



McDonald's Corporation (MCD)

Updated August 23rd, 2022, by Prakash Kolli

Key Metrics

Current Price:	\$263	5 Year CAGR Estimate:	2.4%	Market Cap:	\$193.46B
Fair Value Price:	\$197	5 Year Growth Estimate:	6.0%	Ex-Dividend Date:	08/31/22
% Fair Value:	134%	5 Year Valuation Multiple Estimate:	-5.6%	Dividend Payment Date:	09/16/22
Dividend Yield:	2.1%	5 Year Price Target	\$263	Years Of Dividend Growth:	46
Dividend Risk Score:	A	Retirement Suitability Score:	B	Rating:	Sell

Overview & Current Events

McDonald's, founded in 1940 and headquartered in Chicago, IL, is the world's leading restaurant chain with 40,031 locations in about 119 countries at end of 2021. The highest store counts are in the US (13,438), China (4,395), Japan (2,941), France (1,517), and Germany (1,432). Approximately 93% of the stores are franchised and the rest are company owned. However, the company owns about 55% of the real estate and 80% of the buildings in its network. The company sells burgers, chicken sandwiches, fries, breakfast sandwiches, burritos, nuggets, shakes, sodas, coffee, etc. Total system sales were approximately \$112B and total revenue was around \$23.2B in 2021.

On July 26th, 2022, McDonald's reported Q2 2022 results. For the quarter, total revenue came in at \$5,718.4M, a (-3%) decrease from \$5887.9M compared to Q1 2021 on 4% rise in systemwide sales offset by currency headwinds. Revenue fell (-15%) at company-owned stores, while revenue increased 7% at franchised restaurants. Earnings declined (-46%) to \$1.60 per share compared to \$2.95 per share in comparable periods because of higher input costs, despite price hikes. On a geographic basis, sales increased +3.7% in the US, +13.0% in the international markets, and +16.0% in the international developmental licensed markets. Growth was strong in France, Germany, and Japan offset by weakness in China because of COVID-19 restrictions.

McDonald's took a \$1.2B charge for sales of its business in Russia. The company sold the Dynamic Yield business for \$271M. Also, the Ukraine business was closed in the quarter affecting results.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	\$5.36	\$5.55	\$4.82	\$4.97	\$5.71	\$6.66	\$7.90	\$7.84	\$6.05	\$9.28	\$9.84	\$13.17
DPS	\$2.87	\$3.12	\$3.28	\$3.44	\$3.61	\$3.83	\$4.19	\$4.73	\$5.04	\$5.25	\$5.52	\$7.05
Shares¹	1,003	990	963	907	819	794	767	746	745	744	741	723

McDonald's has a long and successful growth history when it comes to earnings per share growth. In the 2008 through 2019 period, earnings per share compounded at an average rate of 7.1% per annum. During that time the company did encounter challenges, though, as profits dropped in 2014. McDonald's found ways to reignite growth during the following years, 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 are lower, increasing margins. McDonald's is now asset-light and low-cost collecting franchise and real estate fees from thousands of restaurants.

This strategy has been successful, with earnings per share growing 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. Earnings per share growth should be driven by higher sales, declining operating costs, new restaurants, and the impact of share repurchases. We are forecasting 6% annual average growth to 2027.

McDonald's is a long-time Dividend Aristocrat with 46 years of increases. The moderate payout ratio indicates the dividend is safe. We estimate the dividend will increase on average at about 4% annually over the next five years.

¹ Share count in millions.

Disclosure: This analyst is long MCD.



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Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	17.3	17.5	20.0	20.2	21.1	22.3	21.1	25.2	33.2	25.3	26.7	20.0
Avg. Yld.	3.1%	3.2%	3.4%	3.4%	3.0%	2.6%	2.5%	2.4%	2.5%	2.2%	2.1%	2.7%

McDonald's stock price is up since our last report on higher earnings. Our earnings estimate matches consensus. We consider 20X earnings as a reasonable starting place, accounting for slightly reduced growth expectations and a solid business model. The stock is overvalued. Our fair value estimate is \$197. Our 5-year price target is \$263.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	52%	56%	68%	69%	63%	58%	53%	60%	83%	57%	56%	54%

