ZACKS | Our Research. Your Success.

Jan 09, 2020

McDonalds Corp.(MCD)

$205.91 (As of 01/08/20)

Price Target (6-12 Months): **$216.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 04/04/19) Prior Recommendation: Underperform	**Neutral**
Short Term: 1-3 Months	**Zacks Rank:** (1-5) Zacks Style Scores: Value: D | Growth: C | Momentum: B	**3-Hold** VGM:C

Summary

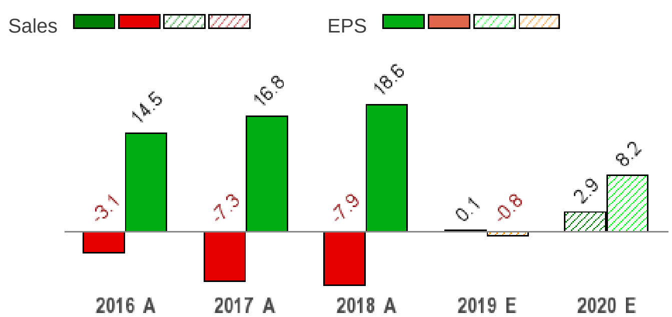
Shares of McDonald's have underperformed the industry in the past year. This downturn can be primarily attributed to lower-than-expected earnings in the preceding three quarters. Furthermore, earnings estimate for current and next year have witnessed downward revisions of late. High labor costs and currency headwinds are added concerns. Its heightened focus on refranchising might cut capital requirements and facilitate EPS growth. However, various sales and digital initiatives as well as positive comps bode well. The company's increased focus on delivery and accelerated deployment of EOTF restaurants in the United States are commendable. McDonald's has been regularly rewarding its shareholders through share repurchases and dividends. Additionally, the company is making efforts to drive growth in international markets.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	$221.93 - $173.41
20 Day Average Volume (sh)	2,930,425
Market Cap	$155.1 B
YTD Price Change	4.2%
Beta	0.45
Dividend / Div Yld	$5.00 / 2.4%
Industry	Retail - Restaurants
Zacks Industry Rank	Top 32% (82 out of 254)
Last EPS Surprise	-4.1%
Last Sales Surprise	-0.9%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	01/29/2020
Earnings ESP	0.4%
P/E TTM	26.2
P/E F1	24.3
PEG F1	2.7
P/S TTM	7.4

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2020	5,053 E	5,471 E	5,591 E	5,470 E	21,656 E
2019	4,956 A	5,341 A	5,431 A	5,302 E	21,037 E
2018	5,139 A	5,354 A	5,369 A	5,163 A	21,025 A

EPS Estimates

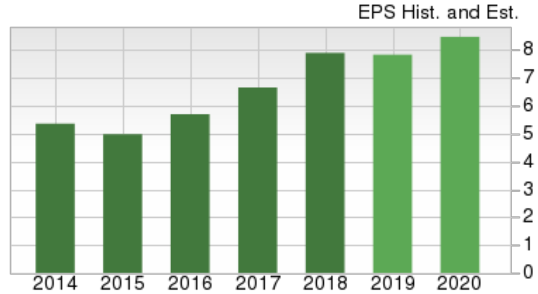
	Q1	Q2	Q3	Q4	Annual*
2020	$1.89 E	$2.16 E	$2.26 E	$2.10 E	$8.48 E
2019	$1.72 A	$2.05 A	$2.11 A	$1.96 E	$7.84 E
2018	$1.79 A	$1.99 A	$2.10 A	$1.97 A	$7.90 A

*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 01/08/2020. The reports text is as of 01/09/2020.

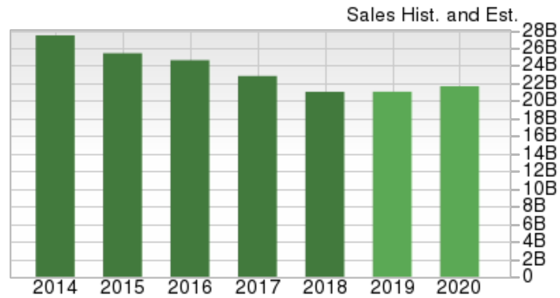
Overview

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 36.7% of total revenues in third-quarter 2019). The segment remains unchanged despite the new organizational structure.

International Operated segment (54.6% of total revenues in third-quarter 2019) – The segment comprises wholly-owned markets, or countries where company operates. It operates in Australia, Canada, France, Germany, Italy, the Netherlands, Russia, Spain and the United Kingdom.

