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McDonald's (MCD) Earnings Report: Q1 2016 Conference Call Transcript

The following McDonald's conference call took place on April 22, 2016, 11:00 AM ET. This is a transcript of that earnings call:

Company Participants

- Chris Stent; McDonald's; Investor Relations
- Steve Easterbrook; McDonald's; President & CEO
- Kevin Ozan; McDonald's; CFO

Other Participants

- Jake Bartlett; SunTrust Robinson Humphrey; Analyst
- Brian Bittner; Oppenheimer; Analyst
- Keith Siegner; UBS; Analyst
- Andrew Charles; Cowen and Company; Analyst
- Will Slabaugh; Stephens Inc.; Analyst
- David Tarantino; Robert W. Baird; Analyst
- John Glass; Morgan Stanley; Analyst
- David Palmer; RBC Capital Markets; Analyst
- Joe Buckley; BofA Merrill Lynch; Analyst
- Jason West; Credit Suisse; Analyst
- Matt DiFrisco; Guggenheim Securities LLC; Analyst
- Jeff Farmer; Wells Fargo Securities, LLC; Analyst
- Jeff Bernstein; Barclays Capital; Analyst

MANAGEMENT DISCUSSION SECTION

Operator:

Hello, and welcome to McDonald's April 22, 2016 Investor Conference Call. At the request of McDonald's Corporation, this conference is being recorded.

(Operator Instructions)

I would now like to turn the conference over to Mr. Chris Stent, Vice President of Investor Relations for McDonald's Corporation.

Mr. Stent, you may begin.

Chris Stent (Investor Relations):

Hello, everyone. Thank you for joining us. With me on the call are President and Chief Executive Officer Steve Easterbrook; and Chief Financial Officer Kevin Ozan.

Today's conference call is being webcast live and recorded for replay by webcast.

Before I turn it over to Steve, I want to remind everyone that the forward-looking statements in our earnings release and 8-K filing also apply to our comments. Both documents are available on

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www.investor.McDonalds.com, as are reconciliations of any non-GAAP financial measures mentioned on today's call with their corresponding GAAP measures.

And now I'd like to turn it over to Steve.

Steve Easterbrook (President & CEO):

Thanks, Chris. Good morning, everyone.

We began 2016 in a manner consistent with how we ended 2015, as a more focused, aligned system with positive momentum in every business segment. I'm pleased to report that this momentum continued through first-quarter 2016 with meaningful gains in both top- and bottom-line performance. Global comparable sales increased 6.2%, and earnings per share grew 26% in constant currencies excluding the impact of the comparison against prior-year strategic charges.

The momentum we are experiencing is broad-based. All business segments are contributing to our growth. The actions we are taking are driving notable change for our customers and giving them more reasons to visit McDonald's . This is reflected not only in our financial performance but also in the recent market share growth we are seeing across most of our major markets.

Our first-quarter comparables sales performance benefited from tailwinds that will not necessarily recur in future quarters, such as Leap Day, strong sales recovery in Japan, and milder weather across the winter. Our underlying operating performance is solid and consistent with our expectations when we developed our 2016 plans. This success is driven in large part by our singular focus on executing the turnaround plan.

Grounded in putting customers back at the heart of everything we do, we're committed to running great restaurants and elevating all our stakes in the McDonald's experience.

Our biennial convention last week came at an opportune time. Nearly 14,000 owner-operators, suppliers, and employees from around the world gathered to galvanize around our biggest business opportunities -- our food, our people, the customer experience and our brand.

It was energizing to see everyone motivated to act and united around the opportunities we are seizing as we strive to be recognized as a model progressive burger company by our customers. When we align behind fewer, bigger priorities we activate our size and scale advantages like no other company in our industry.

Let's turn now to segment performance and the specific initiatives underway across our major markets. Beginning with the US, comparable sales for the quarter increased 5.4%. All Day Breakfast continues to provide customers with new reasons to visit McDonald's to enjoy their favorite breakfast food and beverages in the morning and lunch and throughout the day.

In addition, All Day Breakfast fills a price gap on the menu and customers are responding by trading up or adding All Day Breakfast items to their orders. Whilst we're no longer in the launch phase, this platform remains a significant contributor to top-line results, and we're already looking at ways to extend it in the future in response to customers' feedback.

US is also taking steps to fortify its appeal to value-conscious customers. The McPick 2 platform provides customers with more choices at compelling price points and it gives us added flexibility at both national and local levels. We tested two versions of the platform in the first quarter: McPick 2 for $2 in January, and McPick 2 for 2 for $5 in March. The offerings were designed to target different customers, and both resonated well.

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Beyond All Day Breakfast and value we are pursuing additional opportunities to fuel momentum. This includes further enhancements of our core menu items to improve quality perceptions of our food, sustaining our heightened focus on operations, especially in our drive-throughs, to improve accuracy and speed of service; and additional opportunity to simplify our menu and the overall restaurant experience for our customers and crew.

Customers in the US are noticing a difference. We experienced a 6% improvement in our overall customer satisfaction scores compared to the first quarter of last year, and we're gaining share relative to that QSR sandwich segment with a positive comparable sales gap of 140 basis points for the quarter.

Let's turn now to the international lead segment. First-quarter comparable sales grew 5.2% with the top five markets delivering positive comparable sales for the quarter, though Germany was relatively flat. The UK, Australia, and Canada continued their strong track records of positive comparable sales performance. In fact, first quarter marked the UK's 40th consecutive quarter of growth.

