



McDonald's Corporation (MCD)

Updated January 29th, 2020 by Eli Inkrot

Key Metrics

Current Price:	\$214	5 Year CAGR Estimate:	1.2%	Market Cap:	\$163 B
Fair Value Price:	\$149	5 Year Growth Estimate:	6.0%	Ex-Dividend Date:	02/28/20
% Fair Value:	144%	5 Year Valuation Multiple Estimate:	-7.1%	Dividend Payment Date:	03/16/20
Dividend Yield:	2.3%	5 Year Price Target	\$199	Years Of Dividend Growth:	44
Dividend Risk Score:	B	Retirement Suitability Score:	B	Last Dividend Increase:	7.8%

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 \$163 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 January 29th, 2020 McDonald's reported Q4 and full year results for the period ending December 31st, 2019. For the quarter total revenue came in at \$5.35 billion, up 3.6% compared to Q4 2018. During the quarter roughly flat revenue from company-owned restaurants was more than offset by a 6.9% increase in revenue from franchised restaurants – the latter of which has notably higher margins. Net income came in at \$1.57 billion, an 11.1% increase, while earnings-per-share increased 14.3% (due to a lower share count) to \$2.08. For the year, total revenue equaled \$21.08 billion, representing a 0.2% increase as a -5.9% decline in company-operated restaurants was offset by 5.8% increase in franchised restaurants (a slightly larger portion of the revenue base). Net income improved 1.7% to \$6.03 billion, while reported earnings-per-share increased 4.5% to \$7.88. Earnings-per-share equaled \$7.84 on an adjusted basis.

During the year McDonald's returned \$8.6 billion to shareholders via share repurchases and dividends, successfully achieving the company's target of returning \$25 billion in the three-year period ending in 2019.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	\$4.60	\$5.27	\$5.36	\$5.55	\$4.82	\$4.97	\$5.71	\$6.66	\$7.90	\$7.84	\$8.25	\$11.04
DPS	\$2.26	\$2.53	\$2.87	\$3.12	\$3.28	\$3.44	\$3.61	\$3.83	\$4.19	\$4.73	\$5.00	\$6.38
Shares¹	1,054	1,021	1,003	990	963	907	819	794	767	765	760	700

McDonald's has a long and successful growth history when it comes to both earnings-per-share and dividends. Since 2008 earnings-per-share have compounded at an average rate of 7.1% 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 (sales peaked at \$28 billion in 2013 versus closer to \$21 billion today), 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 successful, as earnings-per-share have grown at a strong pace over the last three years, 2019 notwithstanding. 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

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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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.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	15.4	15.9	17.3	17.5	20.0	20.2	21.1	22.3	21.1	25.2	26.0	18.0
Avg. Yld.	3.2%	3.0%	3.1%	3.2%	3.4%	3.4%	3.0%	2.6%	2.5%	2.4%	2.3%	3.2%

Over the past decade shares of McDonald's have traded hands with an average P/E ratio of 19 to 20 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 somewhat typical of the security's past. With shares trading at 26 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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	49%	48%	52%	56%	68%	69%	63%	58%	53%	60%	61%	58%

