

Arcos Dorados Holdings Inc. (ARCO) Q1 2026 Earnings Call Transcript

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Q1: 2026-05-20 Earnings Summary



EPS of \$0.17 **beats by \$0.07** | Revenue of \$1.22B (12.95% Y/Y) **beats by \$10.89M**

Arcos Dorados Holdings Inc. ([ARCO](#)) Q1 2026 Earnings Call May 20, 2026 10:00 AM EDT

Company Participants

Daniel Schleiniger - Vice President of Investor Relations

Luis Raganato - Chief Executive Officer

Mariano Tannenbaum - Chief Financial Officer

Presentation

Daniel Schleiniger

Vice President of Investor Relations

Good morning, and thank you for joining Arcos Dorados First Quarter 2026 Earnings Webcast. With us today are Luis Raganato, our Chief Executive Officer; and Mariano Tannenbaum, our Chief Financial Officer. Today's webcast, which is being recorded, will consist of prepared remarks from our leadership team, which will be accompanied by a slide presentation that is also available in the Investors section of our website, ir.arcosdorados.com.

To better follow the presentation, please note that you can set your view to full screen on the webcast platform. Additionally, you can submit your questions at any time during the presentation using the Q&A function on the bottom of the screen. After we conclude our opening remarks, we will answer your questions.

Today's call will contain forward-looking statements, and I refer you to the forward-looking statements section of our earnings release and recent filings with the SEC. We assume no obligation to update or revise any forward-looking statements to reflect new or changed events or circumstances. In addition to reporting financial results in accordance with generally accepted accounting principles, we report certain non-GAAP financial results.

Investors are encouraged to review the reconciliation of these non-GAAP financial results as compared with GAAP results, which can be found in today's earnings press release and conference call presentation as well as the unaudited financial statements filed today with the SEC on Form 6-K.

I will now turn the call over to Luis.

Luis Raganato

Chief Executive Officer

Thank you, Dan, and good morning, everyone. Over the last several years, we consistently added to our dominant market share position and elevated brand attributes to historical highs across Arcos Dorados operating footprint. As a result, for the 6 years ended in 2025, total revenue grew almost 60% EBITDA nearly doubled and net income was up more than 2.5x in U.S. dollars.

Moving forward, our objective is to build on this incredible foundation and capitalize on the significant competitive advantages we built over the period. With that in mind, 2026 is off to a good start. First quarter 2026 highlights included some important milestones within the context of a challenging consumer environment. Total revenue grew about 13% and surpassed \$1.2 billion for the first time in the first quarter, overcoming relatively soft consumption in certain markets. This included 16% growth in system-wide comparable sales, which was driven mainly by average check, but we also saw improvements in guest traffic in several markets.

Similar to total revenue, we generated the highest adjusted EBITDA for the first quarter in U.S. dollars. The \$118 million result was driven mainly by strong top line growth, combined with very solid margin expansion, especially in Brazil and SLAD. We have pursued strategies that capitalize on the brand to monetize the significant market share advantage we hold in the region. This together with very strong EBITDA growth is adding to cash flow performance as well.

Along these lines, in a few minutes, Mariano will take you through how we measure adjusted free cash flow to drive shareholder value. Marketing campaigns focused on offering value platforms that appeal to lower income consumers and core menu items that drive brand love as well as licenses and partnerships that keep McDonald's culturally relevant.

The brand experience continued to expand beyond our restaurants, bolstered by the region's most comprehensive digital platform and loyalty program. As much as digitalization has and will change the business, 55% of sales continue to be generated inside our restaurants.

During the quarter, we added 19 new restaurants to the footprint, including 13 freestanding units with a more efficient capital deployment. Not all markets are in the same phase of the economic cycle. So our local teams have deployed specific strategies to adapt to their specific operating environment.

In Brazil, marketing campaigns during the quarter spanned core menu, affordability and partnerships. For example, the introduction of Best Burger, leveraging limited time offers through Economéqui, the first promotions associated with the FIFA World Cup and a strong presence at Lollapalooza Brazil.

In NOLAD, marketing initiatives drove sales performance across the division. Mexico, Panama and Costa Rica continue to leverage affordability platforms and localized offerings. Across markets, family-focused initiatives, seasonal menu and licensed activations such as the Friends menu complemented core and value execution, reinforcing brand affinity and relevance.

In SLAD, menu innovation was a key growth driver. For example, in the beef category, we introduced the Tasty Feat Cuarto in Chile and Uruguay, blending the popular Tasty sauce with the core favorite Quarter Pounder with Cheese to delight guests.