These markets share similar characteristics that underlie their success. This includes the execution of customer-centric brands spanning multiple initiatives such as menu, value, marketing and promotions, service enhancements, as they make meaningful progress toward experience of the future, and strong alignment with their franchisees.

The success we're having is evident not only in our financial results but also in the market share gains we're experiencing in these highly competitive markets. Our market leadership teams are engaging more frequently than ever to share ideas, discuss common opportunities, and ultimately develop holistic brands to fuel momentum into the future. France continued to outperform the branded IEO market despite challenging macroeconomic conditions, including rising unemployment rates and ongoing public safety concerns. Value remains a priority, and the relaunch of the McFirst platform in March, combined with additional value options, including new proteins and product lines, helped strengthen our value proposition. We complemented these efforts with successful limited-time offers at the premium end, including the [Le Grand Premium] with a new chicken fillet, and the new American winter food events to enhance our relevancy in the field of customers in this important market.

Guest counts remain negative in Germany. In an effort to strengthen our appeal to price-conscious consumers we launched a new rising structure in February, to offer the right value equation across the entire menu. Initial results were in line with expectations but it was not sufficient to stem overall guest count declines.

In the high-growth segment, first-quarter comparable sales increased 3.6%, as China and Russia continue to recover from prior-year challenges. China delivered strong comparable sales growth of 7.2%. The market also made significant gains in market share despite persistently challenging macroeconomic conditions. Performance was driven by successful execution of multiple initiatives, including new products like chicken snacks, alongside growth across the delivery, value, and breakfast platforms.

Solid comparable sales performance in Russia reflects ongoing recovery of brand trust. However, we expect macroeconomic uncertainties and decreasing consumer purchasing power to remain headwinds through the rest of 2016.

I would be remiss if I didn't call out Japan, where comparable sales increased 27%, due in part to recovery from the prior-year impact of the 2014 supplier issue. The successful marketing promotions, like the Name It Burger, along with strong value offers, reflect the success the market is having as it executes its revitalization plan and regains brand trust.

I'm pleased with the progress we've made in the 13 months since I became CEO. We're making improvements that our customers are noticing, to serve hotter, fresher food with improved overall service

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experienced. We are returning many of our critical markets to growth in terms of sales, guest counts, and market share. And we are increasing profitability, both for the Company and our franchisees, whose cash flows are approaching all-time highs in many of our major markets.

We've taken bold decisive actions at delivering sustainable benefits. Our decision last year to close underperforming restaurants in several markets, including China, has directly contributed to improved financial performance.

In addition, the improvements we've made to our compensation and benefits package for our employees in US company-operated restaurants, along with expanded archways to opportunity, our programs are now providing tuition assistance to more than 5,000 eligible employees at both Company-operated and franchised restaurants, have resulted in lower crew turnover and higher customer satisfaction scores.

At the same time, we are applying forensic analytics across all aspects of our business, both from an external and internal viewpoint, to identify and pursue opportunities for longer-term growth. This includes innovation in markets around the world. For example, with menu, we're innovating to address customers' changing demands at every price tier. This includes work being done at the premium end of the menu, such as the new Signature collection, which was piloted in the UK in the first quarter, as well as enhancements to our value offer, like the new McPick2 platform in the US. We are also innovating around service. As we roll out self-order kiosks, table service, and the mobile app, we are providing customers with more choice and flexibility as we make progress toward McDonald's experience of the future.

We're evaluating opportunities to enhance the experience of our restaurant employees, too. For example, the US and the UK are working together to develop a new teaching approach for shift managers. This new training module extends beyond core operations education into leadership competencies to help shift managers learn how to coach and motivate crew to deliver a better customer experience.

As we learned from local market innovations, we are tapping into the power of our new segment operating structure to more quickly share knowledge and scale the most successful ideas across markets. The roll-out of All Day Breakfast in Australia in the first quarter was a testament to our ability to move winning plays quickly between markets.

We also continue to pursue opportunities to grow the business through new restaurant openings. In fact, last month we opened our first restaurant in Kazakhstan, our 120th market. We received an overwhelming amount of enthusiasm and support from the local community. By the end of the first day we sold over 2,000 Big Macs.

I'm confident in the actions we are taking. Our turnaround plan is working. For this reason the plan will remain operating work for at least two more quarters. Later this year we will evolve to a longer-term strategic plan to further sustain our momentum.

In closing, I'm encouraged by the progress we have made, and energized by the opportunities ahead. Across our entire system we are more aligned than ever on running great restaurants each and every day, and providing our customers with what's most important to them -- all fresh food, fast friendly service, and a contemporary restaurant experience at the value of McDonald's .

The actions we've taken are working. Customers are noting a difference and are choosing McDonald's more often. As we look to the future we will continue to execute against our turnaround plan in the near term, while we begin to lay a foundation for generating sustainable profitable growth over the long term.

Thanks, everyone. Now I'll turn it over to Kevin.

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Kevin Ozan (CFO):

Thanks, Steve. Hello, everyone.

As Steve mentioned, our business turnaround is taking hold. The positive momentum and solid improvements in our underlying business performance over the last three quarters serve as proof points of our progress. Today I would like to review the major components of our first-quarter operating results, provide a few updates on our outlook for 2016, and discuss recent developments related to our financial strategies.

