

McDonalds Corp.(MCD)

\$216.18 (As of 01/30/20)

Price Target (6-12 Months): **\$227.00**

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:C

Value: D

Growth: C

Momentum: A

Summary

Shares of McDonald's have outperformed the industry in the past year. This uptrend might continue as the company reported better-than-expected results in fourth-quarter 2019. Both earnings and revenues surpassed the Zacks Consensus Estimate after missing the same in the preceding quarter. The company also reported global comparable sales growth for 18th straight quarter. Notably, in 2019 the company recorded highest global same-store sales growth in a decade. The company's 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. McDonald's has been regularly rewarding shareholders through share repurchases and dividends. However, high labor costs and currency headwinds remain woes.

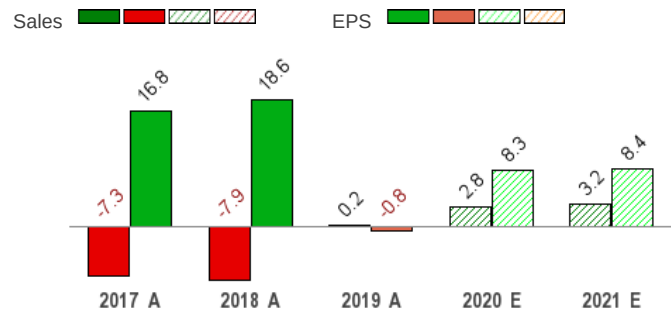
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$221.93 - \$173.41
20 Day Average Volume (sh)	3,500,430
Market Cap	\$162.8 B
YTD Price Change	9.4%
Beta	0.45
Dividend / Div Yld	\$5.00 / 2.3%
Industry	Retail - Restaurants
Zacks Industry Rank	Top 29% (74 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	0.5%
Last Sales Surprise	0.9%
EPS F1 Est- 4 week change	0.1%
Expected Report Date	05/05/2020
Earnings ESP	0.2%
P/E TTM	27.5
P/E F1	25.5
PEG F1	2.9
P/S TTM	7.7

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	5,196 E	5,631 E	5,756 E	5,741 E	22,342 E
2020	5,070 E	5,472 E	5,597 E	5,463 E	21,659 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	\$2.06 E	\$2.35 E	\$2.47 E	\$2.30 E	\$9.20 E
2020	\$1.90 E	\$2.16 E	\$2.30 E	\$2.13 E	\$8.49 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 01/30/2020. The reports text is as of 01/31/2020.

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.

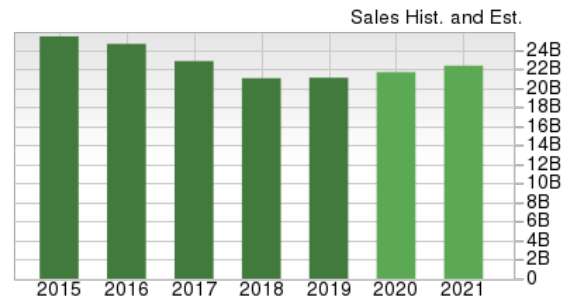
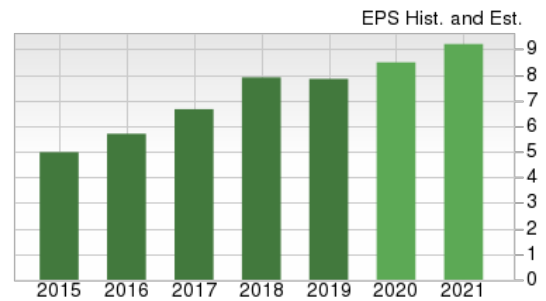
The business is managed as a distinct geographic segment.

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. Experience of the Future have contributed positive comparable sales in all the four quarters in 2019.

▲ **Impressive Comps Trend:** McDonald's sales boosting initiatives are driving global comparable sales (comps). In fourth-quarter 2019, global comps grew 5.9%, marking its 18th straight quarter of positive comps. Notably, in 2019 the company recorded highest global same-store sales growth in a decade. In order to drive comps in the United States, representing about 40% of the company's business, McDonald's intends to 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.

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. Notably, the company anticipates the dynamic yield technology, which is now live in more than 11,000 U.S. drive-throughs, has contributed to growth in average check. The company provides delivery from more than 25,000 restaurants in above 75 countries. 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. In fourth-quarter 2019, the International developmental licensed segment witnessed 7.2% comps growth year over year following growth of 8.1% and 7.9% in third and second-quarter 2019, respectively. Global comps also improved 5.9% from a year ago, driven by positive comparable sales across all segments. 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, 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.

▲ **Regular Returns to Shareholders:** McDonald's has been regularly rewarding shareholders through share repurchases and dividends. Notably, the company has a history of increasing dividend almost every year since the inception of its dividend payout policy in 1976. In November 2019, McDonald's raised dividend by 7.8%. Prior to that, it had increased the company's quarterly dividend by 15%, 7.4%, 5.6%, 4.5%, 4.9% and 5.2% in 2018, 2017, 2016, 2015, 2014 and 2013, respectively. In 2019, the company had returned \$8.6 billion to shareholders via stock repurchase and dividends. The company has returned \$25 billion for the three-year period ending 2019.