International Developmental Licensed Markets (8.7% of total revenues in third-quarter 2019) – The segment consists mainly developmental license as well as affiliate markets in the McDonald's system. Corporate activities are also a part of this segment.

Reasons To Buy:

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

▲ **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.

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 1500 restaurants to EOTF during the year and expects to complete 2000 projects by the end of 2019. On first-quarter 2019 conference call, the company stated that for the first time since the company started Experience of the Future' restaurants it has witnessed positive contribution to U. S. sales comp.

▲ **Impressive Comps Trend:** McDonald's sales boosting initiatives are driving global comparable sales (comps). In third-quarter 2019, global comps grew 5.9%, marking its 17th straight quarter of positive comps. Moreover, U.S comps were up 4.8% year over year. In order to drive comps in the United States, representing about 40% of the company's business, McDonald's aims at improving its focus on growing guest traffic. In this regard, the company is accentuating on operational excellence, product innovation, offering a value menu and rolling out more limited-time offerings. It came up with the 54rd straight quarter of like-for-like sales growth from the United Kingdom. Meanwhile, Australia, Canada, France, Germany and Italy are all witnessing robust sales growth. In addition, the company is undertaking digital initiatives to better serve customers, with nearly all of its U.S. restaurants now using digital menu boards.

McDonald's continues to roll out mobile order and pay, with a new curbside check-in option. Already, it has launched the option in nearly all 20,000 U.S. restaurants. To provide augmented convenience to customers, McDonald's is increasingly focusing on delivery. Notably, the company expects the dynamic yield technology, which is now live in more than 9500 U.S. drive thrus, to be used in every U.S. restaurant with an outdoor digital menu board by the end of the year. The company provide delivery from more than 20,000 restaurants in above 75 countries. During the third quarter, 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 in the reported quarter.

▲ **Efforts to Attract Customers in International Markets:** McDonald's strategic efforts in the international markets continue to drive comps higher. In third-quarter 2019, the International developmental licensed segment witnessed 8.1% comps growth year over year, higher than a 7.9% rise registered in the second quarter. Also, global comps improved 5.9% from a year ago, driven by positive comparable sales across all its segments. Notably, this marked the 17th consecutive quarter of positive comparable sales. Robust sales in the United Kingdom, Germany and France, and positive results across all markets drove comps. 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, reimaging 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.

▲ **Regular Returns to Shareholders:** McDonald's has been regularly rewarding its shareholders through share repurchases and dividends. Evidently, the company has a history of increasing dividend almost every year since the inception of its dividend payout policy in 1976. In September 2018, McDonald's raised its dividend by 15%. Prior to that, it had increased the company's quarterly dividend by 7.4%, 7%, 6%, 5%, 5%, 10% 15% and 11% in 2018, 2017, 2016, 2015, 2013, 2012, 2011 and 2010, respectively. In the last two years (2017 and 2018), the company had returned more than $16 billion via dividends and share repurchases. Per its cash return target, McDonald's returned $30 billion to its shareholders over a three-year period (2014 to 2016) via dividends and share repurchases. This represented an increase of around 80% over the amount of cash returned between 2011 and 2013. During September, the company hiked dividend by 8% to $5 annually. This marked its 43rd consecutive year of dividend payout. Meanwhile, the company expects to return around $25 billion to its shareholders for the three-year period (ending 2019), out of which $22.5 billion was returned during the third quarter.

Reasons To Sell:

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

- **Dismal Earnings Trend:** In three out of the trailing four quarters, the company's earnings lagged the Zacks Consensus Estimate, with average negative surprise being 0.4%. In third-quarter 2019, adjusted earnings came in at $2.11 per share, which missed the consensus mark of $2.20. The bottom line also declined 2% from the prior-year figure. Meanwhile, foreign currency translation had a negative impact of 3 cents per share on earnings in the quarter under review. Following the earnings decline, estimates for the current quarter and year have been downwardly revised by 3.9% and 1.9%, respectively.

- **Negative Currency Translation:** With about 55% of McDonald's operating income coming from the International operated segment, its earnings remain vulnerable to negative currency translation. In fourth- and third-quarter 2018, currency translation impacted the results by 5 cents. Meanwhile, foreign currency translation had a negative impact of 3 cents per share during the third-quarter.

- **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.

Last Earnings Report

McDonald's Q3 Earnings & Revenues Miss Estimates

Quarter Ending	09/2019
Report Date	Oct 22, 2019
Sales Surprise	-0.86%
EPS Surprise	-4.09%
Quarterly EPS	2.11
Annual EPS (TTM)	7.85

McDonald's Corporation reported third-quarter 2019 results, wherein both earnings and revenues missed the Zacks Consensus Estimate.