Let's start with a high-level look at first-quarter performance. Results for the quarter benefited from stronger operating performance, with global operating income up nearly $400 million or 28%, 33% in constant currencies. The most significant contributions came from sales-driven growth in franchise margins, led by the US and the international lead markets, and the sales recovery in Japan that Steve mentioned, which contributed to higher other operating income. These items accounted for almost $200 million, or about half of our operating income growth for the quarter.

The other half of our growth was driven by comparison against the $195 million in strategic charges taken last year related to our restructuring and refranchising initiatives.

Growth in global Company-operated margins also contributed to quarterly results, with margins up 110 basis points. The high-growth markets, in particular China, led the margin improvement.

In the US, while Company-operated margins declined 110 basis points for the quarter, solid comparable sales growth and favorable commodity costs helped offset most of the impact from our prior-year decision to increase crew wages and benefits effective July 1, 2015.

Second quarter of 2016 will be the last quarter that US Company-operated margins will be negatively impacted by these wage comparisons. Similar to the past three quarters, we expect existing labor pressures to negatively impact US Company-operated margins by 350 to 400 basis points in the second quarter.

While we're on the topic of Company-operated margins, I'd like to provide updates on a few of the key margin inputs, including menu pricing and commodity costs. In the US, first-quarter pricing year over year was up over 3% compared with food away from home inflation of around 2.7%.

We continue to keep a close eye on food away from home inflation, which is projected to be between 2.5% and 3.5% for the full year.

For the international lead segment, while price increases vary by market, year-over-year increases for these markets averaged 2% to 3%. From a global pricing standpoint, we're planning for more limited pricing power in those markets that are experiencing low inflation to ensure that we maintain our focus on growing guest counts.

Moving to commodity costs, in the US commodity costs were down 3% during the first quarter and are expected to decline 3.5% to 4.5% for the year. For the international lead segment, commodity costs were relatively flat for the quarter and are expected to remain relatively flat for the year.

Turning now to foreign currencies: more recently the US dollar has weakened against most of the world's other major foreign currencies. At current rates currency translation is expected to be less of a headwind on full-year results and is now estimated to negatively impact second quarter by $0.02 to $0.04 and full year by $0.05 to $0.07. As always, please take this as directional guidance only, because rates will change as we move throughout the year.

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Next I'd like to provide updates on our refranchising, cash return to shareholders, and G&A targets. Last year we committed to strategically evaluating ownership structures with the goal of becoming around 95% franchised over the long term. In the past five quarters we've refranchised about 700 restaurants, including over 200 in the first quarter this year. The large majority of these were sold to existing conventional franchisees.

As part of the forensic review of our ownership structures and strategic allocation of resources around the world, during the first quarter we also initiated new refranchising activities in several markets in Asia and Europe.

In Asia we announced plans to further unlock growth potential, with emphasis on three markets in our high-growth segments: China, Korea, and Hong Kong. These markets collectively operate almost 2,900 restaurants, of which about 70% are company-owned. Given the relatively higher restaurant expansion and franchising potential in these markets, our intent is to identify strategic partners with skills and expertise that will enhance our competitive advantages and bring additional capital resources to further invest in and grow the business. We remain optimistic about the future of our McDonald's brand in Asia, with plans to add at least 1,500 restaurants across China, Hong Kong, and Korea over the next five years.

In Europe we are working to identify a strategic partner in the Nordic markets, which include about 460 restaurants, the vast majority of which are operated by independent franchisees. We believe opportunities exist in the Nordic region and that a sale to a local partner can result in an optimal structure for both McDonald's and the future success of these markets. Due to the unique nature and size of many of these markets, and the importance of finding the right partners, it is important to keep in mind that these transactions may take 12 to 18 months to complete.

At the end of 2015 we also started to lay groundwork to complete the final year of our three-year $30 billion cash return to shareholders target. In February we initiated a $2.7 billion accelerated share repurchase program in conjunction with this target. This program was a significant component of the $3.7 billion in shares repurchased during the quarter. Our ability to pursue a more aggressive share repurchase pace during the first quarter was supported by the financing completed in December last year.

Looking ahead, we expect further debt additions in the coming months as we opportunistically take advantage of favorable interest rates while maintaining our strong investment-grade credit rating. From a G&A standpoint, we remain on track to achieve our net annual G&A savings target of $500 million, the vast majority of which is expected to be realized by the end of 2017. Over the course of the last year we brought greater discipline and focus to the business, and we've made meaningful and tangible progress against our turnaround plans. Although we have come a long way, there is still a lot of work to be done to achieve the goals that we've established.

As we move through 2016 we are keenly focused on maintaining the positive momentum we've created. This momentum is a direct result of a renewed focus on our customers and running great restaurants. We will stay the course and complete the critical steps of our turnaround to position the business for success as we chart our strategic long-term path forward. We are mindful of both the opportunities and challenges ahead. Overall, we continue to expect variability in quarterly results, due to uneven prior-year comparisons and some headwinds that exist, including macroeconomic issues in certain key markets. In addition, we recognize that opportunities still exist to further strengthen and generate strong guest traffic in some of our key markets around the world.