In Argentina, we leveraged the successful premium sandwich platform by introducing a limited time-only Grand Feat Clubhouse featuring Franco Colapinto, the well-known Formula 1 driver and local hero.

Within the chicken platform, Colombia introduced McCrispy strips and the Pollo Mix shareable option with an encouraging guest response. Finally, we reinforced the brand's cultural relevance in Argentina, Chile and Colombia through music, a key consumer passion point at Lollapalooza and Estéreo Picnic.

Digital channels, including mobile app, delivery and self-order kiosks grew 21% versus the prior year and contributed about 64% of system-wide sales. Sales growth in delivery remained strong, boosted by promotional activity by new 3PO partners in Brazil. Of course, with an increasingly modernized restaurant base, self-order kiosk sales also grew at an accelerated rate.

The loyalty program topped 30 million registered members at the end of the quarter, and we expect the program to grow quickly with more active members who visit us more often now that the rollout phase is nearly complete. U.S. dollar revenue performance was strong in all 3 divisions. Brazil delivered the highest growth, thanks mainly to contributions from new restaurants, a higher average check and the appreciation of the Brazilian real.

The first 6 weeks of 2026 were ahead of expectations, but we experienced an important slowdown in restaurant volume in the weeks following Carnival. Our team in Brazil responded with initiatives designed to recapture volume without sacrificing profitability. By the end of the first quarter, we saw a promising reversal in guest volume trends while also delivering better margins versus the prior year period.

In other words, we took a balanced approach to monetize our significant market share advantage in Brazil. The second quarter is off to a very strong start with positive guest traffic and solid average check growth in April and the first half of May. NOLAD comparable sales rose due to higher guest traffic in a couple of key markets. The result was supported by disciplined pricing, targeted mix optimization and continued momentum in Mexico.

Panama and Costa Rica also achieved early progress towards rebalancing traffic and average check. The appreciation of the Mexican peso and Costa Rican colón helped contribute to revenue growth in the period as well. SLAD sustained strong momentum with internal research pointing to either maintained or expanded visit and value share in each SLAD market within the respective QSR industries. This performance underscores our ability to consistently gain market share.

The currency environment in SLAD was mixed. Most local currencies appreciated versus the prior year with the exceptions of Argentina and Venezuela. Elevated inflation in these 2 countries partly offset the currency devaluations and helped to generate U.S. dollar revenue growth in the quarter. Over to you, Mariano.

Mariano Tannenbaum

Chief Financial Officer

Thanks, Luis, and good morning, everyone. As you just heard, we were able to monetize brand and market share advantages in several key markets during the first quarter of 2026. Adjusted EBITDA totaled \$118 million, up almost 30% in U.S. dollars year-over-year. The consolidated margin expanded by 120 basis points with a very encouraging 60 basis point contribution from food and paper and 60 basis points from G&A as well.

Modest pressure in payroll and occupancy and other operating expenses was fully offset by income from certain franchisee restaurant transactions in NOLAD and SLAD. Even without these transactions, consolidated EBITDA margin expanded by 70 basis points versus the first quarter of 2025.

Going back to Food & Paper, both Brazil and SLAD were able to generate margin improvements versus last year, while NOLAD was stable as a percentage of revenue despite accumulated food inflation globally. Payroll expenses were up as a percentage of revenue in Brazil and NOLAD, mainly due to higher hourly crew wages. This was partly offset by payroll expense leverage in SLAD.

Occupancy and other operating expenses included modest pressure in each division, whereas G&A was lower, partly reflecting the benefits of last year's restructuring process. First quarter adjusted EBITDA included \$5.8 million from sub-franchisee restaurant transactions in SLAD and NOLAD, which added \$2.7 million and \$3.1 million, respectively.

In Brazil, adjusted EBITDA was up more than 20% in U.S. dollars. Improved Food & Paper was the main driver of the quarter's 30 basis point margin expansion. NOLAD has had a more challenging time generating margin improvement in recent quarters. Excluding the income from the restaurant transaction, EBITDA margin was down about 40 basis points in the quarter. We are working with the leaders in each market to implement strategies that better balance guest volume and profitability.

SLAD continued generating strong U.S. dollar growth and margin expansion in the first quarter. Even without the income from the restaurant transaction with a local sub-franchisee, SLAD's EBITDA margin rose by about 120 basis points in the period. Moving ahead, we remain optimistic that SLAD is on track to deliver another positive performance this year, navigating the short term while building on the successes of 2025.

Starting with today's earnings release, we will be publishing our adjusted free cash flow for the last 12 months. We believe this calculation over a full business cycle provides a clear picture of our ability to service our debt and fund our CapEx plans. Additionally, this is in line with the 3 pillars of focus that Luis introduced last year, targeting greater operational efficiency and cash flow generation to create long-term shareholder value.