Adjusted earnings came in at $2.11 per share, which missed the consensus mark of $2.20. The bottom line also witnessed a decline of 2% from the prior-year quarter figure. Meanwhile, foreign currency translation had a negative impact of 3 cents per share on earnings in the quarter under review.

Revenues & Comps Discussion

In the third quarter, revenues of $5,340.6 million lagged the Zacks Consensus Estimate of $5,478 million. However, the figure improved 1% year over year. This uptrend can primarily attributed to increase in revenues from franchised restaurants. Moreover, on a constant-currency basis, the top line increased 3% on a year-over-year basis.

At company-operated restaurants, revenues declined 4% year over year to $2,416.6 million. However, the same at franchise-operated restaurants improved 5% to $3,014 million.

Global comps improved 5.9% driven by positive comparable sales across all segments. Notably, this marked the 17th consecutive quarter of positive comparable sales. In the second quarter of 2019, comps were up 5.7%.
Solid Comps Across Segments

U.S.: Comps at this segment grew 4.8% in the third quarter, lower than a 5.7% rise in the prior quarter. Deployment of Experience of the Future and strength in core menu items and successful national and local deal offerings drove the segment's comps.

International Operated Markets: Comps at this segment rose 5.6% year over year, lower than prior quarter's rise of 6.6%.

International Developmental Licensed Segment: The segment's comparable sales increased 8.1% during the third quarter. In the preceding quarter, the segment's comps rose 7.9%.

Other Information

McDonald's returned $2.4 billion to shareholders via stock repurchase and dividends. The company has returned $22.5 billion from its target of $25 million for the three-year period ending 2019.

Valuation

McDonald's shares are up 13.4% over the trailing 12-month period. Over the past year, the Zacks sub-industry and sector are up 18.3% and 19.3%, respectively.

The S&P 500 index is up 23.7% in the past year.

The stock is currently trading at 24.25X forward 12-months Price to Earnings value, which compares to 24.38X for the Zacks sub-industry, 25.33X for the Zacks sector and 18.74X for the S&P 500 index.

Over the past five years, the stock has traded as high as 26.6X and as low as 16.44X, with a 5-year median of 21.39X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our $216 price target reflects 25.44X forward 12-months Price to Earnings value.

The table below shows summary valuation data for MCD.

Valuation Multiples - MCD

		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	24.25	24.38	25.33	18.74
	5-Year High	26.6	26.41	26.13	19.34
	5-Year Low	16.44	20.45	18.99	15.17
	5-Year Median	21.39	23.25	22.91	17.44
P/S F12M	Current	7.16	3.52	1.07	3.47
	5-Year High	7.81	3.85	1.1	3.47
	5-Year Low	3.22	2.91	0.8	2.54
	5-Year Median	5.82	3.25	0.9	3
EV/EBITDA TTM	Current	18.5	16.21	15.28	11.99
	5-Year High	20.19	17.48	15.3	12.86
	5-Year Low	9.9	12.08	10.27	8.48
	5-Year Median	14.01	13.93	12.32	10.67

As of 01/08/2020

Industry Analysis **Zacks Industry Rank:** Top 32% (82 out of 254)

Top Peers

Dunkin Brands Group, Inc. **(DNKN)**	Neutral
Dominos Pizza Inc **(DPZ)**	Neutral
Darden Restaurants, Inc. **(DRI)**	Neutral
Restaurant Brands International Inc. **(QSR)**	Neutral
Starbucks Corporation **(SBUX)**	Neutral
The Wendys Company **(WEN)**	Neutral
Yum! Brands, Inc. **(YUM)**	Neutral
Yum China Holdings Inc. **(YUMC)**	Neutral