In closing, the financial results achieved are a testament to the collective efforts of our franchisees, suppliers, and employees to reset our business. We are on our way to becoming a modern and progressive burger company. Like Steve, I was energized by our worldwide convention last week, as I saw

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firsthand the tremendous focus, discipline, and passion of our unique system. I'm confident that we can continue to deliver on the progress that we've already made to enhance long-term shareholder value in 2016 and beyond.

Thanks. Now I'll turn it over to (Chris) to begin our Q&A.

QUESTIONS & ANSWERS

Operator:

(Operator Instructions) Jake Bartlett, SunTrust.

Jake Bartlett (Analyst - SunTrust Robinson Humphrey):

Thanks for taking the call. Steve, in the last couple press releases you've mentioned positive same-store sales or positive momentum in each segment in the current quarter. It wasn't in this release. Should we be reading something into that? If you clarify, that would be great.

Kevin Ozan (CFO):

Thank you, Jake. And that was a very conscious from us. I felt in the early stages of the turnaround it was important for us to demonstrate confidence that the actions we were taking were resonating, and to provide that shorter term guidance I thought helped to reinforce that we were beginning to get on the move. Now we are two to three quarters in, I'm confident to say that the turnaround is taking hold, and you've seen the results we delivered. And, as a result, customers are responding to the changes we are making. Momentum is a very powerful word in our business and as a result we're confident we're executing our plans and don't actually see it as being necessary to offer shorter term guidance.

Chris Stent (Investor Relations):

Brian Bittner, Oppenheimer.

Brian Bittner (Analyst - Oppenheimer):

Thanks for taking the question. Just want to focus on the US business. There's two questions. You've obviously done an extraordinary job re-igniting the sales growth. Your gap against the industry in the fourth quarter was close to 300 basis points, and it was about half that this quarter. It's still an amazing trend, but is the difference between the two quarters just really the fact that you got a bit more initial strength that came with launching All Day Breakfast, and now this outperformance gap you are seeing is a little bit more of a reasonable expectation that we should have going forward?

And the quick follow-up to that is, as we look past this first quarter and into the future, do you think the stickiness that comes with regaining momentum with your customer base is enough? Or do you really feel the need that you have to take on much more dramatic operational risk, like the All Day Breakfast, that can pay off pretty big going forward? Thanks.

Kevin Ozan (CFO):

Thanks, Brian. In terms of the gap, I think that was a fair assessment. We clearly came out of the traps hard with All Day Breakfast. It exceeded our expectations through the launch phase, and then hits a more settled rate. Frankly, it's still exceeding our expectations through the settled stage, as well, so we are incredibly encouraged.

Frankly, maintaining that positive gap is important to me. The absolute magnitude quarter to quarter I'm less concerned about. As long as we're taking share and customers are turning in our doors rather than

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others, then I'm confident that we're delivering the right plans.

In terms of stickiness, something that gives me a great degree of confidence in the way the USC and the operator leadership and our own leadership team have built the plans, is the success is not being based on tactics. We're establishing foundations of growth. And if I were just to give you four of them currently in play, and clearly we're going to be working on more, the operational improvement, honestly, I would celebrate that as much as All Day Breakfast.

We are focusing on getting the basics right in the restaurant, and the team are really focused and they're delivering well. And customers are telling us that. So I can't emphasize enough how important it is to get the nuts and bolts right for the 20 million-odd customers everyday.

The investments the US team, operators and Company, have made through food and food quality is being recognized by customers. So, whether it's announcement to move to cage-free eggs or removal of antibiotics harmful to human health in the poultry supply chain, whether it is the attention to detail on the quarter pounder beef patty and toasting of buns, the investment in the quality is getting recognized by customers, and that's valuable, that's long term, as well.

Then you've got All Day Breakfast, which has been clearly a very strong catalyst for momentum, which is wonderful. We are in that nice situation now where we are challenging ourselves as to how much more can we do. Customers are asking us for more. We're looking at that very carefully to see whether that's a platform that not only is sustaining but can actually grow.

And then, as we spoke about through this quarter, we have struggled to find the right value platform over the last year or two. We believe through the McPick 2 platform as a whole, we have the flexibility at both national and local level such that we can offer compelling value at different points, different times a year, and maybe slightly different offers in different parts of the country, depending on the consumer set. But we believe that could be a platform that continues to offer growth opportunity and drive customers in.

That's what we've got in play now. And clearly there are other things that we are looking at around new product development and also around investing in our restaurants and what we're calling experience of the future. I won't carry on because I want to get through some more questions, but the point I'm really trying to iterate is these are platforms of growth that give me confidence in the stickiness of our momentum and we have no plans to ease up, I can assure you

Chris Stent (Investor Relations):

Keith Siegner, UBS.

Keith Siegner (Analyst - UBS):

Thank you. Coming off the operator convention, and considering the comments at much of the refranchising thus far, was to existing franchisees. Could you talk about your philosophy for that franchising? In other words, the five to seven unit averages in the US, and maybe how that plays out internationally, could we see consolidation here? Is five to seven the right number, or maybe a few bigger core anchor folks, could there be benefits to that? What is your philosophy towards those franchisees going forward? Thanks.

Steve Easterbrook (President & CEO):

It is a great question, Keith. Part of what we have worked hard across this last year in order to firm up our plans moving forward, some of the big strategic plan is, with our new structure now we have much better visibility into our top 14, 15 markets, and frankly there is not a common philosophy across those because every market is in a different position. If we're to make the strategic choices we have in China and Asia,

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for example, or up into the Scandinavian markets, that's because we have got very forensic and we think that in the long term best interests of the markets of our long-term growth and that ownership model.

