



McDonald's Corporation (MCD)

Updated August 18th, 2019 by Eli Inkrot

Key Metrics

Current Price:	\$218	5 Year CAGR Estimate:	0.0%	Volatility Percentile:	6.3%
Fair Value Price:	\$143	5 Year Growth Estimate:	6.0%	Momentum Percentile:	95.4%
% Fair Value:	152%	5 Year Valuation Multiple Estimate:	-8.1%	Growth Percentile:	54.2%
Dividend Yield:	2.1%	5 Year Price Target	\$192	Valuation Percentile:	6.7%
Dividend Risk Score:	A	Retirement Suitability Score:	C	Total Return Percentile:	6.1%

Overview & Current Events

McDonald's, founded in 1940 and headquartered in Chicago IL, is the world's leading global foodservice retailer with over 38,000 locations in over 100 countries. Approximately 93% of the stores are independently owned and operated. The \$168 billion market cap company has raised its dividend each and every year since paying its first dividend in 1976, qualifying the company as a Dividend Aristocrat.

On July 26th, 2019 McDonald's reported Q2 2019 results for the period ending June 30th, 2019. For the quarter total revenue came in at \$5.34 billion, down slightly from \$5.35 billion in Q2 2018. During the quarter a 6.6% increase in revenue from franchised restaurants was offset by a 7.5% decline in sales from company-owned restaurants as McDonald's continues to rebrand its stores. Global comparable sales increased 6.5%, marking the 16th straight quarter of positive growth in this metric. Operating income came in at \$2.27 billion, a 0.5% increase, while net income increased 1.4% to \$1.52 billion. Reported earnings-per-share equaled \$1.97 compared to \$1.90 in the year ago period. On an adjusted basis, earnings-per-share equaled \$2.05 compared to \$1.99 previously. During the quarter the company returned \$2.0 billion to shareholders via dividends and share repurchases.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	\$3.98	\$4.60	\$5.27	\$5.36	\$5.55	\$4.82	\$4.97	\$5.71	\$6.66	\$7.90	\$7.95	\$10.64
DPS	\$2.05	\$2.26	\$2.53	\$2.87	\$3.12	\$3.28	\$3.44	\$3.61	\$3.83	\$4.19	\$4.64	\$5.85
Shares¹	1,077	1,054	1,021	1,003	990	963	907	819	794	767	767	700

McDonald's has a long and successful growth history when it comes to its earnings-per-share, as well as when it comes to the company's dividend payments. Since 2008 earnings-per-share have compounded at an average rate of 8% per annum. A couple of years ago the company encountered some headwinds, though, as profits dropped between 2013 and 2014. McDonald's found ways to reignite growth during the following years, which included driving comparable sales by offering all day breakfast at its restaurants and expanding the menu through offerings like organic meat and other types of healthier food. Another big strategic shift was McDonald's decision to rebrand many of its restaurants. The company generates lower 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 earnings-per-share have grown at a strong pace over the last three years. McDonald's continues to perform better than many of its peers when it comes to generating rising revenues from existing restaurants, and there is potential for McDonald's to open new restaurants in international markets throughout the next couple of years. Earnings-per-share growth will be driven by higher franchising fees, declining operating costs, and the impact of share repurchases, which have lowered the company's share count considerably over the last couple of years. Management states that the company aims for system wide sales growth of 3%-5% a year in the long run, while the company also targets earnings-per-share growth in the high single-digits. We are forecasting 6% annual growth over the intermediate-term.

1: In millions.

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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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	14.4	15.4	15.9	17.3	17.5	20.0	20.2	21.1	22.3	21.1	27.4	18.0
Avg. Yld.	3.6%	3.2%	3.0%	3.1%	3.2%	3.4%	3.4%	3.0%	2.6%	2.5%	2.1%	3.0%

Over the past decade shares of McDonald's have traded hands with an average P/E ratio of 18 to 19 times earnings. We consider 18 times earnings as a reasonable starting place, taking into consideration the slightly reduced growth expectations to go along with a very solid business model. This valuation could be too conservative if growth continues to accelerate, but this has been more or less typical of the security's past. With shares trading over 27 times our expectation for this year's earnings, this implies the potential for a substantial valuation headwind in the years to come.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	52%	49%	48%	52%	56%	68%	69%	63%	58%	53%	58%	55%