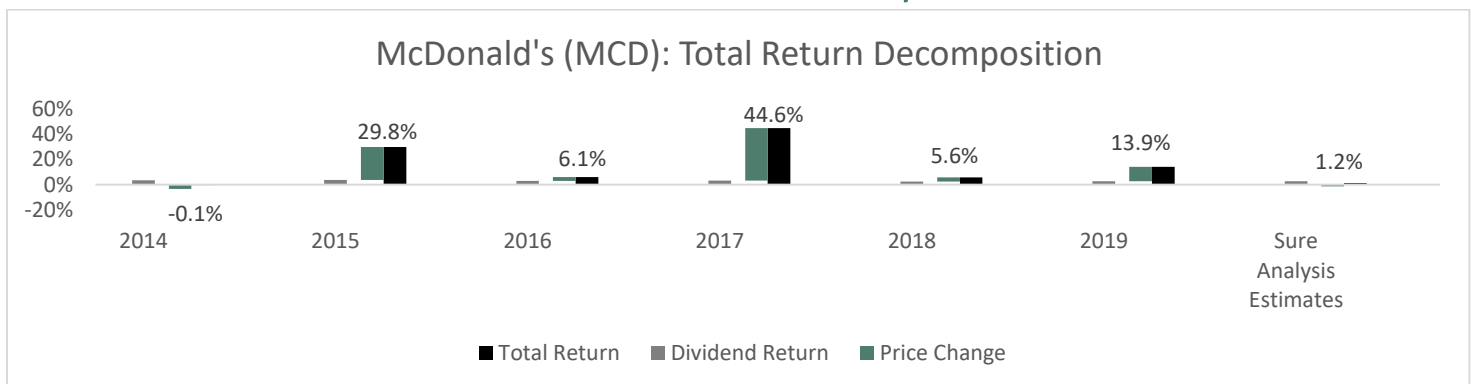
McDonald's dividend payout ratio has been oscillating in a range of ~50% to ~70% throughout the last decade. Due to the stability of McDonald's during past recessions, coupled with a payout ratio that is not overly high, we view McDonald's dividend as very safe; the most recent 7.8% dividend increase being a good example of this.

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 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.

Final Thoughts & Recommendation

Shares are up 6% since our last report. McDonald's is the top restaurant company in terms of size and scale. Thanks to its global reach the company has a very successful history of generating earnings-per-share and dividend growth. That being said, today's valuation is not compelling in our view. Total return potential comes in at just 1.2% as 6% growth and a 2.3% dividend yield could be significantly offset by a valuation headwind. While we believe the business is excellent, the valuation leaves quite a bit to be desired and we continue to rate shares as a sell.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	24075	27006	27567	28106	27441	25413	24622	22820	21025	
Gross Profit	9637	10687	10816	10903	10456	9789	10205	10621	10786	
Gross Margin	40.0%	39.6%	39.2%	38.8%	38.1%	38.5%	41.4%	46.5%	51.3%	
SG&A Exp.	2333	2394	2455	2386	2488	2434	2385	2231	2200	
D&A Exp.	1276	1415	1489	1585	1645	1556	1517	1363	1482	
Operating Profit	7304	8293	8361	8517	7968	7355	7820	8390	8586	
Op. Margin	30.3%	30.7%	30.3%	30.3%	29.0%	28.9%	31.8%	36.8%	40.8%	
Net Profit	4946	5503	5465	5586	4758	4529	4687	5192	5924	
Net Margin	20.5%	20.4%	19.8%	19.9%	17.3%	17.8%	19.0%	22.8%	28.2%	
Free Cash Flow	4206	4420	3917	4296	4147	4725	4239	3698	4225	
Income Tax	2054	2509	2614	2619	2614	2026	2180	3381	1892	

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	31975	32990	35387	36626	34227	37939	31024	33804	32811	
Cash & Equivalents	2387	2336	2336	2799	2078	7686	1223	2464	866	
Inventories	110	117	122	124	110	100	59	59	51	
Goodwill & Int.	2586	2653	2804	2873	2735	2516	2337	2380	2332	
Total Liabilities	17341	18600	20093	20617	21374	30851	33228	37072	39070	
Accounts Payable	944	961	1142	1086	860	875	756	925	1208	
Long-Term Debt	11505	12500	13633	14130	14936	24122	25956	29536	31075	
Total Equity	14634	14390	15294	16010	12853	7088	-2204	-3268	-6258	
D/E Ratio	0.79	0.87	0.89	0.88	1.16	3.40	-11.78	-9.04	-4.97	

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	15.9%	16.9%	16.0%	15.5%	13.4%	12.6%	13.6%	16.0%	17.8%	
Return on Equity	34.5%	37.9%	36.8%	35.7%	33.0%	45.4%	192%	-190%	-124%	
ROIC	19.5%	20.8%	19.6%	18.9%	16.4%	15.4%	17.1%	20.8%	23.2%	
Shares Out.	1050	1020	1000	990	960	910	820	790	770	
Revenue/Share	22.29	25.85	27.02	27.94	27.82	26.90	28.59	27.98	26.76	
FCF/Share	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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