For the 12 months ended March 31, adjusted free cash flow generation reached almost \$110 million versus a negative \$3 million in the previous period. As a reminder, during the first quarter, we also completed the liability management transaction we described on our last call. As of the end of the first quarter, net debt to adjusted EBITDA was unchanged compared with year-end 2025. We continue to have a healthy cash balance and are combining improved profitability and cash flow generation with other initiatives to strengthen our balance sheet and support future growth and modernization.

With that in mind, during the first quarter, we invested \$36.8 million, including \$16.7 million for new restaurants. Growth continues to be a priority for capital allocation as long as the returns on investment are strong. With all the uncertainty currently influencing local economies and consumer behavior, we continue to focus on the factors we control to drive profitable sales growth and generate value through the investments we make inside and outside our restaurants. I am encouraged by the progress achieved during the first quarter, and our objective remains to deliver improved underlying margin performance throughout the year. Back to you, Luis.

Luis Raganato
Chief Executive Officer

Thanks, Mariano. I have just a few more things to mention before we open up for Q&A. Arcos Dorados is in a unique position in the Latin American consumer space. We operate in a segment of the economy that will never disappear as we meet a basic need for guests. Within that segment, we developed significant competitive advantages, spanning the emotional connection we have with consumers, the multiple channels we use to generate sales, the business foundation built on operational efficiency and the prudent management of the company's capital structure.

We also partner with the communities we serve to support economic development and new formal job opportunities for young people. In fact, over the last several months, we have been recognized by Great Place to Work among large companies as the #1 Great Place to Work in both Argentina and Uruguay and the #4 Great Place to Work in Brazil, the highest ever ranking in that country's history.

In Mexico, the prestigious Expansión Media Group publishes an annual Súper Empresas ranking, which evaluates organizational culture among the country's largest companies. The ranking is based on factors, including leadership, professional growth, company policies and social responsibility, among others.

We were honored to have been ranked #1 in the 2026 ranking. The recognition we received in each of these markets is a reflection of a company-wide commitment to running their restaurants while also generating new formal job opportunities that have a positive impact on the communities we serve. Soon, we will publish the Arcos Dorados 2025 social impact and sustainable development report.

In addition to the impact team's ongoing work on youth opportunity and the other pillars of the recipe for the future, you will find the details of how we met the targets of the sustainability-linked bond we issued back in 2022. Check back on the website, recipeforthefuture.com in the next few weeks to download the report.

Also, please mark your calendars for Arcos Dorados' next Investor Day. We are working on an agenda for the morning of October 1 in New York with the participation of several members of the company's executive leadership who will provide an update on how we are addressing the business' 3 pillars of focus: today, growth and tomorrow.

In the coming weeks, we will provide more details on how you can participate in the event. We hope you will join us. Finally, let me reinforce a couple of key messages from today's presentation. The plan for 2026 was developed to optimize sales growth drivers over the course of the year and capture efficiencies to drive improved profitability. This should help us generate positive adjusted free cash flow to create additional shareholder value. The team is focused and the second quarter is off to a good start.

Thank you for joining today's call. Dan, back to you.

Question-and-Answer Session

Daniel Schleiniger

Vice President of Investor Relations

Thanks, Luis. We will now begin the Q&A session.

[Operator Instructions]

Okay. Thanks. We actually have quite a few questions already in the queue. We're going to try to go systematically through these. We're going to start with a question related to our beef costs, which we have from both Bob Ford of Bank of America, who says, how should we think about beef costs and pricing for the balance of the year across markets? And also Froylan Mendez from JPMorgan, can you provide more detail on the evolution of beef prices in Brazil during the first quarter and quantify how much of the margin improvement was attributed to this tailwind?

And also, how do you expect beef prices to trend for the remainder of the year? And what implications could this have to your margin performance in full year '26 in Brazil? So with all of that, I'll turn it over to you, Mariano.

Mariano Tannenbaum

Chief Financial Officer

Thank you. Good morning, everyone, and thank you, Bob and Froylan, for the question. Regarding Food & Paper, I will start with Brazil. Food & Paper and beef in particular, was the main driver of margin improvement in Brazil during this quarter. As we already or I mentioned during the previous call, this is the second quarter where we are seeing beef cost reduction in Brazil.

So we are very pleased with that. Compared to last year, there's a clear moderation on price increases, and that's, of course, helping our margin performance at the restaurant level.

