

McDonalds Corp.(MCD)

\$193.29 (As of 06/03/20)

Price Target (6-12 Months): **\$203.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 04/04/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:D

Value: D

Growth: D

Momentum: C

Summary

Shares of McDonald's have outperformed the industry so far this year. Notably, the company is benefitting from increase in drive-thru sales. Also, its increased focus on delivery and accelerated deployment of EOTF restaurants in the United States is commendable. Additionally, the company is making every effort to drive growth in international markets as well. However, coronavirus related woes pose concerns. This along with costs associated with brand positioning in all the key markets and ongoing investments in initiatives might weigh on margins, at least in the near term. Also, decline in comps pose threat for the company. Notably, earning estimates for 2020 have declined over the past 60 days, depicting analyst's concern regarding the stock growth potential.

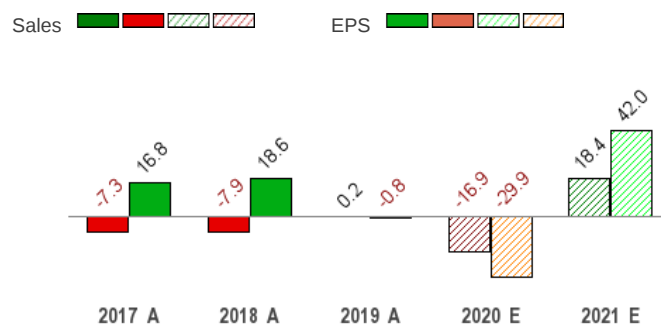
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$221.93 - \$124.23
20 Day Average Volume (sh)	3,697,341
Market Cap	\$143.7 B
YTD Price Change	-2.2%
Beta	0.66
Dividend / Div Yld	\$5.00 / 2.6%
Industry	Retail - Restaurants
Zacks Industry Rank	Top 34% (87 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-7.6%
Last Sales Surprise	0.4%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	07/24/2020
Earnings ESP	0.0%
P/E TTM	25.4
P/E F1	35.1
PEG F1	4.8
P/S TTM	6.9

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	4,941 E	4,929 E	5,498 E	5,475 E	20,749 E
2020	4,714 A	3,255 E	4,500 E	5,126 E	17,522 E
2019	4,956 A	5,341 A	5,431 A	5,349 A	21,077 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.70 E	\$1.86 E	\$2.17 E	\$2.06 E	\$7.81 E
2020	\$1.47 A	\$0.65 E	\$1.39 E	\$1.76 E	\$5.50 E
2019	\$1.72 A	\$2.05 A	\$2.11 A	\$1.97 A	\$7.84 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 06/03/2020. The reports text is as of 06/04/2020.

Overview

Founded in 1948, Oak Brook, IL-based McDonald's is a leading fast-food chain that currently operates roughly 38,000 restaurants in more than 100 countries. The company mainly operates and franchises quick-service restaurants (QSRs) under the McDonald's brand. Nearly 93% of the company's restaurant worldwide are owned and operated by independent local business men as well as women. The company's revenues include sales by company-operated restaurants and fees from restaurants, which are managed by franchisees.

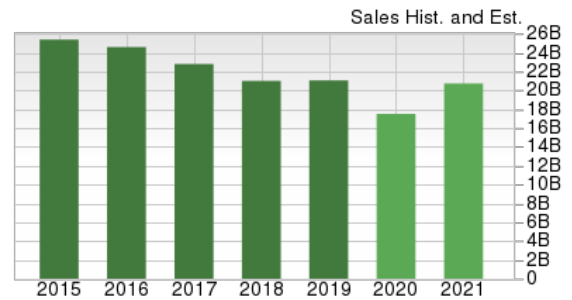
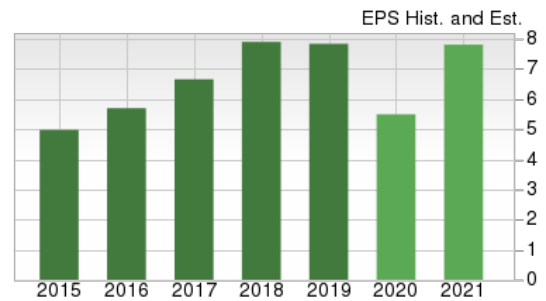
The business is managed as a distinct geographic segment.

