



McDonald's Corporation (MCD)

Updated February 2nd, 2023, by Prakash Kolli

Key Metrics

Current Price:	\$263	5 Year CAGR Estimate:	3.9%	Market Cap:	\$195.02B
Fair Value Price:	\$212	5 Year Growth Estimate:	6.0%	Ex-Dividend Date:	02/26/23
% Fair Value:	124%	5 Year Valuation Multiple Estimate:	-4.2%	Dividend Payment Date:	03/15/23
Dividend Yield:	2.3%	5 Year Price Target	\$284	Years Of Dividend Growth:	47
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 \$116B and total revenue was around \$23.2B in 2022.

On January 31st, 2023, McDonald's reported Q4 2022 and full year results. For the quarter, total revenue came in at \$5,926.5M, a (-1%) decrease from \$6,009.1M compared to Q4 2021 on a 5% rise in systemwide sales offset by currency headwinds. Revenue fell (-13%) at company-owned stores, while revenue increased 7% at franchised restaurants. Earnings climbed 19% to \$2.59 per share compared to \$2.18 per share in comparable periods on lower operating costs. On a geographic basis, sales increased +10.3% in the US, +12.6% in the international markets, and +16.5% in the international developmental licensed markets. Growth was strong in the UK, France, Germany, Japan, and Brazil offset by weakness in China because of COVID-19 restrictions.

For the year, revenue was down to \$23,183M and diluted GAAP earnings per share declined to \$8.33 because of foreign exchange, one-time charges from sale of the Russian business, a tax audit in France, and Ukraine store closures offset by the sales of the Dynamic Yield business.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	\$5.55	\$4.82	\$4.97	\$5.71	\$6.66	\$7.90	\$7.84	\$6.05	\$9.28	\$10.10	\$10.61	\$14.20
DPS	\$3.12	\$3.28	\$3.44	\$3.61	\$3.83	\$4.19	\$4.73	\$5.04	\$5.25	\$5.66	\$6.08	\$7.40
Shares¹	990	963	907	819	794	767	746	745	744	741	737	719

McDonald's has a long and successful growth history when it comes to earnings per share growth. In the 2013 through 2022 period, earnings per share compounded at an average rate of 6.8% per annum. During that time the company did encounter challenges, though, as profits dropped in 2014 and again during the pandemic. McDonald's found ways to reignite growth 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 share repurchases. We are forecasting 6% annual average growth to 2028. McDonald's reasonable 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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	17.5	20.0	20.2	21.1	22.3	21.1	25.2	33.2	25.3	26.1	24.8	20.0
Avg. Yld.	3.2%	3.4%	3.4%	3.0%	2.6%	2.5%	2.4%	2.5%	2.2%	2.3%	2.3%	2.6%

McDonald's stock price is down since our last report, despite good results. 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 \$212. Our 5-year price target is \$284.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	56%	68%	69%	63%	58%	53%	60%	83%	57%	56%	57%	52%

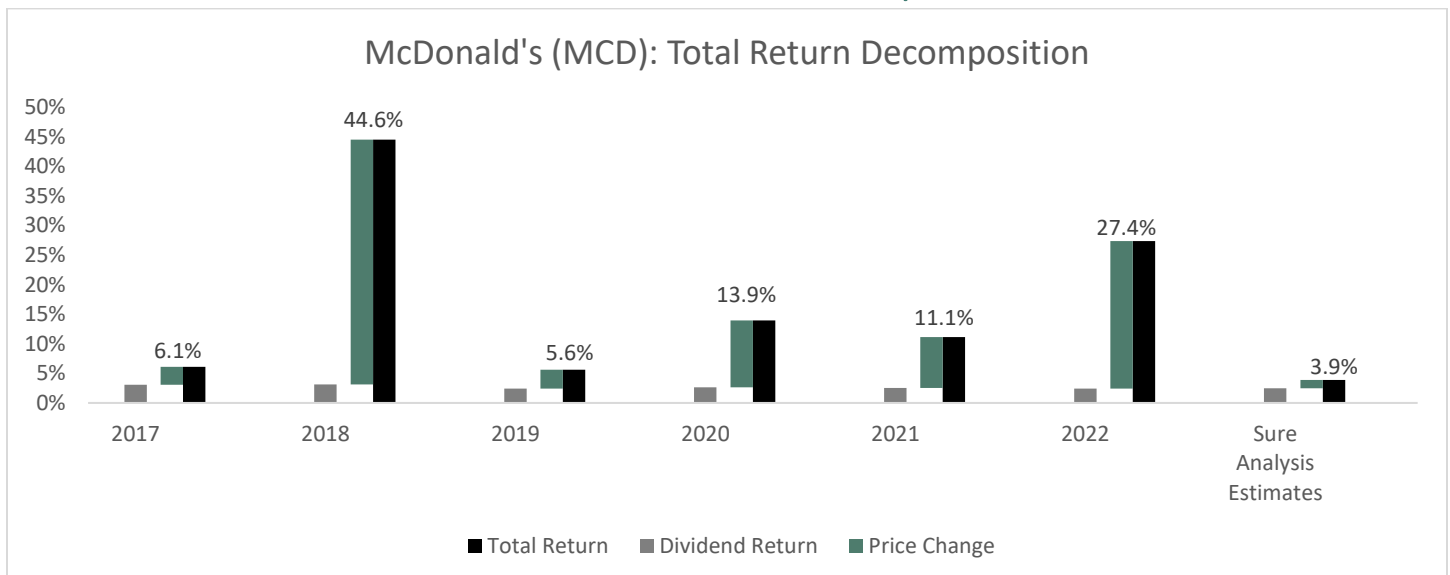
McDonald's competitive advantage lies in its global scale, cost advantages, immense network of restaurants, well-known brand, and real estate assets. The company has one of the most well-known brands in the world and has successfully replicated its business model globally. Next, McDonald's often owns 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 after the pandemic too.