Looking ahead, we expect costs, especially beef to remain dynamic. Global demand, as you know, is still shaping domestic prices. Brazil is still with beef costs lower than in many places in the world. We are working on that. For the outlook, we are cautiously optimistic about the evolution of Food & Paper costs in Brazil. Besides beef, we are seeing the rest of the main categories pretty stable. And going out for Brazil, we haven't seen the same pressure that we have seen last year in beef costs in Brazil, in the rest of the countries where we operate, and we are not seeing further pressures during this year.

So in summary, we are very pleased with the performance in the last 2 quarters. We have seen beef cost reductions, and we are cautiously optimistic for the outlook for the remaining of 2026.

Daniel Schleiniger

Vice President of Investor Relations

Great. Thanks, Mariano. The next question, we're going to stay with Bob Ford from Bank of America. Can you talk about loyalty penetration rates in your bigger markets and what that's doing to frequency and average ticket? And where are you rolling out loyalty or have yet to lap in terms of the markets what's already been rolled out? And that one is for you, Luis.

Luis Raganato

Chief Executive Officer

Alright. Thank you very much, Bob, for the question. First, to start, loyalty boosts the power of the app because it brings visit frequency while increasing the percentage of identified sales. The program continued to grow this first quarter, reaching more than 30 million registered members. And this is an increase of 62% versus the end of last year, representing 25% of total sales.

In the first quarter, we launched one additional market, Bob, Panama. So our loyalty programs available in 10 countries now that account for 94% of our stores. Regarding the KPIs, analyzing the transactions of the program, we calculated a 20% to 25% increase in visit frequency. And the performance of 90-day active users, frequency and redemption rates is above the average of the market. And regarding margins, we're seeing a positive impact since redeemed products have, on average, a higher margin.

We are seeing a minimal impact on average check, and this is compensated greatly by the increase in frequency. And another advantage is that it helps us to analyze the customers' behavior to better manage the customer lifetime value that has reached record high figures. So that's the answer Dan.

Daniel Schleiniger

Vice President of Investor Relations

Thank Luis. I actually have a couple more from Bob. Both of them will be for you, Mariano go one at a time here. First is what's behind your sub-franchisee acquisitions and sales in NOLAD and Argentina were flat? And how do you think about the optimal balance of corporate versus sub-franchise locations these days?

Mariano Tannenbaum

Chief Financial Officer

Perfect. Basically, this is business as usual for us. We currently have more than 2,500 restaurants in the region. And it's normal for us to acquire some restaurants from sub-franchisees and to sell some restaurants operated by us to sub-franchisees. And that happens on a regular basis. So this quarter, we acquired some restaurants in Mexico, and we sold a restaurant in SLAD. So this is normal for us. You are going to see these type of transactions as you have seen them in the past, and you will see them in the future regarding the mix between Arcos operated restaurants and sub-franchisees, we are not expecting any big changes on the percentage. You recall, more or less, we operate 70% of total restaurants and the sub-franchisees operate around 30%, and we are planning to maintain that percentage quite stable throughout this year and next year.

Daniel Schleiniger

Vice President of Investor Relations

Great. Thanks Mariano. And then final one from Bob Ford, Bank of America. How should we think about the cuts to the central administrative structure net of the severance and opportunities for further improvement due to AI or other efficiencies? And that's back to you, Mariano.

Mariano Tannenbaum
Chief Financial Officer

Perfect. Well, as you know, maintaining a strong discipline over the G&A expenses, it's a core priority for Arcos as we continue to focus on efficiency and operating leverage while supporting the needs of the business. Following this G&A restructuring that started in November last year until January this year, we entered -- we can say that we entered 2026 with a leaner and more agile cost structure. It's better aligned with our strategic priorities and growth agenda.

So at a consolidated level, G&A over revenues is down 60 bps versus the prior year, and that's supported, of course, by sales growth and the reductions that we -- that I just mentioned.

The only thing is, of course, the increase in the U.S. dollar that is helping our -- sorry, the real appreciation of the local currencies in the last months is helping our results and our EBITDA, but at the same time, is making our G&A in dollars a bit higher. But throughout the year, we expect to maintain the leverage that we obtained during this first quarter, and we are very pleased with these results.

In terms of AI, we are beginning this journey with, of course, training all our staff, adoption of AI tools. And we are convinced that we have the scale to generate value through AI and agents, and we will talk about this with much more detail during our Investor Day in September.

Daniel Schleiniger
Vice President of Investor Relations

Thanks, Mariano. The next question is going to be a combination of 3 questions for Luis. And I'll start with Eric Huang from Santander. Three questions from his side. I'll start with first. Comp sales in Brazil remained quite pressured, but we saw sequential improvement in your main competitors' indicator in the quarter. Could you walk us through the competitive environment and current expectations towards a rebound in comp sales in Brazil?