Industry Comparison Industry: Retail - Restaurants

Industry Peers

	MCD Neutral	X Industry	S&P 500	SBUX Neutral	YUM Neutral	YUMC Neutral
VGM Score	C	-	-	B	C	B
Market Cap	155.07 B	429.48 M	23.84 B	104.97 B	30.90 B	18.25 B
# of Analysts	10	5	13	14	8	3
Dividend Yield	2.43%	0.00%	1.79%	1.85%	1.64%	0.99%
Value Score	D	-	-	D	D	C
Cash/Price	0.01	0.03	0.04	0.03	0.02	0.09
EV/EBITDA	19.32	14.80	13.88	18.15	16.76	11.86
PEG Ratio	2.73	2.06	2.02	2.24	2.01	2.92
Price/Book (P/B)	NA	2.82	3.33	NA	NA	5.86
Price/Cash Flow (P/CF)	20.65	11.55	13.76	21.55	27.06	17.51
P/E (F1)	24.28	21.88	18.76	29.17	24.57	26.17
Price/Sales (P/S)	7.42	0.92	2.63	3.96	5.66	2.11
Earnings Yield	4.12%	4.50%	5.32%	3.43%	4.07%	3.83%
Debt/Equity	-5.20	0.94	0.72	-1.79	-1.30	0.01
Cash Flow ($/share)	9.97	1.53	6.94	4.12	3.77	2.77
Growth Score	C	-	-	A	C	A
Hist. EPS Growth (3-5 yrs)	11.79%	7.71%	10.56%	15.73%	0.29%	NA
Proj. EPS Growth (F1/F0)	8.19%	8.35%	7.46%	7.67%	12.46%	7.02%
Curr. Cash Flow Growth	13.21%	7.73%	14.83%	5.49%	-9.66%	8.02%
Hist. Cash Flow Growth (3-5 yrs)	1.40%	6.24%	9.00%	12.19%	-11.09%	NA
Current Ratio	0.84	0.63	1.23	0.92	1.57	1.37
Debt/Capital	NA%	61.12%	42.99%	NA	NA	0.76%
Net Margin	28.09%	3.14%	11.08%	13.58%	20.88%	8.05%
Return on Equity	-85.71%	8.47%	17.16%	-75.45%	-11.69%	21.63%
Sales/Assets	0.49	1.17	0.55	1.36	1.18	1.40
Proj. Sales Growth (F1/F0)	2.94%	3.09%	4.16%	7.07%	4.77%	5.84%
Momentum Score	B	-	-	B	A	D
Daily Price Chg	1.62%	0.18%	0.39%	1.16%	0.18%	1.27%
1 Week Price Chg	0.96%	0.28%	-0.30%	0.79%	-0.05%	-0.49%
4 Week Price Chg	5.75%	2.09%	2.38%	2.64%	2.73%	5.59%
12 Week Price Chg	-1.15%	2.11%	6.40%	2.50%	-8.37%	10.75%
52 Week Price Chg	14.21%	1.39%	22.97%	39.14%	12.08%	40.37%
20 Day Average Volume	2,930,425	172,819	1,610,101	5,552,115	1,345,706	1,371,651
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.02%	0.00%	0.00%	0.00%	0.41%	0.00%
(F1) EPS Est 12 week change	-3.05%	-0.27%	-0.50%	-1.23%	-2.30%	-0.59%
(Q1) EPS Est Mthly Chg	0.20%	0.00%	0.00%	0.17%	0.00%	0.00%

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	C
Momentum Score	B
VGM Score	C

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.

Disclosures

This report contains independent commentary to be used for informational purposes only. The analysts contributing to this report do not hold any shares of this stock. The analysts contributing to this report do not serve on the board of the company that issued this stock.The EPS and revenue forecasts are the Zacks Consensus estimates, unless indicated otherwise on the reports first page. Additionally, the analysts contributing to this report certify that the views expressed herein accurately reflect the analysts personal views as to the subject securities and issuers. ZIR certifies that no part of the analysts compensation was, is, or will be, directly or indirectly, related to the specific recommendation or views expressed by the analyst in the report.

Additional information on the securities mentioned in this report is available upon request. This report is based on data obtained from sources we believe to be reliable, but is not guaranteed as to accuracy and does not purport to be complete. Any opinions expressed herein are subject to change.

ZIR is not an investment advisor and the report should not be construed as advice designed to meet the particular investment needs of any investor. Prior to making any investment decision, you are advised to consult with your broker, investment advisor, or other appropriate tax or financial professional to determine the suitability of any investment.This report and others like it are published regularly and not in response to episodic market activity or events affecting the securities industry.

This report is not to be construed as an offer or the solicitation of an offer to buy or sell the securities herein mentioned. ZIR or its officers, employees or customers may have a position long or short in the securities mentioned and buy or sell the securities from time to time.ZIR is not a broker-dealer.ZIR may enter into arms-length agreements with broker-dealers to provide this research to their clients.Zacks and its staff are not involved in investment banking activities for the stock issuer covered in this report.

ZIR uses the following rating system for the securities it covers. **Outperform-** ZIR expects that the subject company will outperform the broader U.S. equities markets over the next six to twelve months. **Neutral-** ZIR expects that the company will perform in line with the broader U.S. equities markets over the next six to twelve months. **Underperform-** ZIR expects the company will underperform the broader U.S. equities markets over the next six to twelve months.