Your question more to the US, I'm sensing is more to the US where we have typically been five to seven. The philosophy that is critical to us is never losing that entrepreneurial spirit and the owner-operators being engaged in their local communities. Now, that can be done at a 50-restaurant level, that can be done at a 5-restaurant level, it can be done at a 1-restaurant level. So, to us the importance is having the right partnership with the operator with the right mindset.

Could we see consolidation? We could do a little. Does that give us fewer, stronger operators and a stronger balance sheet in their ability to invest and to scale? It could do at the same time.

We're also introducing new franchisees to the system because they come in with new ideas and new energy and keep us fresh. We also see it through the next generation programs we have where sons or daughters of existing franchisees want to enter the business, and that brings us new ideas and the fresh energy. The underlying philosophy remains the same. The execution market by market, I believe we've got much deeper, meaningful thoughts to it that we can address this market by market. And I think it will serve us well into the long term.

Chris Stent (Investor Relations):

Andrew Charles, Cowen.

Andrew Charles (Analyst - Cowen and Company):

Great, thank you. You guys mentioned before the national-value platform coming up later this year will incorporate multiple price points for multiple menu items. So I'm curious about the learnings you gathered from the two McPick 2 tests. You mentioned there were several different customer bases that they targeted. I'm just curious what you derived from these promotions to help shape the national-value platform for later this year. Thanks.

Steve Easterbrook (President & CEO):

Yes, fair question, Andrew. When I said there were different customer groups, when you are looking at a, say, $2, you're typically addressing the value conscious, the most value conscious customers, so people who are looking for a deal. And that is important, and particularly important at certain times of year. So, if you are coming out of the Christmas period and it has been a high-spend period, a dollar here and a dollar there matches to consumers through January, in particular, for example. So, that deal for the value-conscious consumer at that particular time at the national level resonated well.

If you look at a 2-for-$5, for example, it is a different construct. You are looking at people who are maybe going in, maybe there's two people going and they start to construct a meal around that deal, and feel they are getting value that way. So, slightly different customer group. It could be the same customer may care for both, but there could be a different group, as well.

Part of what we are learning is at what level do we want to deploy this at a national level and use that national marketing muscle, and how much do we want to allow the flexibility at the regional level, because we've got these re-energized regions, 23 of them around the US,, and they want to bring it to life. But maybe the menu mix in that deal could be different in the southwest of the country than it would be in the northeast. And I think that flexibility, knowing your consumer group, knowing your competitive group, knowing what that value price is allows us to unleash on the power of our regional marketing muscle. So, you will see us dial it up and down national and local. But the one thing you will always see, there will always be value at McDonald's .

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Chris Stent (Investor Relations):

Will Slabaugh, Stephens.

Will Slabaugh (Analyst - Stephens Inc.):

Thanks, guys. Another question on the US. We've been hearing from some of the casual diners, in particular, that QSR meal platforms, such as your 2-for-$5 have been taking share at lunch. So, I'm curious if you have any color on daypart growth in the US. And then, secondarily, if you feel like there's more room to innovate around that $4 to $5 price point to make McDonald's even more of a meal solution versus maybe historically some of that focus on the $1 to $2 price points and driving value traffic.

Steve Easterbrook (President & CEO):

I'll certainly kick off then maybe Kevin can come in and relieve me. We are seeing success across all dayparts. One of the very reassuring elements of All Day Breakfast was, whilst we clearly added incremental visits and incremental spends across rest of day, our breakfast business has also prospered, as well. So that's very strong.

In terms of innovating at different price points, that's absolutely what we are try to do, whether it is through breakfast filling a little price gap between the entry level and whether it's DVM or the Big Mac quarter pounder cheese, six nugget level. So, we continue to innovate. Kevin may want to offer a little more on this.

Kevin Ozan (CFO):

The only additional color I'd add is, in the first quarter, all dayparts were positive, contributing to that comp sales growth. The lunch daypart is definitely providing the largest impact, but every single daypart was positive. So, it isn't being driven by one specific daypart or anything along those lines. The advantage from our standpoint is to see the broad-based growth across the entire day and evening, so that's what gives us confidence going forward.

Steve Easterbrook (President & CEO):

In terms of where our growth is coming from, just to close off that final piece, the reality is we grow in share and open that gap now in the QSR in the sandwich segment. But when we get 14,000 restaurants on a roll, customers tend to come from quite a few places. So, I'm not surprised that other people are feeling the impacts of it at the moment. Yes, we want to win our home game, we want to win the QSR segment, and we want to get back to a leadership position there.

Chris Stent (Investor Relations):

David Tarantino, Baird.

David Tarantino (Analyst - Robert W. Baird):

Hi, good morning, and congrats on a great start to the year. My question is about the US business. And in particular I was wondering if you could share some detail on what the guest count trend you saw in Q1 was. Perhaps if you could also factor in the trading day in that response. And then you mentioned towards the end of the prepared remarks that you want to drive better guest counts as this year progresses in key markets. I assume that includes the US. So if you could talk about what you think the keys are to drive better guest counts in the US, whether it is value or speed of service, that would be helpful. Thanks.

