



# McDonald's (MCD)

Updated October 24<sup>th</sup>, 2018 by Jonathan Weber

## Key Metrics

<b>Current Price:</b>	\$177	<b>5 Year CAGR Estimate:</b>	5.5%	<b>Volatility Percentile:</b>	7.3%
<b>Fair Value Price:</b>	\$152	<b>5 Year Growth Estimate:</b>	5.9%	<b>Momentum Percentile:</b>	69.4%
<b>% Fair Value:</b>	117%	<b>5 Year Valuation Multiple Estimate:</b>	-3.0%	<b>Growth Percentile:</b>	46.3%
<b>Dividend Yield:</b>	2.6%	<b>5 Year Price Target</b>	\$202	<b>Valuation Percentile:</b>	25.0%
<b>Dividend Risk Score:</b>	A	<b>Retirement Suitability Score:</b>	B	<b>Total Return Percentile:</b>	20.1%

## Overview & Current Events

McDonald's is the largest publicly-traded restaurant company in the world. The Oak Brook (IL) – based company was founded in 1940 and has a market capitalization of \$136 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 reported its third quarter earnings results on October 23. The company generated revenues of \$5.4 billion during Q3, a decline of 6.6% versus the prior year's quarter. The sales decline can be attributed to McDonald's refranchising strategy. Most revenues that are generated at McDonald's-branded restaurants around the world belong to the respective franchisee. McDonald's generates its revenues from franchise fees primarily. The sales performance at its restaurants, franchised and non-franchised, was strong during Q3, as comparable restaurant sales rose by 4.2%.

McDonald's earnings-per-share rose to \$2.10, a 19% increase versus the prior year's quarter. Profit growth was driven by higher franchise fees, lower taxes, and the impact of a declining share count. McDonald's has raised its dividend by 15% at the beginning of the fourth quarter. The new quarterly payout is \$1.16 per share.

## Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
<b>EPS</b>	\$3.67	\$3.98	\$4.60	\$5.27	\$5.36	\$5.55	\$4.82	\$4.97	\$5.71	\$6.66	<b>\$7.60</b>	<b>\$10.10</b>
<b>DPS</b>	\$1.63	\$2.05	\$2.26	\$2.53	\$2.87	\$3.12	\$3.28	\$3.44	\$3.61	\$3.83	<b>\$4.19</b>	<b>\$5.50</b>
<b>Shares</b>	1110	1080	1050	1020	1000	990	960	910	820	790	<b>760</b>	<b>630</b>

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
<b>Avg. P/E</b>	15.8	14.4	15.4	15.9	17.3	17.5	20.0	20.2	21.1	22.3	<b>23.3</b>	<b>20.0</b>
<b>Avg. Yld.</b>	2.8%	3.6%	3.2%	3.0%	3.1%	3.2%	3.4%	3.4%	3.0%	2.6%	<b>2.6%</b>	<b>2.7%</b>

McDonald's valuation has expanded significantly over the last decade, which is not 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. After a steep increase in McDonald's share price over the last couple of months McDonald's is trading at more than 23 times this year's earnings right now, a substantial premium to what we deem fair value.

*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.*



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McDonald's dividend yield is 2.6% right now. Its dividend yield has been higher in the past, but shares offer a higher yield than the broad market nevertheless. The recent 15% dividend increase could be a hint for a strong dividend growth rate over the coming years, as earnings growth and a low payout ratio will allow for substantial dividend increases.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
<b>GP/A</b>	30.2%	29.3%	30.1%	32.4%	30.5%	29.8%	30.7%	25.9%	32.9%	31.4%	<b>31.0%</b>	<b>32.0%</b>
<b>Debt/A</b>	53.0%	53.6%	54.1%	56.4%	56.8%	56.3%	62.6%	81.5%	107%	109%	<b>110%</b>	<b>110%</b>
<b>Int. Cov.</b>	12.8	15.3	17.3	17.2	16.6	16.5	13.9	11.3	8.8	10.3	<b>10.5</b>	<b>11.0</b>
<b>Payout</b>	44.4%	51.5%	49.1%	48.0%	53.5%	56.2%	68.0%	69.2%	63.2%	57.5%	<b>55.1%</b>	<b>54.5%</b>
<b>Std. Dev.</b>	33.9%	22.5%	15.4%	16.7%	14.2%	11.9%	12.8%	19.4%	15.0%	13.2%	<b>15.0%</b>	<b>15.0%</b>

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.

