



McDonald's Corporation (MCD)

Updated July 26th, 2018 by Jonathan Weber

Key Metrics

Current Price: \$159	5 Year CAGR Estimate: 7.5%	Volatility Percentile: 9.0%
Fair Value Price: \$152	5 Year Growth Estimate: 5.9%	Momentum Percentile: 43.6%
% Fair Value: 104%	5 Year Valuation Multiple Estimate: -0.9%	Valuation Percentile: 53.2%
Dividend Yield: 2.5%	5 Year Price Target: \$202	Total Return Percentile: 48.1%

Overview & Current Events

McDonald's is the largest publicly-traded restaurant company in the world. The company was founded in 1940 and has a market capitalization of \$125 billion. As a Dividend Aristocrat, McDonald's has a long dividend growth history, which has made it a favorite holding for many retail investors.

McDonald's announced its most recent quarterly results on July 26. The restaurant company reported earnings per share of \$1.99, an increase of 15% year over year. Revenues totaled \$5.4 billion, a decrease of 12% year over year. The revenue decline was caused by the company's refranchising efforts.

McDonald's continues to perform significantly better than the restaurant industry as a whole. Comparable restaurant sales during the second quarter rose by 4.0% globally and by 2.6% in the US. McDonald's also continued to reward shareholders via dividends and share repurchases, paying out a total of \$2.5 billion during the second quarter.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	\$3.67	\$3.98	\$4.60	\$5.27	\$5.36	\$5.55	\$4.82	\$4.97	\$5.71	\$6.66	\$7.60	\$10.10
DPS	\$1.63	\$2.05	\$2.26	\$2.53	\$2.87	\$3.12	\$3.28	\$3.44	\$3.61	\$3.83	\$4.10	\$5.50

McDonald's has a long and successful growth history, but a couple of years ago the company encountered some headwinds. McDonald's has found ways to reignite growth, including driving comparable sales by offering all day breakfast at its restaurants and expanding the menu through offerings like organic meat and healthier alternatives. Another big strategic shift was McDonald's decision to refranchise many of its restaurants. The company generates less revenue now, but its costs have come down to more than offset this top-line change. McDonald's has turned itself into an asset-light, low-cost company that collects franchise fees from a larger number of total restaurants.

This strategy has been very successful, as EPS have grown at a strong pace over the last three years. It is highly likely that McDonald's will continue to perform well in the future. Earnings per share growth will be driven by higher franchising fees, lower costs and the impact of share repurchases.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	15.8	14.4	15.4	15.9	17.3	17.5	20.0	20.2	21.1	22.3	20.9	20.0
Avg. Yld.	2.8%	3.6%	3.2%	3.0%	3.1%	3.2%	3.4%	3.4%	3.0%	2.6%	2.5%	2.7%

McDonald's valuation has expanded significantly over the last decade, which isn't a big surprise since shares were trading at a quite inexpensive valuation ten years ago. As the broad market's valuation multiple has risen, so has McDonald's. The valuation has come down slightly so far in 2018, but is still close to the ten-year high.

Going forward some multiple contraction seems more likely than multiple expansion from the current level.

McDonald's dividend yield of 2.5% isn't as high as it has been at some points in the past, but it is still significantly above the broad market's 1.8% dividend yield, and McDonald's has a strong dividend growth history.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	30.2%	29.3%	30.1%	32.4%	30.5%	29.8%	30.7%	25.9%	32.9%	31.4%	31.0%	32.0%
Debt/A	53.0%	53.6%	54.1%	56.4%	56.8%	56.3%	62.6%	81.5%	107%	109%	110%	110%
Int. Cov.	12.8	15.3	17.3	17.2	16.6	16.5	13.9	11.3	8.8	10.3	10.5	11.0
Payout	44.4%	51.5%	49.1%	48.0%	53.5%	56.2%	68.0%	69.2%	63.2%	57.5%	53.9%	54.5%
Std. Dev.	33.9%	22.5%	15.4%	16.7%	14.2%	11.9%	12.8%	19.4%	15.0%	13.2%	15.0%	15.0%

The start of McDonald's refranchising efforts is clearly visible in the above table, as the lower amount of assets held has led to a rise in the gross profit to assets ratio beginning several years ago. At the same time as the company's asset base has shrunk, McDonald's has taken on billions of debt to finance the company's share repurchases. This has made the debt to assets ratio rise above 100%, but since interest coverage is still very solid investors do not need to worry.