Steve Easterbrook (President & CEO):

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I can say for the US guest counts were positive with the quarter. If we were to net out the Leap Day guest counts were positive for the quarter. That is a further sign of momentum returning to the US business.

In terms of the comment regarding guest count in key markets around the world, around the world we have strong value platforms in many of our major markets. So, this is not a price-driven guest count type discussion. This is around what can we do to enhance the experience such that customers enjoy sufficiently they just come back more often, or we attract lapsed customers back or new customers to the business.

But the first point of check in, is our value platform right. We are working on that, for example, in Germany. I acknowledged that. We haven't quite got it right yet so we will continue to firm that up.

In many of our other markets our desire to grow guest count, which is the ultimate signal of strength of the business, is more around enhancing the broader experience. So, as I say, this is not price, this is how can we make the visit to McDonald's more convenient, more fun, more engaging, such that when you come to make those decisions of where you're going to eat more people just turn our way than anywhere else. It is a much more holistic desire, but ultimately guest counts is the lifeblood of our business, and I would like to see greater strength there. But I'm very happy with the trends we are seeing.

Chris Stent (Investor Relations):

John Glass, Morgan Stanley .

John Glass (Analyst - Morgan Stanley):

Thank you. I wanted to talk about the refranchising that you guys talked about in Asia specifically, maybe just put some numbers to it. Those three markets you've identified, China, Hong Kong and Korea, what's the total operating profit in those collectively? What's the capital spending in those markets collectively? As you think about a refranchising transaction, I assume it's dilutive at some level. Do you think of it as holistically it is accretive once you put buybacks in place? Some high-level thoughts about how the mechanics of that might work in the early days.

Kevin Ozan (CFO):

In those three markets, as I mentioned, it is about 2,900 restaurants, about 70% Company-owned. We don't break out capital by markets so I won't get into the total capital related to that. But it's fair to say that, as you know, we are growing substantially in places like China and Korea, so it's got a meaningful amount of capital that we are spending on growing there.

And the thinking is that if we can find the right partners there, we want to make sure we find the right strategic partner that has complementary skills and expertise, and also has sufficient capital to unlock the growth potential there. The way we think about it is if someone else can use their resources to grow the business we will participate in that growth through an increased royalty and effectively reduce G&A and capital that right now were spending related to those countries.

Steve Easterbrook (President & CEO):

John, just to add to what Kevin said, the underlying message that I was very keen to communicate, which is why I went out to China to visit the team and make the announcement, this is about accelerating growth. Our run rate in China, for example, is typically around 250 restaurant openings per year. We want to find the right strategic partner that meets and most likely exceeds that.

So, this is about accelerating into the market opportunity. And as we sit here with our more appropriate fiscal discipline across our business, we have a lot of demands for our capital, a lot of choices where we

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want to invest our G&A, and therefore we are just making that resource allocation discussion. China is wonderful opportunity. We're going to continue to participate in it, and our desire and expectation to just accelerate our growth there.

Chris Stent (Investor Relations):

David Palmer, RBC.

David Palmer (Analyst - RBC Capital Markets):

Thanks, good morning. I was wondering how you view the path to improve restaurant margins. As we look at the spreadsheet here, we are seeing a few hundred basis points lower margins roughly, or more, than where you were at peak back in 2010, in spite of the fact that food margins will likely be close to that level. So, it is really coming through leverage throughout the rest of the restaurant's P&L. And the refranchising will cause some Company margin (inaudible) across the system. Is it going to take a lot of AUV growth to approach your past peaks or is there other efficiency productivity stuff that you are working on that can help those margins? Thanks.

Kevin Ozan (CFO):

Thanks, David. I'd say, as we both well know, margins are certainly a top line game for us. We need positive comp sales to help grow margins. Specifically related to the US, now that we are seeing certainly stronger comp sales, that will help our margins going forward.

As I mentioned, in the second quarter this year, beginning in the third quarter, we will begin to lap the additional labor costs related to crew wages and benefits, so that will help from a comparison standpoint. But historically we've always said that in a normal inflationary environment we need about a 2% to 3% comp to maintain margins. Nothing structurally has changed in our business to change that on a long-term basis. A little inflation would not hurt from a pricing standpoint, so we have to be careful with commodity costs where they are. But I think we feel pretty good about margins going forward as long as we can maintain our growth in comparable sales there.

Steve Easterbrook (President & CEO):

David, the way I look at the US, I think, given the investment cost that they absorbed around the crew wages and benefits, I think they turned in a very, very strong performance in terms of their operating margin. Sales growth clearly supports it. Lower turnover of crew has made us more efficient and effective in the restaurants. The commodity outlook is increasingly favorable, as we've just highlighted.

We're 9 months into the cycle. After 12 months I think we will see a nice step up in Company-operated margins. And do take a look at international lead markets, as well. Again, strong performance as they go through. First of all, top-line growth is the primary driver. As they go through their refranchising plans, as well, you will see continued strength in the operating margin there, as well. So, I feel we have lined up this business to deliver long-term strong margin returns for all stakeholders.

Chris Stent (Investor Relations):

Joe Buckley, Bank of America /Merrill Lynch.

Joe Buckley (Analyst - BofA Merrill Lynch):

Thank you. Steve, you talked about the operational improvements in the US. Are there specific things, like staffing or speed of service, that drive it? Are there one or two or three things you can point to on the operational improvement side? And then just a question on the high-growth markets. Could you talk a

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little bit more about the performance of the various markets in that category?

