Glass with Morgan Stanley.

John Glass
Analyst, Morgan Stanley & Co. LLC
Q

Thanks very much. I wondered just on Loyalty if you think about how you think about that impacts sales in various markets in 2022. Is there a way to quantify early on what you've seen in later stages of 2021 in the US, for example, or earlier markets like, for example, France where you've had Loyalty for a number of years maybe as a benchmark? How has that contributed to their sales growth as we think about how that may benefit the system in 2022 and beyond?

Christopher J. Kempczinski
President, Chief Executive Officer & Director, McDonald's Corp.
A

Thanks, John. It's Chris. We're excited about what we're seeing with Loyalty. I think two things for us got us excited about it. The first is we are seeing that our consumers who end up going into the Loyalty program, their satisfaction with McDonald's is stronger. And so for us that's important because what it says is we're providing something of value to them, not just any of the offers or rewards that they might be able to get, but they're also enjoying the personalization and the feeling that we are through Loyalty able to deliver them a MyMcDonald's experience. So that's the first point.

The second point – and we've talked about this in the past – is that with a brand like ours where you have reach of, call it, 80% or so in our biggest markets, that the power of Loyalty is about being able to drive frequency, and so for us, we are seeing nice frequency benefits as we are able to deploy Loyalty about 10%, as I made in my comments. And so what that ends up doing in terms of contribution to comp is a function of just how quickly we can bring on active monthly users, and that's the focus. Finding programs, finding ideas where we can get more of our customers coming into our restaurants engaged as active users and Loyalty. And to the degree that we're successful in that, the contribution to comp will be bigger, but we're excited about what we're seeing.

Mike Cieplak

Senior Vice President, Treasurer & 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, just a follow-up on the Loyalty piece. And I guess thinking more broadly about digital within the US this year in general. As far as sort of the digitization of the drive-thru, some of the other points of digital focus that you've mentioned earlier and where that can go this year and beyond, is the general view that the contribution to sales and maybe even over time to cost savings, managing margins, does that continue to increase? Do the gains that you saw in 2021 get further even in 2022 given your focus and given the investment in addition to, again, the Loyalty answer that you kind of just addressed?

Christopher J. Kempczinski

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

A

We definitely see digital more broadly as a long-term macro trend that's going to affect our business. We're now at about 25% of our business is through digital channels. I think that number is going to continue to grow. We have some markets where that number is north of 50% of the business, like in China, like in France. Others are very close like in the UK where it's right at about 50%. So digital for us is a long-term play. It's part of why, as you know, earlier last year, we made a move to create the Global Chief Customer Officer because I think our opportunity is to meld more seamlessly the physical experience with the digital experience. And I think that's a big part of what Manu and his organization is going to be able to do. So for us, we're excited about what digital can do, and I do think that there is – right now there's a lot of focus on what it can do for the customer experience. But as you digitize more of your transactions, I do think it opens up opportunities on the operations side as well, and so for us, this is going to be something we'll be talking about for years to come.

Mike Cieplak

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

A

Our next question is from Jared Garber with Goldman Sachs. Jared, are you there? We're going to move on. I think our next question will be from – are you there, Jared?

Jared Garber

Analyst, Goldman Sachs & Co. LLC

Q

Yeah, sorry about that. I had a phone issue. Wanted to ask a question about unit growth. Obviously the franchisee free cash flow seems really strong, so not a demand issue, but wanted to get a sense of what you're seeing in terms of maybe the construction environment with respect to labor and staffing or permitting or equipment availability and supply chain.

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

A

Yeah. It's a fair comment. I think in my prepared remarks I mentioned that our CapEx was a little – for 2021 was a little bit lower than we originally had anticipated, and it was really just due to timing of projects more than anything. I think it is fair to say that everything is taking a little bit longer, I'd say, than how it used to. That's from permitting to getting supplies and construction materials to dealing with labor issues at construction firms, et cetera. And so we did see some of that in 2021. My sense is it's starting to get a little bit better, but it's still not back to where things were pre-pandemic. So everything still is taking a little bit longer from permitting to construction to getting all of the equipment and technology that we need for opening and remodeling restaurants. But the guidance we provided related to both CapEx and openings, we feel pretty good about both of those. But we'll keep an eye on those as the year progresses to make sure that it's kind of advancing the way we expect right now from a supply chain perspective.

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

A

Our next question is from Jeff Bernstein with Barclays.