I'll combine that with one from Thiago Bortoluci from Goldman Sachs. Who asked us, could you comment on how traffic has sequentially evolved since mid last year and how it is into the second quarter?

And I'll add to that, Julia Rizzo from Morgan Stanley, who says she would like to hear management's expectations on the pace of sales recovery in Brazil. And then she has the second part about margins in Brazil. I'll come back to you on Mariano on that one. But the first piece that has to do with Brazilian sales and competitive environment, over to you, Luis, first.

Luis Raganato

Chief Executive Officer

All right. Thank you, Dan. Thank you, Eric, Thiago and Julia for the questions. Bear with me, I will try to cover everything.

First, although I can't speak to a specific competitors' performance, I can tell you that we believe that we are managing top line growth in a way that is sustainable over time. It is important to understand that the Brazilian QSR industry is undergoing a correction in guest volume. And since this is an industry-wide reality, we have focused our efforts on monetizing the significant market share advantage we do have.

So while we are doing that, while also improving profitability margins. That is what we did during the first quarter when we delivered EBITDA margin expansion while also increasing the brand's visit share versus the prior year quarter. And as I mentioned in the first statements, the second quarter is off to a very good start. And this was thanks to the proactive step that the team -- the Brazilian team took to reverse guest volume trends with maintaining healthy margins.

And for the rest of the question, and I will start with 2025 and a little bit of context. We did have a challenging 2025 and volume trends remained under pressure during the first quarter of this year, which was the main reason for the quarter's comp sales result. The industry experienced volumes down mid-to-high single digits. And this was especially evident in the Post-Carnival season. This happened in the first half of March, and we experienced an important decline in guest volumes in that period.

What we're seeing is that disposable income among consumers continues to be limited which is why it was important for us to maintain our focus on offering a compelling value proposition with competitive pricing. That is where Economéqui the value -- national value platform starts to play. And we try to do this without sacrificing margins and delivering a great experience through all the channels.

The focus of the operations team is to have the right profiles, the right quantity, the right level of training to deliver the best accuracy and speed through all the channels. And having said that, what we saw is that when the industry continued to focus on promotional activities very driven by pricing and transactional -- very transactional, we focused on a more comprehensive plan. That complements actions targeted to increase traffic and shield market share with actions that aim to build the love for the brand. As a result of the mix of these initiatives, guest volume trends in the second half of March improved significantly.

The contribution to sales came more in the first quarter from average check and channel shifts than volume, but we generated important improvements in margins. And in this context, it's worth mentioning that even we had flattish comparable sales, we achieved our highest visit share level since 2022, and this is according to CREST. We managed to maintain a multiple of more than 2x the guest traffic of the nearest competitor. And we also saw some of the brand equity scores we track like value, quality, top of mind, brand preference that are at or near their all-time highs, which not only supports current sales performance, but also we believe that puts us in a position of strength for when market conditions improve moving forward.

And the last piece of the answer would be with what we're seeing in the second quarter. We have continued supporting guest volume and sales growth. And again, by making the brand both more affordable and more aspirational. And so we have initiatives, including doubling down on Economéqui, the national value platform. You know that today, the attractive price that we have is [indiscernible] for less than \$4. You can make your own combo, your own menu. We have 4 items that our guests can choose. And we introduced the World Cup sandwiches. It's a lineup of sandwiches inspired by different countries participating in the FIFA World Cup. This has happened for the last 20 years. Of course, the story is in Brazil. And the results so far have been promising.

April vehicles, guest volume and comparable sales reached the best growth levels over the last 20 months. And so far, the month of May is following a similar trend. So with that, we are convinced that we're in a position of strength to face the current or any situation that could arise. And just to highlight that our 2026 plan was designed to optimize sales growth drivers and to improve profitability. We want to generate additional shareholder value.

Daniel Schleiniger

Vice President of Investor Relations

Thank you, Luis. And I think you just answered another question that came in. I'll mention it very quickly, but I think you just answered it, which is from [indiscernible] what do you think is driving the traffic pickup in second quarter in Brazil and considering the pickup in inflation and pricing power. I think you just addressed that.

So I'm going to shift back to the second part of Julia's question from Morgan Stanley that I mentioned, which was the sustainability of first quarter '26 margin tailwinds through the year. And I think she's talking specifically about Brazil, Mariano.

Mariano Tannenbaum

Chief Financial Officer

Perfect. Thanks, Julia, for the question. I already spoke -- talked about Food & Paper dynamics in Brazil. But in general, your question is more general about margin in Brazil, update and outlook. So this quarter, we saw EBITDA margin expansion of 30 bps, reaching 12.7% EBITDA margin in the division. This increase as I already mentioned, was mainly driven by the reduction of Food & Paper costs with less pressure from prices and very good results from all our revenue management strategies.