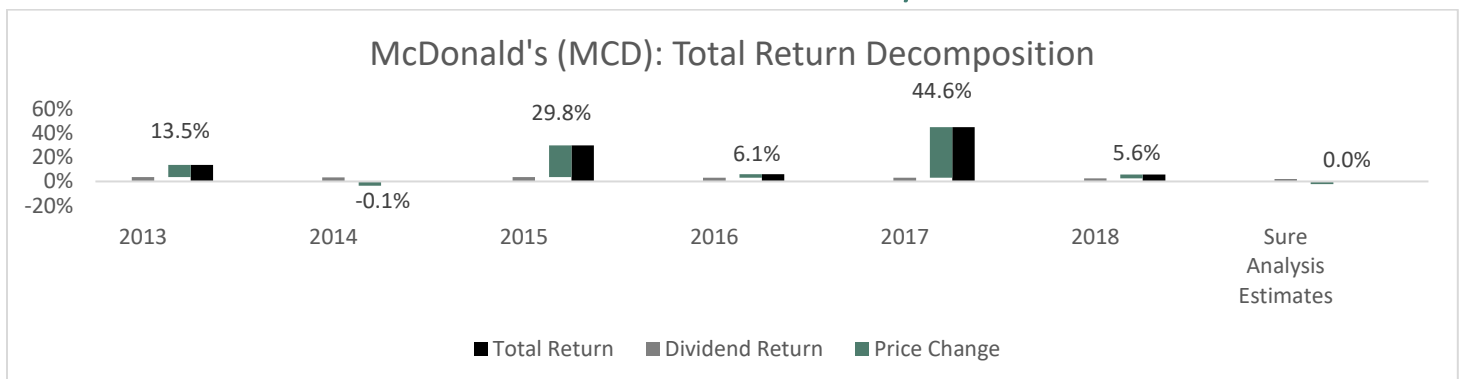
McDonald's dividend payout ratio has been oscillating in a range of ~50% to ~70% throughout the last decade. During the last couple of years McDonald's has increased its dividend at a slower pace than earnings-per-share growth, which has allowed the dividend payout ratio decline somewhat. Due to the stability of McDonald's during past recessions, coupled with a payout ratio that is not overly high, we view McDonald's dividend as very safe.

McDonald's competitive advantage lies in its global scale, immense network of restaurants, well-known brand and real estate assets. Indeed, the company's superior track record against numerous competitors has illustrated why these aspects are important to the company's success. During the last recession McDonald's posted an excellent results, with earnings-per-share of \$2.91, \$3.67, \$3.98 and \$4.60 over the 2007 through 2010 stretch, while the dividend kept on increasing to boot. As of the most recent quarter the company held \$1.1 billion in cash, \$3.9 billion in current assets and \$46.2 billion in total assets (51% of which was net property and equipment) against \$3.2 billion in current liabilities and \$53 billion in total liabilities. Long-term debt stood at \$32.6 billion against ~\$6 billion in annual earnings power.

Final Thoughts & Recommendation

Shares are up 10% since our last update. McDonald's is the top restaurant company in terms of size and scale thanks to its global reach, and the company has a very successful history generating earnings-per-share growth as well as dividend growth. That being said, today's valuation is not compelling in our view. Total return potential comes in a 0% as 6% growth and a 2.1% dividend yield could be entirely offset by a -8.1% valuation headwind. While we believe the business is excellent, the valuation leaves quite a bit to be desired. We rate shares as a sell.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	22745	24075	27006	27567	28106	27441	25413	24622	22820	21025
Gross Profit	8792	9637	10687	10816	10903	10456	9789	10205	10621	10786
Gross Margin	38.7%	40.0%	39.6%	39.2%	38.8%	38.1%	38.5%	41.4%	46.5%	51.3%
SG&A Exp.	2234	2333	2394	2455	2386	2488	2434	2385	2231	2200
D&A Exp.	1216	1276	1415	1489	1585	1645	1556	1517	1363	1482
Operating Profit	6780	7304	8293	8361	8517	7968	7355	7820	8390	8586
Op. Margin	29.8%	30.3%	30.7%	30.3%	30.3%	29.0%	28.9%	31.8%	36.8%	40.8%
Net Profit	4551	4946	5503	5465	5586	4758	4529	4687	5192	5924
Net Margin	20.0%	20.5%	20.4%	19.8%	19.9%	17.3%	17.8%	19.0%	22.8%	28.2%
Free Cash Flow	3799	4206	4420	3917	4296	4147	4725	4239	3698	4225
Income Tax	1936	2054	2509	2614	2619	2614	2026	2180	3381	1892

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	30225	31975	32990	35387	36626	34227	37939	31024	33804	32811
Cash & Equivalents	1796	2387	2336	2336	2799	2078	7686	1223	2464	866
Inventories	106	110	117	122	124	110	100	59	59	51
Goodwill & Int.	2425	2586	2653	2804	2873	2735	2516	2337	2380	2332
Total Liabilities	16191	17341	18600	20093	20617	21374	30851	33228	37072	39070
Accounts Payable	636	944	961	1142	1086	860	875	756	925	1208
Long-Term Debt	10578	11505	12500	13633	14130	14936	24122	25956	29536	31075
Total Equity	14034	14634	14390	15294	16010	12853	7088	-2204	-3268	-6258
D/E Ratio	0.75	0.79	0.87	0.89	0.88	1.16	3.40	-11.78	-9.04	-4.97

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	15.5%	15.9%	16.9%	16.0%	15.5%	13.4%	12.6%	13.6%	16.0%	17.8%
Return on Equity	33.2%	34.5%	37.9%	36.8%	35.7%	33.0%	45.4%	192%	-190%	-124%
ROIC	18.9%	19.5%	20.8%	19.6%	18.9%	16.4%	15.4%	17.1%	20.8%	23.2%
Shares Out.	1080	1050	1020	1000	990	960	910	820	790	770
Revenue/Share	20.54	22.29	25.85	27.02	27.94	27.82	26.90	28.59	27.98	26.76
FCF/Share	3.43	3.89	4.23	3.84	4.27	4.20	5.00	4.92	4.53	5.38

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

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