



McDonald's Corporation (MCD)

Updated November 9th, 2020 by Eli Inkrot

Key Metrics

Current Price:	\$220	5 Year CAGR Estimate:	0.1%	Market Cap:	\$165 B
Fair Value Price:	\$143	5 Year Growth Estimate:	6.0%	Ex-Dividend Date:	11/30/20
% Fair Value:	154%	5 Year Valuation Multiple Estimate:	-8.3%	Dividend Payment Date:	12/15/20
Dividend Yield:	2.3%	5 Year Price Target	\$191	Years Of Dividend Growth:	45
Dividend Risk Score:	B	Retirement Suitability Score:	C	Last Dividend Increase:	3.2%

Overview & Current Events

McDonald's, founded in 1940 and headquartered in Chicago IL, is the world's leading global foodservice retailer with about 39,000 locations in over 100 countries. Approximately 93% of the stores are independently owned and operated. The \$165 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 October 7th, 2020 McDonald's declared a \$1.29 quarterly dividend, representing a 3.2% year-over-year increase and marking the company's 45th consecutive year of increasing its payout.

On November 9th, 2020 McDonald's reported Q3 2020 results for the period ending September 30th, 2020. For the quarter, total revenue came in at \$5.42 billion, down -1.5% compared to Q3 2019, as stronger operating performance in the U.S. was offset by declines in the International segments as a result of the COVID-19 pandemic. Revenue at company-owned restaurants was down -5%, while revenue from franchised restaurants – which has notably higher margins – was up 1%. Net income came in at \$1.76 billion, a 9.6% increase, while earnings-per-share equaled \$2.35 versus \$2.11 prior. On an adjusted basis earnings-per-share equaled \$2.22 compared to \$2.11 previously. For the first nine months of the year McDonald's has generated adjusted earnings-per-share of \$4.35 compared to \$5.87 in the first nine months of 2019, with results being materially impacted by the pandemic in the second quarter.

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	\$6.20	\$10.04
DPS	\$2.26	\$2.53	\$2.87	\$3.12	\$3.28	\$3.44	\$3.61	\$3.83	\$4.19	\$4.73	\$5.16	\$6.55
Shares¹	1,054	1,021	1,003	990	963	907	819	794	767	746	750	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 healthier offerings. 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) 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 had grown at a strong pace. 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 could 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.

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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However, most of that is on hold, at least in the short-term, amid the ongoing COVID-19 crisis. We believe McDonald's will come out of this crisis stronger, but we do expect earnings to be down significantly this year. We are using \$7.50 in underlying earnings power and a 6% growth rate for valuation and fair value estimate purposes.

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	29.3	19.0
Avg. Yld.	3.2%	3.0%	3.1%	3.2%	3.4%	3.4%	3.0%	2.6%	2.5%	2.4%	2.3%	3.4%

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 19 times earnings as a reasonable starting place, taking into consideration the slightly reduced growth expectations, short-term depressed earnings and 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 29 times our expected earnings power, this implies the potential for a meaningful 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%	69%	65%