Jeffrey A. Bernstein
Analyst, Barclays Capital, Inc.

Q

Great. Thank you very much. Just wanted to follow up on the inflation and pricing commentary. And I appreciate the color you gave on commodities. So just shifting a little more to labor. I think you mentioned you're now down maybe only 1% with stores reduced operating hours in the US. I know the comment a couple of weeks ago was 10%. So I'm just wondering if you can provide some color on that improvement and whether you still expect another year of maybe 10% inflation in 2022 similar to 2021. And as it relates to that, just the pricing, if there is any more color you can provide in terms of elasticity. I think you were running 6% price in 2021, which I think would be above your historical comfort zone. So I'm just wondering what your thoughts are for 2022, whether there's any concern about affordability on the lower end. Thank you.

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

A

Sure. I'll address a couple of those, and then I think Kevin will pick up on a couple as well. So in terms of the progress that we've made, I would point out the 10% number that I referenced was when I actually had that comment, that was middle of December, and we were in peak Omicron. I know the report on that came out later, but actually the time I had that interview, that was mid-December. So we've had about six weeks or so, call it five weeks, of ability to continue to work away on the staffing side. And that's where our – again our franchisees have done, I think, just a terrific job of finding ways to get the talent that they need into the restaurants to keep the restaurants running. And so that is where we're now at, which is this 1% of restaurants with limited hours.

I think for us part of what we needed to do in 2021 to be able to leave the year with expanded roster size is you've certainly seen that there has been labor inflation. And we announced, as you know, back in April of last year a move from McCopCos, where we were going to take up the average wage in McCopCos. We had about low-teens, I'd say, increases at that point. We went up probably a tick higher as the year progressed on that in McCopCos, and our franchisees similarly saw inflation, call it, in the mid-teens from a labor standpoint. One of the things that we also did, though – and I think Joe and the US team did a lot of good work with our franchisees on this – is talking about our employee value proposition and beyond wages, other things that we can be doing to make sure that we've got the best proposition to get people in our restaurants. Things like paid time off, Archways and what we do around tuition reimbursement and just a focus on making sure the reward and recognition is there. All of those things cumulatively – wages, focus on the employee value proposition and just engaging with the crew – is what allowed us to make the progress. As you go into this year, we are expecting that there is going to continue to be pressure on wages. Certainly as we're thinking about our pricing, we're thinking about how do we put pricing that can anticipate that, but I'll let Kevin tell you more on that.

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

A

Yeah. So to Chris' point, we had kind of this one-time, if you will, adjustments or concerted effort to adjust people's wages. Right now, there isn't a specific plan to have a one-time event like that in 2022. But what we do need to do is continue to make sure that our folks are being paid at a similar level compared to industry as the intent was last year. So that will continue to have some pressure, but we won't have kind of the one-time big bang, if you will.

From a pricing perspective, in the US in 2021, consistent with what I have been saying kind of for the first nine months, we ended up with pricing for the year a little over 6% or so. Again, that was to deal with the 4% commodity price increases that are food and paper increases we had as well as labor inflation and just the competitive environment. That was relatively similar to where Food Away from Home was for the year in 2021. And the positive from our perspective that we keep an eye on is do we see flow-through to sales in line with what we've historically seen. And we have continued to see kind of that flow-through of 70% to 80% of those price increases kind of taking hold. So that's where we keep a really close eye on. As we take price increases, we look at two primary things. One, how customers reacting both from customer research as far as how they view value as well as whether they're still coming from a transaction standpoint. And then, two, just understanding where we are versus the competitive environment and cost pressures. And so that's the way we'll continue to look at as we go into 2022.

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

A

Our next question is from David Palmer with Evercore.

David Palmer
Analyst, Evercore ISI

Q

Thanks. Good morning. What percent of your purchases in the US were Loyalty users in the quarter? And just bigger picture, ultimately what is your goal with your Loyalty mix? What's going to get that active Loyalty user rate to step change much higher? Is that customer ID at the drive-thru or other tools? And maybe give us a sense of the future of where you see Loyalty going. Thanks.

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

A

Yeah, so that's a good question. It's one I haven't gotten before in terms of the actual percent of consumers that were Loyalty consumers. I think probably maybe a different way, I don't know precisely that number, but I would say right now when you look at app usage in the US, which probably for me is the best proxy that we have, most of our app usage, I think we certainly see people opting in for the Loyalty program when they do that. And so app usage is right now running in the mid-single digits on that number right now, so I think that's probably as good a proxy as I can give you for the percent. But certainly that's something that Mike and the team on Investor Relations can follow up with as well.