McDonald's global scale makes the company less vulnerable to headwinds in one geographic region, and the company has performed well compare to other restaurant companies over the last couple of years. With its inexpensive offerings McDonald's is also relatively recession-proof, during the 2008-2009 financial crisis McDonald's kept growing.

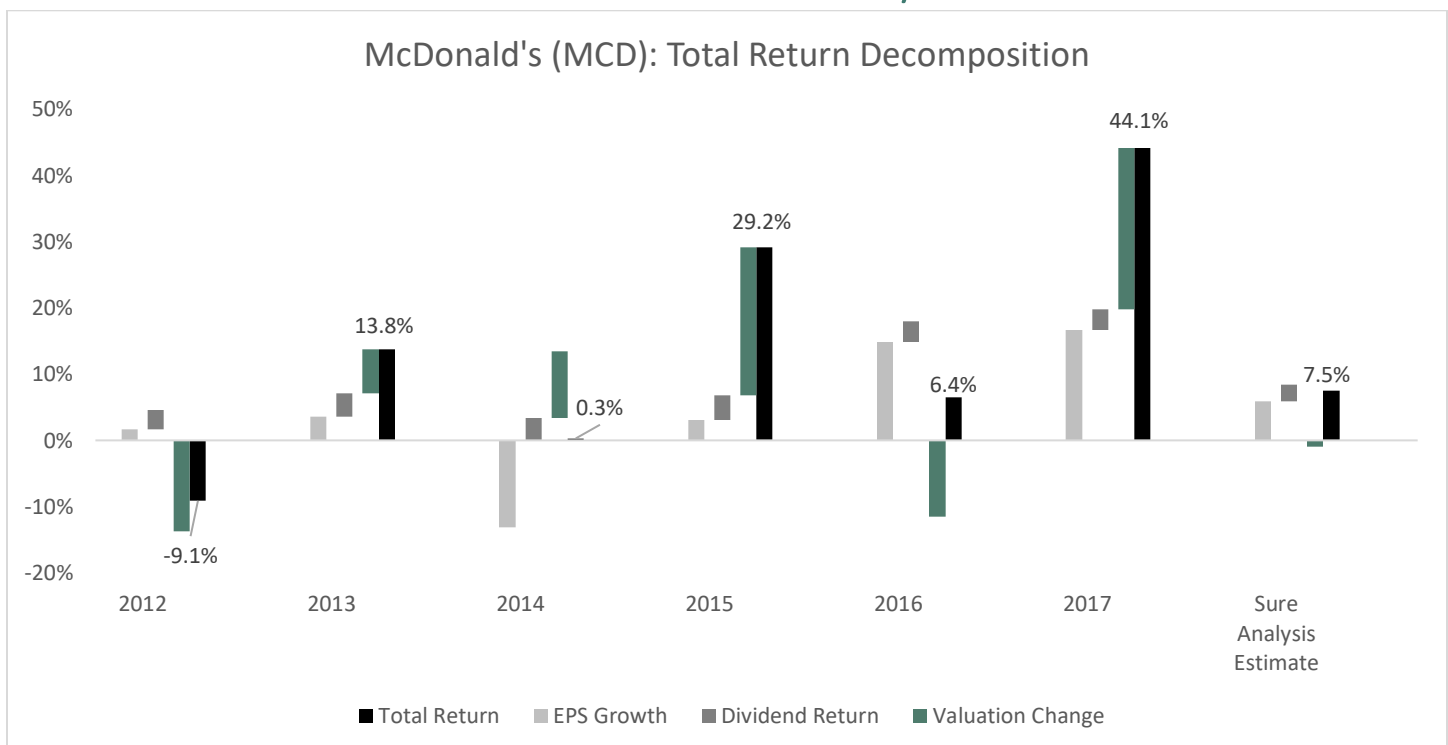
The payout ratio jumped up a couple of years ago (when McDonald's earnings declined in 2014 and they still increased the dividend), but has been coming down since. Due to a strong earnings growth outlook McDonald's should be able to grow the dividend easily whilst the payout ratio remains in the mid-50% range.

Final Thoughts & Recommendation

McDonald's provides a 2.5% dividend yield, which is high relative to what the market as a whole is offering. Shares of the company are more expensive than they used to be on average over the last decade. Solid earnings growth will still allow for some share price gains going forward.

McDonald's has been a low-risk investment that provides rising dividends in the past, and it will remain the same going forward. Due to the fact that the valuation is a bit high right now, we rate McDonald's as a hold at current prices.

Total Return Breakdown by Year



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