Beginning Jan 1, 2019, the company had begun operating its results under a new organizational structure.

U.S. – This is the company's largest segment (accounting for 37.2% of total revenues in 2019). The segment remains unchanged despite the new organizational structure.

International Operated segment (54.1% of total revenues in 2019) – The segment comprises wholly-owned markets, or countries where the company operates. It operates in Australia, Canada, France, Germany, Italy, the Netherlands, Russia, Spain and the U.K.

International Developmental Licensed Markets (8.7% of total revenues in 2019) – The segment comprises primarily developmental license and affiliate markets in the McDonald's system. Corporate activities are also part of this segment.



Reasons To Buy:

▲ **Strong Brand Recognition:** McDonald's is the world's largest chain of fast-food restaurants with presence in more than 100 countries. Its offerings have reached the billion-dollar brand status through sustained product innovation and geographic expansion. With an almost 10% share of the global informal-eating-out market, there is ample scope for it to grow in the future as it boasts a scale advantage compared to its peers. Growing guest counts remains the company's top priority and it intends to regain customers by focusing on food quality, convenience and value. Moreover, McDonald's expects its velocity accelerators of Experience of the Future, digital and delivery to drive growth over the long term. Given various initiatives undertaken to drive growth, the stock has a decent upside potential.

McDonald's efforts to strengthen its position through various sales initiatives along with increased focus on franchising bode well

In 2018, McDonald's had completed the conversion of 4,500 restaurants to Experience of the Future' (EOTF) restaurants. Moreover, the company had completed the conversion of 2,000 restaurants to EOTF during 2019. The company announced that it has converted approximately 10,000 restaurants to EOTF or about 70% of the estate.

▲ **Focuses on Delivery to Drive Sales:** During the coronavirus pandemic the company is focusing on drive-thru, delivery & take-away. Prior to the coronavirus outbreak, drive-thru accounted for about two-thirds of all sales in the United States. Drive-thru now accounts for approximately 90% of sales. Moreover, McDonald's continues to roll out mobile order and pay, with a new curbside check-in option. It has already launched the option in nearly all 20,000 U.S. restaurants. To provide enhanced convenience to customers, McDonald's is increasingly focusing on delivery. The company provides delivery from more than 25,000 restaurants in above 75 countries. In third-quarter 2019, it partnered with Grubhub for the rollout of McDelivery to nearly 500 restaurants in the NYC and Tri-State area. It also partnered with DoorDash.

▲ **Efforts to Attract Customers in International Markets:** McDonald's strategic efforts in the international markets continue to drive comps higher. McDonald's is consistently trying to improve its performance in the International Operated Markets including Australia, Canada, France, Germany and the UK. The company intends to drive comps growth in these markets through introduction of value meals, customizing the menu to local customer tastes, reimagining of restaurants, efficient marketing and promotions, improved service and increased convenience via delivery. With the roll-out of self-order kiosks, digital menu boards, table service, and the mobile app, customers are offered more choices and flexibility as the company progresses toward its Experience of the Future initiative, which is based on adding technology to its eateries. Notably, the converted restaurants are now seeing even stronger financial results than those who have not yet made the switch.