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

A

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

Sara H. Senatore
Analyst, BofA Securities, Inc.

Q

Thank you. A question about margins and sort of related pricing. Couple commentary you made about like G&A leverage and expecting to drive operating margins higher, so I guess part one is, is that an allusion to the idea that maybe the low to mid-40s is no longer the right range? And specifically in G&A, should it be lower than 2%, which I think was kind of your previous expectation? Or should we think about that range as still in place, but maybe towards the high end? And the related question is given how strong your franchisee cash flows are, given how strong your performance is, is now the right time to instead of taking price to press that advantage and I know you said that you're seeing what you expect in terms of elasticity, but is there any thought to kind of really, I guess, turning the screws on competitors with respect to your ability to price aggressively?

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

A

Let me start with the last one, and then I'll come back to the first part. On the pricing, so one of the things we do certainly keep an eye on is what we've been talking about and focused on here is kind of what the increase is. But we certainly look at kind of our absolute prices compared to competitors. And even with those price increases that I talked about in 2021, we are still pretty well positioned versus our competition. We look at it by competitor, by item, by every which way you would think about. And so, again, what helps us from a research standpoint is the way consumers view value and their perspective of value. And I think in 2022, that will continue to be really important as inflation is hitting customers potentially harder than it's hit people in a long time. And so we're very cognizant of making sure that our value proposition continues to be strong. And so we do look at kind of absolute pricing compared to just increases also.

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

A

Yeah, I would just add. I talked about this on the last call. I mean, in the US, we've had several years where we have been out-comp'ing the industry, and as we go into 2022, we are in a share-taking mentality. As you noted, we are in a very strong position, and so my message to the US team is about continuing to find ways for us to create further separation between us and the competition because I think we are relatively in an even better position on that. How they go about doing that, value can be one component, but there are other things as well. But certainly our aspiration and expectation in this year is we are going to continue to take share.

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

A

And on the operating margin and G&A point, I think at our investor meeting in fall of 2020, if I remember correctly it was – it seems like ages ago at this point – we talked about operating margin in the mid-40s. Right now, we're – low to mid-40s. Right now that's where we've been both for 2021 and the guidance we're giving for 2022. 2022 is being, I'll say, pressured a little bit from all the inflationary pressures that we've just talked about. Once those, God willing, normalize, I think we expect to certainly continue to get leverage on that operating margin because while this is all going on, we certainly expect to continue to increase sales. So I think 2022 is being held back a little bit by, look, unusually high inflation pressures both on the commodity and labor side. And in our mind to be able to still remaining at that low to mid-40s range during those to us is a really good sign that we feel good about when we come out of that inflationary environment that we'll be able to certainly get leverage on that.

Same with the G&A side. The 2.4% that we were of sales in 2021 was driven by incentive compensation. We've been talking about 2.4% of sales for most of the year, which is where we came in. But then to continue getting leverage and go back to around 2.2% to 2.3% for this year and then continue to get leverage on that as we grow sales in our mind will also help the operating margin leverage.

Mike Cieplak

Senior Vice President, Treasurer & 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 for the question. So on menu innovation, you recently announced a menu hacks promotion, so innovation without adding anything new. Can you talk about your philosophy around innovation this year, how you're thinking about the frequency of new items, given added SKUs and wanting to limit complexity? And then somewhat related, how do you see value playing a role in 2022? I know it's come up a bit. But what are you seeing in the overall competitive environment, given the pullback in discounting we've seen over the past couple of years?

Christopher J. Kempczinski

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

A

So as we think about innovation, if you go back to kind of our Accelerating the Arches strategy, the C of the MCD is about core menu, and I think our focus needs to be on continuing to drive our global core because those are our most powerful equities. They're ones that we see a lot of consumer excitement about. An interesting thing that we've learned through the pandemic and just the latest on consumer sentiment, the vast majority of consumers, call it still 80% or so of consumers in our top markets, are saying that they are still looking to buy products that they are familiar with. And so that consumer psyche, I think, plays well to our global core menu.