In addition, I would mention that leverage of G&A as the same case as in the consolidated level, we saw leverage of G&A over revenues after the restructuring process that I already mentioned, and we are seeing positive results on that.

On the other hand, we experienced small deleverage in payroll and occupancy and other operating expenses but we expect to reverse that with increase in sales in the coming months. Of course, the appreciation of the currency of the Brazilian real as many other key currencies where we operate, such as the Colombian peso, the Chilean peso, the colón, Costa Rica, the Mexican peso, the Argentine peso. But the appreciation of the Brazilian real, in particular, also was a relevant factor for EBITDA growth.

So looking ahead to 2026, after a tough 2025 in Brazil in terms of margins because of the cost increases, we're cautiously optimistic in relation to the Food & Paper expenses. And of course, we expect to continue increasing sales that will allow us to generate additional level and leverage on fixed cost lines.

Daniel Schleiniger

Vice President of Investor Relations

Great. Thanks, Mariano. We're going to stay with you for a couple more questions from Eric Huang at Santander. His second question, the tax rate in the quarter showed significant improvement on a quarter-over-quarter basis. What can we think about in terms of the effective tax rate going forward?

Mariano Tannenbaum

Chief Financial Officer

Yes. We always say and in this case, even if it plays in our favor that we need to look at the ETR on an annual basis. And in this respect, we expect the ETR to be in line with the ETR we saw last year. Of course, we are always looking at different projects in different ways as the one that we mentioned in the last call about Brazil to improve our ETR. We are working on several projects. But for now, I would say that we expect an ETR in line with what we had during 2025.

Daniel Schleiniger

Vice President of Investor Relations

Great. And then the final one from Eric, also for Mariano, this is back to the divisional margin question. NOLAD margins were somehow pressured year-over-year. What are the main drivers for the pressure in the quarter? And what could be expected going forward?

Mariano Tannenbaum

Chief Financial Officer

Yes. Well, thanks for the question. Margins in NOLAD. All in all, we're 50 bps above prior year. But of course, main explanation here is the gain that we recorded from the restaurant transaction that happened in Mexico. The other good news in terms of margin in NOLAD is also leverage in the G&A line. In terms of Food and Paper, it remained flat. We saw increases or improvements in SLAD and in Brazil.

In NOLAD, we saw a flattish Food & Paper that -- but having said that, we see a sequential improvement compared to both the previous quarter and the 2025 run rate. Then in terms of payroll and occupancy and other expenses, those 2 lines remain under some pressure. We have seen minimum wage increases in many of NOLAD country and sales growth at 1.6%. Comparable sales has been running below the labor and other cost inflation, and that resulted in temporary deleverage in NOLAD.

That said, the underlying performance of the business remains solid. Mexico, our largest market in the division continues to perform very well with positive traffic, robust comparable sales growth and Food & Paper costs in Mexico below prior year. So that's supporting the overall profitability profile of the division.

So we are confident that this -- all the initiatives that we are implementing and the expectation of recovery on sales would support a path to higher profitability in the coming quarters. That's what we are looking for. That's our expectation, and we need to work hard to improve and we acknowledge that to improve margins in the division.

Daniel Schleiniger

Vice President of Investor Relations

Great. Thanks, Mariano. We're going to move now to Thiago Bortoluci from Goldman Sachs, who had a couple of more questions. The first one for you, Luis, is the gap between total sales, same-store sales and unit growth suggests there's a better productivity in NOLAD. Can you give us a little more color there?

Luis Raganato

Chief Executive Officer

Right. Thanks again, Thiago, for the question. And the answer is yes. We are having a better productivity in the division. We have a very solid expansion plan, and we are very pleased, in particular in Mexico with the organic and inorganic evolution of the business. And as you know, we are focused on improving the return on investments to increase our cash flow generation, not only [indiscernible] in the company as a whole.

Back to you, Dan.

Daniel Schleiniger

Vice President of Investor Relations

Thanks, Luis. And then the final one from Thiago is related to capital allocation. You're splitting your store growth into a broader ownership and format mix. That has materially reduced your average cost per store, I assume per store opening. How should we think about this composition going forward? And how should it move the ROIC curve versus previous cohorts? Back to you, Mariano.

Mariano Tannenbaum

Chief Financial Officer

Perfect. Thanks, Thiago. Actually, what -- how we are seeing this is we're not planning to change the ownership, as I mentioned before, we are pleased with the split between restaurants operated by us, by Arcos and restaurants operated by sub-franchisees. We are still opening the majority of stores as freestanding units, we are convinced that this model is where we should focus the majority of our store openings. Having said that, of course, if there are opportunities in other store formats, we are seeing good returns, we are going for them.