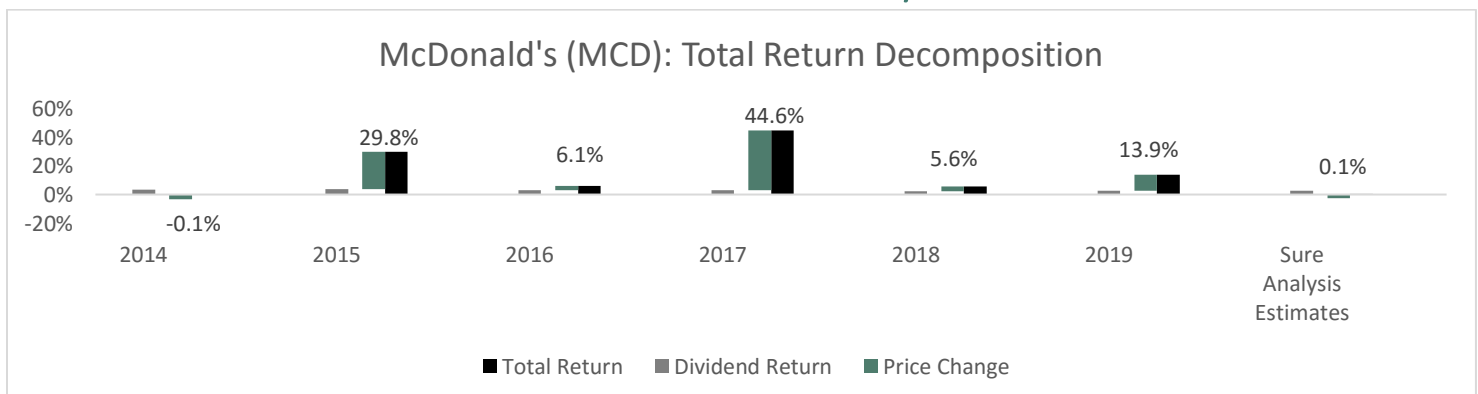
McDonald's dividend payout ratio has been oscillating in a range of ~50% to ~70% throughout the last decade. Due to the stability of McDonald's during past recessions, coupled with a payout ratio that is not overly high, we view McDonald's dividend as safe; the most recent 3.2% dividend increase being 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. During this crisis, we expect temporarily lower earnings followed by a return to growth.

Final Thoughts & Recommendation

Shares are up 12% 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 0.1% per annum, as 6% growth and a 2.3% dividend yield could be offset by a valuation headwind. While we believe the business is excellent, the valuation leaves quite a bit to be desired. Shares earn a sell rating.

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	21077
Gross Profit	9637	10687	10816	10903	10456	9789	10205	10621	10786	11115
Gross Margin	40.0%	39.6%	39.2%	38.8%	38.1%	38.5%	41.4%	46.5%	51.3%	52.7%
SG&A Exp.	2333	2394	2455	2386	2488	2434	2385	2231	2200	2229
D&A Exp.	1276	1415	1489	1585	1645	1556	1517	1363	1482	1618
Operating Profit	7304	8293	8361	8517	7968	7355	7820	8390	8586	8886
Op. Margin	30.3%	30.7%	30.3%	30.3%	29.0%	28.9%	31.8%	36.8%	40.8%	42.2%
Net Profit	4946	5503	5465	5586	4758	4529	4687	5192	5924	6025
Net Margin	20.5%	20.4%	19.8%	19.9%	17.3%	17.8%	19.0%	22.8%	28.2%	28.6%
Free Cash Flow	4206	4420	3917	4296	4147	4725	4239	3698	4225	5728
Income Tax	2054	2509	2614	2619	2614	2026	2180	3381	1892	1993

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	47511
Cash & Equivalents	2387	2336	2336	2799	2078	7686	1223	2464	866	899
Inventories	110	117	122	124	110	100	59	59	51	50
Goodwill & Int.	2586	2653	2804	2873	2735	2516	2337	2380	2332	2677
Total Liabilities	17341	18600	20093	20617	21374	30851	33228	37072	39070	55721
Accounts Payable	944	961	1142	1086	860	875	756	925	1208	988
Long-Term Debt	11505	12500	13633	14130	14936	24122	25956	29536	31075	34177
Total Equity	14634	14390	15294	16010	12853	7088	-2204	-3268	-6258	-8210
D/E Ratio	0.79	0.87	0.89	0.88	1.16	3.40	-11.78	-9.04	-4.97	-4.16

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%	15.0%
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%	23.7%
Shares Out.	1,054	1,021	1,003	990	963	907	819	794	767	746
Revenue/Share	22.29	25.85	27.02	27.94	27.82	26.90	28.59	27.98	26.76	27.55
FCF/Share	3.89	4.23	3.84	4.27	4.20	5.00	4.92	4.53	5.38	7.49

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

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