▲ **Re-franchising Strategy Safeguards Earnings:** Management's re-franchising strategy involves a shift to a greater percentage of franchised restaurants. Notably, in January 2017, the company entered into a strategic partnership and sold the control of its Chinese business, thereby reducing its own share to 20%. The company intends to add over 1,500 stores more in the region within the next five years. Currently, nearly 95% of the company's restaurants are franchised. In addition to the sale of its assets in China, McDonald's is looking for similar deals in markets of South Korea, Japan and South-east Asia. In fact, it has already completed several other important refranchising transactions since November 2016, including Singapore, Malaysia, the Nordics and Taiwan. These partnerships are part of the company's efforts to streamline its business and focus on the quality of its offerings, which should further increase the attractiveness of McDonald's business. Thus, these deals will have an upside impact on its earnings and margins as the company is expected to gain from trimming its overall cost of operations and preserving its capital. The reduction in ownership, i.e. re-franchising, weighs on near-term revenues, as it replaces company-operated sales by franchised sales. However, over the long term, it will reduce the company's capital requirements and facilitate earnings per share growth and ROE expansion. Going forward, the company aims to continue optimizing its ownership mix by refranchising restaurants in certain of its large mature markets, like the United States.

Reasons To Sell:

- ▼ **Coronavirus to Hurt Future Results:** McDonald's results in the coming quarters are likely to be impacted by the coronavirus outbreak. Restaurant closure or limited operations may hurt the company's results. All restaurants in the United States are operating through drive-thru, delivery & take-away only. However, the company has been operating in limited capacity in Australia, Canada, Germany and Russia. In fact, some of the restaurants in these markets have been closed. Almost all the restaurants in France, Italy, Spain and the U.K. have been temporarily closed. Although 99% restaurants are open in China, demand remains low. In Brazil, 65% of its restaurants are open but majority have limited operations.
- ▼ **Comps Decline in Q1 Due to Coronavirus:** The company's comps declined in the first quarter after reporting positive comps in the preceding 19 quarters. In first two months of the quarter under review, global comparable sales increased 7.2%. In the second-half of March, global comps declined sharply due to the pandemic. The company ended the quarter with comps decline of 3.4% against a gain of 5.4% in the prior-year quarter.
- ▼ **Negative Currency Translation:** With about 55% of McDonald's operating income coming from the International operated segment, its earnings remain susceptible to negative currency translation. Meanwhile, foreign currency translation had a negative impact of 2 cents per share during the first-quarter 2020. Foreign currency headwinds had a negative impact of 21 cents in 2019.
- ▼ **High Costs:** Apart from minimum wage increases, additional health care costs related to 'Obamacare' in the United States also raise labor costs. Further, costs associated with brand positioning in all the key markets and ongoing investments in initiatives might weigh on margins, at least in the near term.
- ▼ **Macro-Economic Pressure:** The company is grappling with difficulties like decelerating growth in Asia along with weakness in some parts of Europe, where the economic/political conditions are expected to be further challenging post Brexit. Meanwhile, over the past few quarters, the U.S. restaurant space has not been too enticing for investors. Despite economic growth, somewhat lower energy prices and higher income, consumers increased their spending only modestly on dining out, which resulted in low consumption over the past few quarters. This is because, along with wage growth, inflation is also on the rise, which translates to lower real income and thus less disposable income. The situation has taken a worse turn, thanks to higher health care costs and tightened credit availability in the United States. Moreover, as consumers demand high-quality products at lower prices, it is pushing grocery stores to decrease their food prices in order to remain competitive. This is resulting in a bigger gap between food-at-home and food-away-from-home indices.
- ▼ **Cutthroat Competition:** Competition among fast-casual restaurants is expected to remain fierce with respect to price, service, location and concept, which may adversely impact McDonald's restaurant operating margins and profits. The company is facing competition from Wendy's that operate under almost similar business models and offer similar products. Chipotle Mexican Grill, a provider of healthier menu options, poses significant competition for McDonald's, especially when consumers in the United States are opting for healthier menu options instead of fast food. Moreover, other restaurateurs like Yum! Brands, Inc.'s Taco Bell, Dunkin' Brands Group, Inc. and Jack in the Box Inc. are also cashing in on the popularity of the breakfast platter thereby giving McDonald's a run for its money in this space also.

High labor costs and currency headwinds are major concerns. Moreover, revenues have been under pressure for quite some time due to strategic refranchising initiative.

Last Earnings Report

McDonald's Q1 Earnings Lag Estimates, Comps Decline

McDonald's reported first-quarter 2020 results, wherein earnings missed the Zacks Consensus Estimate but revenues beat the same. However, both top and bottom lines declined year over year.