Steve Easterbrook (President & CEO):

Okay, thanks, Joe. Operational improvement in the US, it is so multifaceted that I could take hours. I'd love to because I just love what they are doing. Simply put, we have made the experience easier for customers and easier for crew and easier to get right. So they have a particular focus, having identified that the core frustration of a customer was accuracy for the drive-through which then impacts service times.

They put a number of initiatives in place, such as simplified menu boards, new crew training procedures, as we've discussed, ask-ask-tell, just another way that we help ensure we get the accuracy right through the whole customer experience, from ordering through pay through collect. But we're into the real details. We are into the font size on the printers, the receipts, such that it is easier to spot the special requests, for example, or the special orders.

I can't even tell you how detailed the team has got to help our restaurant teams get it right more often. Ultimately the beneficiary is the customer on this and they are paying it back through all the customer metrics we have, whether it is through mystery shoppers, through our own operational grading standards. We are seeing these effects take place. And, honestly, that is the primary driver of customer satisfaction, getting it right, hot, fresh food, friendly service.

In terms of high growth, I tend to call out China and Russia just because of the scale and the potential in those markets. But we had great performance out of Netherlands, great performance out of Hong Kong, great performance out of Poland, great performance out of Korea through the quarter. And these are not one-offs.

So, I appreciate the question because it gives us a chance to demonstrate how broad the momentum in this business is, and it's not limited just to the high-growth markets. If I just look at Western Europe as a whole, growing strong in Central Europe, growing strong in Middle East, strong growth in the Middle East, Latin America. There's turbulence, as there often is, in that, overall strong growth. Asia, Australasia, as well as North American, and calling out Canada as well as the US.

So, we are seeing a lot of strong momentum. Is it perfect? No. Are there markets we still have work to do? Absolutely, yes, and we are never satisfied. But part of the confidence we have that the turnaround is taking hold is because of the broad-based growth we are expecting.

Chris Stent (Investor Relations):

Jason West, Credit Suisse.

Jason West (Analyst - Credit Suisse):

Yes, thanks. Obviously things are going very well here but just to nitpick a little bit. If you look at the US comps on a two-year or three-year basis, particularly backing out Leap Day, they are still not extremely robust quite yet. Just wondering your thoughts around the ability to continue to accelerate the business on a two-year basis. And maybe if there's anything out there in the US that you think is holding back the customer from coming more regularly or showing a little bit more strength there as you move forward and the compares start to get a little tougher? Thanks.

Steve Easterbrook (President & CEO):

Actually early stage of the turnaround. So, we don't think we've cracked it. What we have done, we are beginning to get back and grow on that two-year basis, when you look at it on a week-to-week basis, I

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can assure you, on a month-to-month basis, and a quarter-to-quarter basis. And our two-year life light is moving into positive territory, and that's at the early stage of the turnaround.

As we build out our plans for further sustained growth, clearly we want to see that trend continue. I'm not sure there's much more to say on that. It is early stages, but, I tell you what, we've got it back and some. So, there is two-year growth across each of the months across the first quarter, which I feel good about. And that is one of the measures we look at so that complacency doesn't set it.

We have a restless energy here. We've just got going. A lot of the theme around the bi-annual convention last week was around accelerating with momentum and not just sitting tight with the momentum. So, that's how we are galvanizing ourselves, that's how we're challenging ourselves.

But these platforms that the US has introduced, I'm confident we will maintain that stickiness. But we want to layer further platforms on top of that, which is exactly the ingredients of success through that kind of 2003-2004 through to 2010-2011 period, was were laying platforms of growth on top of each other in a complementary and customer-driven. And we have no plans to let up, that's for sure.

Chris Stent (Investor Relations):

Matt DiFrisco, Guggenheim.

Matt DiFrisco (Analyst - Guggenheim Securities LLC):

Thank you. I just wonder if you could give us a follow-up on the G&A question there. I think you said $500 million savings realized by the end of 2017. I think the G&A in this current quarter seemed a little bit higher than maybe some had modeled. I wondered if you can give us a little bit greater clarity on that cadence throughout even just as far as how much of that $500 million should be realized through 2016, if you can give us some color on that.

Kevin Ozan (CFO):

Thanks, Matt. Regarding the G&A, let me first talk about first quarter, which was up just compared to last year, basically because of the higher incentive compensation than last year. A lot of that is driven by last year's lack of incentive comp, if you will, in the first quarter as much as this year's incentive comp that's in there.

Looking forward, both to 2016 and beyond, a couple things. We achieved about $75 million of our total savings in 2015. And built within that 1% to 2% guidance is another about $75 million in 2016.

Now, there are two swing factors, if you will, that could impact the actual reported G&A this year. And I'm talking on a constant currency basis. Obviously currency also impacts it. But when we think about the targets, we exclude currency. So the actual numbers you will see reported may be different because of currency impact.

But ignoring that, the other two swing factors, if you will, are, one, incentive comp where, if you think about 2014, we had very little, if you will, incentive comp as a Company. 2015 we got back to a more normal. So, you can get a big swing from one year to the next on incentive comp but all of that is driven by business performance. So, we will only have the incentive comp, obviously, if we are driving business performance. But that could swing things plus or minus that down 1% to 2% guidance.