So if I would say the main source of CapEx efficiency is not about format and not about ownership. It's more about the overall approach of maximizing the returns on capital, looking at better execution, supplier localization, more efficient construction by maintaining the high standards of each restaurant that we open.

We are having a very tough discipline in our investment approach. What we have done is we have been searching for highest returns on new store openings and moving investments from countries where we -- or markets where we were seeing lower returns to markets where we were seeing higher returns. And that, I think, that overall strategy is what is giving us currently the efficiencies that we are seeing in the CapEx. That's also -- you can see that in the new adjusted free cash flow chart that we are including starting this quarter.

Capital expenditure in this first quarter totaled \$36.8 million, down from \$48.8 million in the prior year period. This period, we are opening -- or we opened 19. And in the previous year, we opened 10 restaurants. So having opened 9 more restaurants, the investment is much lower, and that's all about disciplined focus and a more disciplined approach to investment.

Daniel Schleiniger

Vice President of Investor Relations

Great. Thanks, Mariano. The next question is from Froylan Mendez at JPMorgan. This one will be for you, Luis. With digital sales reaching very high penetration, how should we think about the impact of total CapEx and CapEx mix in terms of store openings and format mix over the next few years? Also, how could this be managed under the restrictions and/or commitments of the MFA?

Luis Raganato

Chief Executive Officer

Right. Thank you very much, Froylan, this answer is going to be related with the one that Mariano just gave. Just a reminder that our growth plan is aligned with our long-term vision. This vision is to unlock McDonald's full potential in the region. It already incorporates market opportunities and funding strategies to support the expansion. We keep the same focus on modernization and digitalization, the same focus that we've had in the last couple of years.

We are currently at 75% of Experience of the Future restaurants. The objective is to achieve 90% in the next couple of years. And of course, if conditions change, we are flexible in adjusting the pace and focus of investments as you know that and Mariano has talked about that in the way that we are already doing, and we have done in the past.

We are prioritizing and we will prioritize the most profitable markets and restaurant formats. As you know, the relationship with the McDonald's Corporation team is stronger than ever. So we do have space to adjust anything we think we need. And as you know, we are, in fact, in the process of revisiting every element of our development process to ensure that every dollar invested brings the best possible return. Dan?

Daniel Schleiniger

Vice President of Investor Relations

Okay. We'll stick with you, Luis. Also similar or on the topic of digital sales. Álvaro García from BTG. On digital sales penetration, Luis stressed that 55% of sales remain in-store, and this quarter saw more normalized growth of digital sales. So how should we think about digital sales penetration in a weaker purchasing power environment?

Luis Raganato

Chief Executive Officer

All right. Álvaro, thank you for the question. The 55% of on-premise that we talked about that they refer to the opportunity that we have still in the sales delivered by our full brand experience. That is great news because it shows us it's a testament of how aspirational the experience inside our restaurants in the region is. They do not get in conflict with digital sales. That, in fact, are built largely by our self-owned kiosks that are inside our restaurants. So we expect to keep on growing digital sales and on-premise sales despite any market situation. Dan, back to you.

Daniel Schleiniger

Vice President of Investor Relations

Thanks, Luis. Moving now to a couple of questions from [indiscernible]. The first -- both I think are going to be for you, Mariano, but I'll start with the first one. In the company's annual report, is the CapEx for new restaurants a blended figure that includes both company-operated and franchise restaurants? And what do you expect the opening cost for new restaurants to be going forward? Will it be more through owned properties or leased properties?

Mariano Tannenbaum

Chief Financial Officer

Perfect. Thanks, Len, for the question. Yes, the CapEx is all the CapEx that the company does. Remember that in the case of new restaurants, Arcos makes the investment in the building. And then Arcos also makes the investment in the inside of the store in case it's an Arcos-operated restaurant and the sub-franchisee makes the investment inside the store in case this is a sub-franchisee restaurant.

But always Arcos has an investment there as a developmental licensee as we are. In this case, what do you expect the opening cost for new restaurants to be going forward? Well, as I already mentioned in the previous question related to this topic, we are working very hard, and we have been so far, I think, successful in reducing the average cost per restaurant open, and we will continue to look for opportunities to reduce this cost.

This has been a priority for Luis since he started as CEO last year. And the whole team, my whole team in finance and the development team are working very hard to find efficiencies and to reduce the investment, but it's important to note, always maintaining the high quality of the standards of the restaurants opened. And we are very pleased that we are seeing higher returns by lower investments, but keeping sales and margins in the new restaurants.