Adjusted earnings came in at \$1.47 per share, which missed the Zacks Consensus Estimate of \$1.59. However, the bottom line also declined 15% year over year. Meanwhile, foreign currency translation had a negative impact of 2 cents per share on earnings in the quarter under review.

Quarter Ending 03/2020

Report Date	Apr 30, 2020
Sales Surprise	0.40%
EPS Surprise	-7.55%
Quarterly EPS	1.47
Annual EPS (TTM)	7.60

Revenues & Comps Discussion

In the first quarter, revenues of \$4,714.4 million beat the Zacks Consensus Estimate of \$4,696 million. However, the figure declined 6% year over year. This downtrend can primarily be attributed to the coronavirus pandemic. Moreover, on a constant-currency basis, the top line decreased 5% on a year-over-year basis.

At company-operated restaurants, revenues came in at \$2,025.8 million, down 10% year over year. Moreover, the same at franchise-operated restaurants declined 4% to \$2,608 million.

In first two months of the quarter under review, global comparable sales increased 7.2%. In the second-half of March global comps declined sharply due the pandemic. The company ended the quarter with comps decline of 3.4% against a gain of 5.4% in the prior-year quarter. Notably, comps declined in the first quarter after reporting positive comps in the preceding 19 quarters. In fourth-quarter 2019, comps were also up 5.9%.

Solid Comps Across Segments

U.S.: Comps at this segment grew 0.1% in the first quarter, against a rise of 4.5% in the prior-year quarter. Deployment of Experience of the Future, strength in core menu items and successful national and local deal offerings drove the segment's comps.

International Operated Markets: Comps at this segment declined 6.9% year over year, against a gain of 6% in the year-ago quarter.

International Developmental Licensed Segment: The segment's comparable sales decreased 4.3% in the first quarter. In the prior-year quarter, the segment's comps had improved 6%.

Other Information

In an effort on preserve financial flexibility to tide over the current situation, the company has suspended the share repurchase program. It has enhanced cash position with \$6.5 billion of new debt financing. The company has also reduced capital expenditures by \$1 billion for 2020.

Valuation

McDonald's shares have declined 2.1% in year-to-date period and 3.4% in the trailing 12-month period. Stocks in the Zacks sub-industry are down 4.1%, but the sector is up 10.2%, in the year-to-date period. Over the past year, the Zacks sub-industry is down 1.9%, but the sector is up 24.6%.

The S&P 500 index is down 4.4% in the year-to-date period but up 9.1% in the past year.

The stock is currently trading at 25.43X trailing 12-month earnings, which compares to 28.79X for the Zacks sub-industry, 31.75X for the Zacks sector and 20.08X for the S&P 500 index.

Over the past five years, the stock has traded as high as 28.21X and as low as 17.47X, with a 5-year median of 23.61X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$203 price target reflects 26.71X trailing 12-month earnings.

The table below shows summary valuation data for MCD.

Valuation Multiples - MCD					
		Stock	Sub-Industry	Sector	S&P 500
P/E TTM	Current	25.43	28.79	31.75	20.08
	5-Year High	28.21	29.42	31.75	22.23
	5-Year Low	17.47	23.17	23.32	15.96
	5-Year Median	23.61	26.08	26.44	19.11
P/S F12M	Current	7.61	3.77	1.1	3.47
	5-Year High	7.81	3.93	1.12	3.47
	5-Year Low	3.5	2.81	0.81	2.53
	5-Year Median	5.98	3.3	0.94	3.02
EV/EBITDA TTM	Current	18.52	17.4	17.14	11.4
	5-Year High	20.19	17.74	17.14	12.86
	5-Year Low	10.54	11.94	10.97	8.26
	5-Year Median	14.55	14.29	12.67	10.81