The other swing is the timing of some of these large refranchising transactions. When we do our plans at the beginning of the year, we are effectively estimating when those will occur. They become very complex as we get into these transactions. So, to exactly pinpoint the timing of when those occur becomes really difficult. So, it is possible that something that we may have thought was going to happen

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at the end of 2016 could potentially slip to the beginning of 2017, and that may impact the timing of some of our G&A savings. But other than that, we are on track for the $500 million. We are still completely confident in the $500 million by the end of 2017, and it becomes just a timing issue between 2016 and 2017.

Chris Stent (Investor Relations):

Jeff Farmer, Wells Fargo .

Jeff Farmer (Analyst - Wells Fargo Securities, LLC):

Now that you've moved off of the 2-for-$5 national marketing window, I think that was late March, and you moved to Monopoly, did you see a big chunk of your franchisees choose to stay with that 2-for-$5 promotion? And the follow-up question would be, if so, is there any insight to be had as it relates to the 2-for-$5's impact on transaction growth, average check, whatever you want to point to, operating profit per transaction, anything like that on the read-through perspective?

Steve Easterbrook (President & CEO):

A good number of the franchisees did stick with the 2-for-$5. They felt it was a really strong contributor to their March, which it was, from a top line, from the guest count, and from a bottom-line perspective. What we're also seeing now is our local co-ops now having really good discussions around the McPick 2-for-$2, 2-for-$5, and which windows to execute.

So, I don't have a general response for you but I would say that the conversation around value at a regional level and a co-op level is where to dial up 2-for-$5, where to dial up the 2-for-$2, what time of year, and to be complementary to whatever else is going on. For example, if you can collect the Monopoly tokens on certain items, then reinforcing that through the value just drives further trial of the Monopoly promotion, for example, so it is complementary. Again, the local teams are on that. As I say, you can certainly expect to see them up to platform feature through the rest of this year at either a national or local level.

Kevin Ozan (CFO):

The only other thing I would say about the 2-for-$5 is we did see some trade up and definitely a higher average check with that platform. And you can see from the margin performance in the US overall for the quarter that these value platforms support good margins, I will say, too. So, it is not just discounting products at low margins. We still can realize good margins with that platform.

Chris Stent (Investor Relations):

Jeff Bernstein, Barclays.

Jeff Bernstein (Analyst - Barclays Capital):

Great. Thank you very much. Just a follow-up on the US quick-service category. Obviously your rebound has been strong. And, yet, others seem to be holding onto their strong results, as well. And I think you've demonstrated that with the fact that the gap between yourself and the industry has narrowed pretty meaningfully. So, I'm wondering whether that has surprised you, how you would assess maybe the quick-service category where the share is maybe coming from. It seems like everyone's got pretty compelling values so that would be a big driver taking share from elsewhere.

And being that you just spoke to franchisees last week, I'm just wondering, as an aside, I'm sure they some pretty good, but what is the greatest pushback you are hearing today now that it seems like you

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have the momentum? Where are they coming back at you asking for some change or frustration of any kind? Just wondering what their sentiment is. Thanks.

Steve Easterbrook (President & CEO):

In terms of the share discussion, no surprise at all, to be honest. It is an incredibly category. It is around the world. Here in the US I think 9 of our 11 major markets grew share in the last three months, which I think is a very strong support. The two that didn't we are fully aware that and addressing that in the near term.

The US performance, just continuing outperformance paints us as a winner. You either win or you lose market share. If we keep gaining then typically when a business of our scale gains in our sector we do pretty well. So, there's no surprise. It will continue to ebb and flow but as long as we keep gaining share then I will remain very, very satisfied in the achievements.

In terms of the overall rate of move from last week, the one-to-four challenge we have now is holding the operators back. There's a lot of enthusiasm to be part of the future plans that we've laid out. We started to give them a sneak peak of what that longer term strategy should look like and there's a lot of excitement around it. There's investment that goes along with that, so there's things we still need to work through and that's why we are having these test markets and test regions to further explore and learn.

But at the moment the enthusiasm is great and we're just trying to keep people focused and channeled and making sure that we are helping them build their businesses for long-term profitability, as well as our own. In terms of anything on the negative side it was difficult to find much last week, to be honest. And that's not always been the case. I'm not going to assume it will always be the case in the future. But I think the alignment for the owner-operators is as strong as I can remember it. And it gives me just further confidence that we are on the right track and we are all winning together on this one.

Chris Stent (Investor Relations):

We are near the top of the hour so I'll turn it over to Steve who has a few closing comments.

Steve Easterbrook (President & CEO):

Thanks, Chris. Thanks again to everyone for joining us this morning. In closing, I do want to re-emphasize the strong alignment, as I've just mentioned, we have across the system on running great restaurants and elevating all aspects of the customer experience. The actions we're taking to serve our guests, hotter, fresher food, the faster friendly service, and the contemporary restaurant experience, and at the value of McDonald's are working. Customers are noticing a difference and they coming to McDonald's more often.

This is reflected in our first-quarter financial results and in the market share gains we are experiencing in many markets around the world. We know there's still more work to do, and that's why we remain committed to executing our turnaround plans for at least two more quarters.

I am encouraged by the progress we've made, and I'm excited about our longer term opportunities to strengthen our business and re-assert McDonald's leadership position around the world. Thanks to all of you and have a great day.

Operator:

This concludes McDonald's Corporation Investor Conference Call. You may now disconnect.

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