What I love about the hacks, what I've loved about the Famous Orders, we're finding ways to create news without adding complexity into the restaurant. And so I think you're going to see us continuing to do that as kind of a primary focus area. That doesn't mean that there aren't going to be innovations that we do with new menu items, limited time offers. Those are certainly part of what keep the consumer excited and can help drive frequency, but I think we need to stay focused on driving core menu and creative ideas like the hacks idea is just one way to go about doing that.

Kevin M. Ozan

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

A

And then on the value side that you brought up, again, talking about the US specifically, right now we still have D123 as our nationally advertised value platform in the US, but that's really complemented and carried a lot through local fields. There's a localized approach that allows the local co-ops to kind of determine the value proposition for their local field based on local preferences, et cetera. That's particularly important at the breakfast time. So you'll see a lot of local value being driven by the local co-ops. And then you will see – on a national level, you'll still see a couple or few times a year nationally posted deals like we recently had two for $6. My hope is the environment – the competitive environment remains where it's been which has been relatively healthy from a value perspective, not crazy discounting, et cetera. We haven't seen any of that for a while, and so our intention is not to do anything dramatically different than what you would have seen in 2021.

Mike Cieplak
Senior Vice President, Treasurer & 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 the question. So can you expand a bit more on what you're seeing from a throughput perspective? I think you mentioned service times, while still better than 2019 levels, did slow in 2021. And how do you think about balancing further menu innovation and other strategic initiatives with opportunities to improve service times from here? Thanks.

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

A

Sure. We did see a little bit of a step-back in service times because of the – I think the operating environment, the challenges of just making sure that we have the staffing that we need. And as we head into this year, I think every market we've had conversations in the last several weeks, every market is laser-focused on opportunities that we can have to get back to sort of continuing to make progress on reducing service times. The reason that that's so important is when we reduce service times, we see customer satisfaction go up. And so that is something that we're all focused on.

I think the other thing is, as we're able to open more service channels – and I'll use the dining room as an example – that takes pressure off of channels like the drive-thru. We put extraordinary pressure on the drive-thru, as we had some dining rooms closed in 2021. Right now in the US, about 80% of our restaurants have the dining room open. Expectation is that more of those will continue to open. And as we're able to do those things, as we're able to make sure that we've got the staffing at the size that we need and with the predictability that we need, I think the expectation is we're going to see service times start to come back down. And again, versus 2019, we're better off than where we started in 2019, but we think there's opportunity for us to continue to be showing progress on that.

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

A

Our next question is from Brian Bittner with Oppenheimer.

Brian Bittner
Analyst, Oppenheimer & Co., Inc.

Q

Thanks. Good morning. My question relates to the IOM segment. And obviously there's a lot of several important large markets that make up this segment. But can you update us on how much market share you believe you've taken in the overall IOM segment since the beginning of COVID? And what's been the primary drivers of these share gains? And how does it frame how you think about the potential strength of the IOM business in a post-COVID world?

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

A

I'll take it, and then Kevin can fill in. But I think as you mentioned, there's a lot of different markets in IOM, and it's always a little bit of a challenge to talk about them in the aggregate. But I think it's fair to say that we've taken significant share across those groups of markets, and we had a lot of momentum that was going into the pandemic in IOM. While certainly these markets have been hit particularly hard through COVID, we're seeing that they're continuing to outperform by a pretty significant measure their competition. And so for us as you think about then rolling out of things like shutdowns that we're dealing with in Australia, we've had to deal with some of those things in Canada, Germany has been impacted. As we start to move through those, I think the momentum and the health of our franchisees is going to allow us to continue to take share, and then it's going to be taking share off of a more normalized comp environment.

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

A

Yeah, the only thing I'd add is, I mean, to your point and to Chris' point, obviously IOM is a conglomeration of several different markets. So the markets are in different places. Markets like the UK, Canada have been really strong even throughout the pandemic, whereas some markets like France and Germany are still more in recovery mode. I'd say we expect 2022 to – again, I'm assuming no more stops and significant restrictions – but assuming that that is the case, I think our expectation is that as we progress through the year, we will see the markets that needed to recover, recover nicely through the year, and the markets that have been doing well continue to be strong. And as Chris mentioned, most of the major markets have gained share throughout the pandemic, and so we, again, hopefully are coming out of the pandemic in a really strong place in substantially all of those markets.

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

Okay. Thank you, everyone, for joining today. Thanks, Chris. Thanks, Kevin. Everyone, have a great day.

Operator: This concludes McDonald's Corporation investor conference call. You may now disconnect.