As of 06/03/2020

Industry Analysis Zacks Industry Rank: Top 34% (87 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
Bloomin Brands, Inc. (BLMN)	Neutral	3
Chipotle Mexican Grill, Inc. (CMG)	Neutral	3
Darden Restaurants, Inc. (DRI)	Neutral	3
Papa Johns International, Inc. (PZZA)	Neutral	2
Restaurant Brands International Inc. (QSR)	Neutral	3
Starbucks Corporation (SBUX)	Neutral	4
Yum Brands, Inc. (YUM)	Neutral	3
Yum China Holdings Inc. (YUMC)	Neutral	2

Industry Comparison Industry: Retail - Restaurants				Industry Peers		
	MCD	X Industry	S&P 500	SBUX	WING	YUMC
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	4	2	2
VGM Score	D	-	-	C	C	D
Market Cap	143.72 B	275.01 M	22.50 B	92.97 B	3.60 B	18.45 B
# of Analysts	16	6	14	15	10	6
Dividend Yield	2.59%	0.00%	1.88%	2.06%	0.36%	0.98%
Value Score	D	-	-	D	D	C
Cash/Price	0.04	0.11	0.06	0.03	0.01	0.09
EV/EBITDA	17.56	11.83	12.98	17.55	77.55	11.83
PEG Ratio	4.78	4.79	3.05	4.62	10.87	4.79
Price/Book (P/B)	NA	1.98	3.11	NA	NA	5.84
Price/Cash Flow (P/CF)	19.12	9.03	12.18	19.29	124.51	15.92
P/E (F1)	35.07	43.59	22.19	63.56	119.54	45.44
Price/Sales (P/S)	6.90	0.62	2.40	3.49	17.39	2.24
Earnings Yield	2.85%	0.22%	4.31%	1.57%	0.84%	2.20%
Debt/Equity	-5.44	1.09	0.76	-2.56	-1.53	0.01
Cash Flow (\$/share)	10.11	1.81	7.01	4.12	0.98	3.08
Growth Score	D	-	-	D	A	F
Hist. EPS Growth (3-5 yrs)	12.05%	6.19%	10.87%	14.15%	14.79%	5.56%
Proj. EPS Growth (F1/F0)	-29.87%	-91.16%	-10.74%	-55.76%	39.45%	-42.64%
Curr. Cash Flow Growth	-0.99%	4.82%	5.48%	5.49%	-7.19%	10.09%
Hist. Cash Flow Growth (3-5 yrs)	1.88%	6.26%	8.55%	12.19%	18.99%	25.34%
Current Ratio	1.89	0.80	1.29	0.70	1.17	1.38
Debt/Capital	NA%	69.14%	44.75%	NA	NA	0.79%
Net Margin	27.86%	3.21%	10.59%	12.71%	10.61%	6.72%
Return on Equity	-70.25%	2.29%	16.29%	-50.19%	-11.05%	17.46%
Sales/Assets	0.44	1.04	0.55	1.12	1.23	1.22
Proj. Sales Growth (F1/F0)	-16.87%	-10.07%	-2.65%	-11.26%	15.28%	-7.80%
Momentum Score	C	-	-	A	C	B
Daily Price Chg	3.04%	3.04%	2.42%	2.31%	-2.09%	3.09%
1 Week Price Chg	1.04%	2.84%	4.60%	0.48%	0.60%	6.21%
4 Week Price Chg	9.22%	17.04%	13.40%	9.07%	-1.05%	3.77%
12 Week Price Chg	2.68%	4.94%	12.78%	16.51%	70.03%	17.28%
52 Week Price Chg	-3.42%	-32.83%	0.89%	-0.48%	37.86%	18.50%
20 Day Average Volume	3,697,341	359,314	2,528,787	8,973,916	590,664	2,710,118
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.15%
(F1) EPS Est 4 week change	0.00%	0.04%	-0.14%	0.81%	25.68%	0.15%
(F1) EPS Est 12 week change	-35.61%	-94.49%	-16.00%	-57.33%	13.45%	36.21%
(Q1) EPS Est Mthly Chg	0.00%	4.99%	-0.02%	9.86%	59.68%	4.65%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	D
Growth Score	D
Momentum Score	C
VGM Score	D

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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