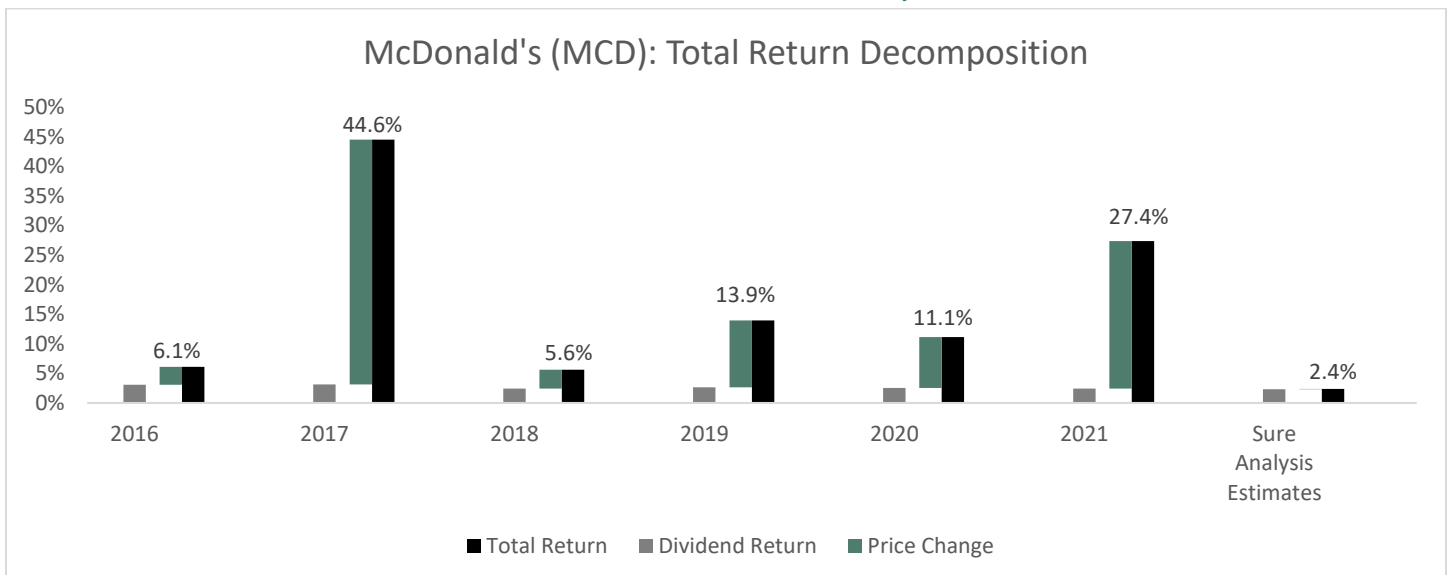
McDonald's competitive advantage lies in its global scale, cost advantages, immense network of restaurants, well-known brand, and real estate assets. The company has one of the most well-known brands in the world and has successfully replicated its business model globally. Next, McDonald's often owns prime real estate making it difficult for competitors to gain traction. That said, barriers to entry are non-existent and competition in the market space is intense. However, the company's superior track record against numerous competitors has illustrated why it is No. 1. During the Great 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. Results bounced back in 2021 as well.

At end of Q2 2022, long-term debt was \$34,576.5M offset by \$1,872.5 in cash and equivalents. The company is slowly paying down debt after peaking in 2020. The leverage ratio is ~3.4X and interest coverage is about 8.7X.

Final Thoughts & Recommendation

Total return potential comes in at 2.4% per annum, as 6% growth, and a 2.1% dividend yield could be offset by a (-5.6%) valuation headwind. McDonald's is performing better than many of its peers during high inflation because of its value proposition. However, COVID-19 in China, the war in Ukraine, and inflation are headwinds. The current valuation is not compelling in our view. While we believe the business is excellent, the stock price is rich. The shares earn a sell rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	27567	28106	27441	25413	24622	22820	21025	21077	19210	23220
Gross Profit	10816	10903	10456	9789	10205	10621	10786	11115	9752	12580
Gross Margin	39.2%	38.8%	38.1%	38.5%	41.4%	46.5%	51.3%	52.7%	50.8%	54.2%
SG&A Exp.	2455	2386	2488	2434	2385	2231	2200	2229	2245	2378
D&A Exp.	1489	1585	1645	1556	1517	1363	1482	1618	1751	1868
Operating Profit	8361	8517	7968	7355	7820	8390	8586	8886	7206	9873
Op. Margin	30.3%	30.3%	29.0%	28.9%	31.8%	36.8%	40.8%	42.2%	37.5%	42.5%
Net Profit	5465	5586	4758	4529	4687	5192	5924	6025	4730	7545
Net Margin	19.8%	19.9%	17.3%	17.8%	19.0%	22.8%	28.2%	28.6%	24.6%	32.5%
Free Cash Flow	3917	4296	4147	4725	4239	3698	4225	5728	4624	7102
Income Tax	2614	2619	2614	2026	2180	3381	1892	1993	1410	1583

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	35387	36626	34227	37939	31024	33804	32811	47511	52630	53850
Cash & Equivalents	2336	2799	2078	7686	1223	2464	866	899	3449	4709
Inventories	122	124	110	100	59	59	51	50	51	56
Goodwill & Int.	2804	2873	2735	2516	2337	2380	2332	2677	2773	2782
Total Liabilities	20093	20617	21374	30851	33228	37072	39070	55721	60450	58460
Accounts Payable	1142	1086	860	875	756	925	1208	988	741	1007
Long-Term Debt	13633	14130	14936	24122	25956	29536	31075	34177	37440	35620
Total Equity	15294	16010	12853	7088	-2204	-3268	-6258	-8210	-7825	-4601
LTD/E Ratio	0.89	0.88	1.16	3.40	-11.78	-9.04	-4.97	-4.16	-4.79	-7.74

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	16.0%	15.5%	13.4%	12.6%	13.6%	16.0%	17.8%	15.0%	9.5%	14.2%
Return on Equity	36.8%	35.7%	33.0%	45.4%	192%	-190%	-124%	---	---	---
ROIC	19.6%	18.9%	16.4%	15.4%	17.1%	20.8%	23.2%	23.7%	17.0%	24.9%
Shares Out.	1,003	990	963	907	819	794	767	746	750	752
Revenue/Share	27.02	27.94	27.82	26.90	28.59	27.98	26.76	27.55	25.61	30.89
FCF/Share	3.84	4.27	4.20	5.00	4.92	4.53	5.38	7.49	6.17	9.45

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

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