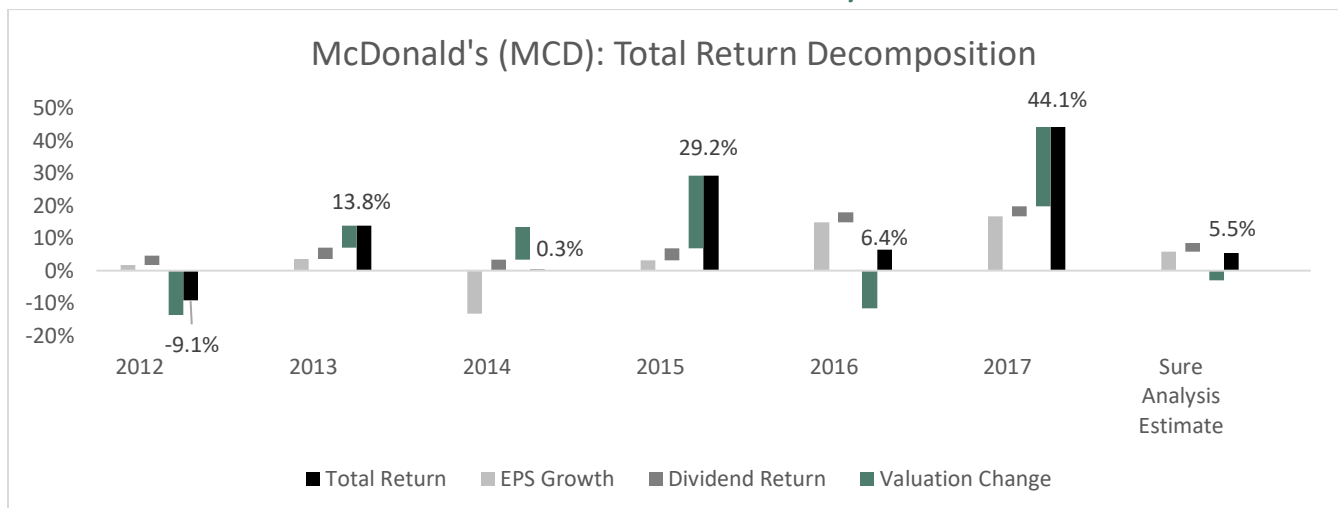
McDonald's global scale makes the company less vulnerable to headwinds in one geographic region, and the company has performed well compared to other restaurant companies over the last couple of years. With its inexpensive offerings McDonald's is also relatively recession-proof. During the 2008-2009 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 while the payout ratio remains in the mid-50% range.

## Final Thoughts & Recommendation

McDonald's is a very successful restaurant company that has a highly compelling history of consistent earnings and dividend growth. The company's strategy of refranchising many of its restaurants is working out well, and McDonald's will generate strong earnings growth during 2018. Going forward the growth rate will likely slow down, as tax rate tailwinds are lapped. McDonald's total returns will likely be negatively impacted by multiple compression over the coming years. We rate McDonald's as a hold at current prices.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Revenue</b>	23522	22745	24075	27006	27567	28106	27441	25413	24622	22820
<b>Gross Profit</b>	8639	8792	9637	10687	10816	10903	10456	9789	10205	10621
<b>Gross Margin</b>	36.7%	38.7%	40.0%	39.6%	39.2%	38.8%	38.1%	38.5%	41.4%	46.5%
<b>SG&amp;A Exp.</b>	2356	2234	2333	2394	2455	2386	2488	2434	2385	2231
<b>D&amp;A Exp.</b>	1208	1216	1276	1415	1489	1585	1645	1556	1517	1363
<b>Operating Profit</b>	6449	6780	7304	8293	8361	8517	7968	7355	7820	8390
<b>Op. Margin</b>	27.4%	29.8%	30.3%	30.7%	30.3%	30.3%	29.0%	28.9%	31.8%	36.8%
<b>Net Profit</b>	4313	4551	4946	5503	5465	5586	4758	4529	4687	5192
<b>Net Margin</b>	18.3%	20.0%	20.5%	20.4%	19.8%	19.9%	17.3%	17.8%	19.0%	22.8%
<b>Free Cash Flow</b>	3782	3799	4206	4420	3917	4296	4147	4725	4239	3698
<b>Income Tax</b>	1845	1936	2054	2509	2614	2619	2614	2026	2180	3381

## Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Total Assets</b>	28462	30225	31975	32990	35387	36626	34227	37939	31024	33804
<b>Cash &amp; Equivalents</b>	2063	1796	2387	2336	2336	2799	2078	7686	1223	2464
<b>Inventories</b>	112	106	110	117	122	124	110	100	59	59
<b>Goodwill &amp; Int.</b>	2237	2425	2586	2653	2804	2873	2735	2516	2337	2380
<b>Total Liabilities</b>	15079	16191	17341	18600	20093	20617	21374	30851	33228	37072
<b>Accounts Payable</b>	620	636	944	961	1142	1086	860	875	756	925
<b>Long-Term Debt</b>	10218	10578	11505	12500	13633	14130	14936	24122	25956	29536
<b>Total Equity</b>	13383	14034	14634	14390	15294	16010	12853	7088	-2204	-3268
<b>D/E Ratio</b>	0.76	0.75	0.79	0.87	0.89	0.88	1.16	3.40	-11.78	-9.04

## Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Return on Assets</b>	14.9%	15.5%	15.9%	16.9%	16.0%	15.5%	13.4%	12.6%	13.6%	16.0%
<b>Return on Equity</b>	30.1%	33.2%	34.5%	37.9%	36.8%	35.7%	33.0%	45.4%	192%	-190%
<b>ROIC</b>	17.9%	18.9%	19.5%	20.8%	19.6%	18.9%	16.4%	15.4%	17.1%	20.8%
<b>Shares Out.</b>	1110	1080	1050	1020	1000	990	960	910	820	790
<b>Revenue/Share</b>	20.53	20.54	22.29	25.85	27.02	27.94	27.82	26.90	28.59	27.98
<b>FCF/Share</b>	3.30	3.43	3.89	4.23	3.84	4.27	4.20	5.00	4.92	4.53

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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