At end of Q4 2022, long-term debt was \$35,903.5M offset by \$2,583.8 in cash and equivalents. The company is slowly paying down debt after peaking in 2020. The leverage ratio is ~3.12X and interest coverage is about 8.6X.

Final Thoughts & Recommendation

Total return potential comes in at 3.9% per annum, as 6% growth, and a 2.3% dividend yield could be offset by a (-4.2%) 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 hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	28106	27441	25413	24622	22820	21025	21077	19210	23220	23183
Gross Profit	10903	10456	9789	10205	10621	10786	11115	9752	12580	13207
Gross Margin	38.8%	38.1%	38.5%	41.4%	46.5%	51.3%	52.7%	50.8%	54.2%	57.0%
SG&A Exp.	2386	2488	2434	2385	2231	2200	2229	2245	2378	2492
D&A Exp.	1585	1645	1556	1517	1363	1482	1618	1751	1868	---
Operating Profit	8517	7968	7355	7820	8390	8586	8886	7206	9873	9371
Op. Margin	30.3%	29.0%	28.9%	31.8%	36.8%	40.8%	42.2%	37.5%	42.5%	40.4%
Net Profit	5586	4758	4529	4687	5192	5924	6025	4730	7545	6177
Net Margin	19.9%	17.3%	17.8%	19.0%	22.8%	28.2%	28.6%	24.6%	32.5%	26.6%
Free Cash Flow	4296	4147	4725	4239	3698	4225	5728	4624	7102	5488
Income Tax	2619	2614	2026	2180	3381	1892	1993	1410	1583	1648

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	36626	34227	37939	31024	33804	32811	47511	52630	53850	50436
Cash & Equivalents	2799	2078	7686	1223	2464	866	899	3449	4709	2584
Inventories	124	110	100	59	59	51	50	51	56	---
Goodwill & Int.	2873	2735	2516	2337	2380	2332	2677	2773	2782	---
Total Liabilities	20617	21374	30851	33228	37072	39070	55721	60450	58460	56439
Accounts Payable	1086	860	875	756	925	1208	988	741	1007	---
Long-Term Debt	14130	14936	24122	25956	29536	31075	34177	37440	35620	35904
Total Equity	16010	12853	7088	-2204	-3268	-6258	-8210	-7825	-4601	-6003
LTD/E Ratio	0.88	1.16	3.40	-11.78	-9.04	-4.97	-4.16	-4.79	-7.74	-5.98

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	15.5%	13.4%	12.6%	13.6%	16.0%	17.8%	15.0%	9.5%	14.2%	11.8%
Return on Equity	35.7%	33.0%	45.4%	192%	-190%	-124%	---	---	---	---
ROIC	18.9%	16.4%	15.4%	17.1%	20.8%	23.2%	23.7%	17.0%	24.9%	20.3%
Shares Out.	990	963	907	819	794	767	746	750	752	741
Revenue/Share	27.94	27.82	26.90	28.59	27.98	26.76	27.55	25.61	30.89	31.27
FCF/Share	4.27	4.20	5.00	4.92	4.53	5.38	7.49	6.17	9.45	7.40

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

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