In terms of if we are going to open more owned properties or leased, the majority of the stores we opened, the vast majority of the stores we opened are on leased properties and not on owned properties. That doesn't mean that we don't buy any land, but the majority of the cases is on leased land.

Daniel Schleiniger*Vice President of Investor Relations*

Great. Thanks, Mariano. The second question from Len is after reaching a 90% EOTF mix by the end of 2027 or so, how many restaurants do you expect to be reimaged or upgraded to EOTF each year thereafter?

Mariano Tannenbaum*Chief Financial Officer*

Well, in the industry, the standard -- in the QSR industry, the standard is to modernize or remodel approximately 10% of the restaurant base each year. So that means every 10 years, a restaurant more or less 10 years is due to modernization or redevelopment. And we are expecting to do that. Probably it could be EOTF, it could be something new. We are working with McDonald's in order to develop the new restaurant that will come. But we are still planning to keep modernizing our stores. That is a key component for being modern, being attractive for our customers and to continue increasing same-store sales in our restaurants.

Daniel Schleiniger*Vice President of Investor Relations*

Thanks, Mariano. We have another question from Lorena Reich from Lucror Analytics. Wondering why you no longer compare system-wide comparable sales with blended inflation. And also if you can comment on the expected impact from the World Cup in guest traffic and sales in Q2 and Q3. And that question is for you, Luis.

Luis Raganato*Chief Executive Officer*

Right. Thank you, Lorena, for the question. I think I already covered the part of the World Cup actions we've seen and we are pleased with the performance of that campaign in the first weeks. And regarding the question about the inflation under normal circumstances, inflations or inflation is a good measuring stick for comparable sales but it is not a rule. For example, in Brazil, I already said this, that the QSR industry is undergoing a correction in guest traffic.

And when that occurs, it is important to maintain as much traffic as possible, which we believe we have done and the evidence is that we have a strong visit share performance. We believe it is also a time to monetize the significant market share advantage we built in the market to try to help offset the cost increases that are also impacting the industry. That way, we build top line in a sustainable way without buying traffic while also maintaining healthy margins.

So at this moment, you can apply this concept to a couple of other markets as well in the region. Long term, we expect to maintain an optimized combination of sales growth drivers based on market conditions and the factors that we can control.

Daniel Schleiniger

Vice President of Investor Relations

Great. Thanks, Luis. And we have one more question from Thomas from an individual investor, and he's asking the Food & Paper cost as a percentage of revenue decrease is part of -- is it a part of an average price increase? Or is it a cost efficiency initiative? And in the case of a cost efficiency initiative, could you elaborate on those initiatives? So I'll pass that one to you, Mariano.

Mariano Tannenbaum

Chief Financial Officer

Okay. I'll try to be fast, so we can end at time. Pricing strategy, it's very important, remains disciplined and closely aligned with inflation. We continue to avoid aggressive pricing actions to protect long-term brand health. So we're not increasing prices above inflation. And our affordability platform as the one that Luis mentioned in Brazil, Economéqui is performing very well, reinforcing value and traffic.

At the consolidated level, the Food & Paper improved 60 basis points versus prior year, but that's more a mix between input cost trends, very disciplined revenue management where we can -- we are looking for opportunities in pricing, but being disciplined, as I mentioned before, currency appreciation over imported items, as already I mentioned about real appreciation of main currencies. So I would say there's a mix, reduction in costs, initiatives from our supply chain team, revenue management. So with that mix, but always keeping in mind that we are monitoring prices to be in line or below inflation. That's how we obtained this 60 bps improvement versus prior year. And that's why we remain cautiously optimistic for the rest of 2026.

With that, Dan, back to you.

Daniel Schleiniger

Vice President of Investor Relations

Thanks, Mariano. And before we wrap up the Q&A session, I think, Luis, you had a couple of things that you wanted to mention.

Luis Raganato

Chief Executive Officer

Yes. Thank you, Dan. Well quick a couple of thoughts. Even though we continue to see a challenging environment in some markets with pressure on consumer confidence and private consumption, we remain very confident because we're in a position of strength and have exciting marketing plans that will help us face any situation. And let me mention again that we are targeting sustainable top line growth and improved operational efficiency to drive profitability, generate free cash flow and create shareholder value. Thank you for your time.

Daniel Schleiniger

Vice President of Investor Relations

Thanks, Luis. So that does bring us to the end of the Q&A session. Thanks again for your interest in Arcos Dorados and for joining today's webcast. Look forward to speaking with you again in the middle of August on our second quarter 2026 earnings webcast. Have a nice rest of your day.

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