Reasons To Sell:

- ▼ **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 fourth-quarter 2019. 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 Earnings & Revenues Top Estimates in Q4

McDonald's reported fourth-quarter 2019 results, wherein both earnings and revenues surpassed the Zacks Consensus Estimate after missing the same in the preceding quarter.

Adjusted earnings came in at \$1.97 per share, which beat the consensus mark by a penny. However, the bottom line was flat with the prior-year quarter figure. Meanwhile, foreign currency translation had a negative impact of 2 cents per share on earnings in the quarter under review.

Quarter Ending **12/2019**

Report Date	Jan 29, 2020
Sales Surprise	0.94%
EPS Surprise	0.51%
Quarterly EPS	1.97
Annual EPS (TTM)	7.85

Revenues & Comps Discussion

In the fourth quarter, revenues of \$5,349 million beat the Zacks Consensus Estimate of \$5,300 million. Moreover, the figure improved 4% year over year. This uptrend can primarily be attributed to increase in revenues from franchised restaurants. Moreover, on a constant-currency basis, the top line improved 4% on a year-over-year basis.

At company-operated restaurants, revenues came in at \$2,363.3 million, almost flat year over year. However, the same at franchise-operated restaurants improved 7% to \$2,985.7 million.

Global comps improved 5.9% driven by positive comparable sales across all segments. Notably, this marked the 18th consecutive quarter of positive comparable sales. In third-quarter 2019, comps were also up 5.9%. Notably, the company recorded highest global same-store sales growth in a decade.

Solid Comps Across Segments

U.S.: Comps at this segment grew 5% in the fourth quarter, higher than a 4.8% 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 6.1% year over year, higher than prior-quarter's rise of 5.6%.

International Developmental Licensed Segment: The segment's comparable sales increased 7.2% in the fourth quarter. In the preceding quarter, the segment's comps had risen 8.1%.

Other Information

McDonald's returned \$2.3 billion to shareholders via stock repurchase and dividends. In 2019, the company had returned \$8.6 billion to shareholders via stock repurchase and dividends. The company has returned \$25 billion for the three-year period ending 2019.

Cash and cash equivalents at the end of 2019 was \$898.5 million, compared with \$866 million at the end of 2019. Long-term debt as of Dec 31, 2019 was \$34,118.1 million, compared with \$31,075.3 million at the end of 2018.

2019 Highlights

Full-year adjusted earnings came in at \$7.84 per share, reflecting a decline of 1% from 2018. Foreign currency headwinds had a negative impact of 21 cents in 2019. Revenues improved 0.2% in 2019 to \$21,076.5 million.

Valuation

McDonald's shares are up 22.3% over the trailing 12-month period. Over the past year, the Zacks sub-industry and sector are up 19% and 15.1%, respectively.

The S&P 500 index is up 20.4% in the past year.

The stock is currently trading at 25.35X forward 12-months Price to Earnings value, which compares to 24.87X for the Zacks sub-industry, 24.88X for the Zacks sector and 18.83X for the S&P 500 index.

Over the past five years, the stock has traded as high as 26.6X and as low as 18.23X, with a 5-year median of 21.47X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$227 price target reflects 26.64X 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	25.35	24.87	24.88	18.83
	5-Year High	26.6	26.41	26.23	19.34
	5-Year Low	18.23	20.45	19.07	15.18
	5-Year Median	21.47	23.25	22.95	17.45
P/S F12M	Current	7.5	3.59	1.06	3.49
	5-Year High	7.81	3.85	1.11	3.49
	5-Year Low	3.47	2.91	0.8	2.54
	5-Year Median	5.86	3.25	0.91	3
EV/EBITDA TTM	Current	19.28	16.64	15.33	12.25
	5-Year High	20.19	17.48	15.39	12.86
	5-Year Low	10.33	12.08	10.62	8.48
	5-Year Median	14.02	13.99	12.38	10.7

As of 01/30/2020

Industry Analysis Zacks Industry Rank: Top 29% (74 out of 255)



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	D	A
Market Cap	162.80 B	420.85 M	23.94 B	100.75 B	32.24 B	16.54 B
# of Analysts	15	4.5	13	14	9	3
Dividend Yield	2.31%	0.00%	1.77%	1.91%	1.58%	1.09%
Value Score	D	-	-	C	D	B
Cash/Price	0.01	0.03	0.04	0.03	0.02	0.10
EV/EBITDA	20.28	14.92	14.14	18.63	17.32	10.64
PEG Ratio	2.86	2.18	2.01	2.20	2.11	2.63
Price/Book (P/B)	NA	2.87	3.25	NA	NA	5.31
Price/Cash Flow (P/CF)	20.05	11.43	13.56	20.81	28.24	15.87
P/E (F1)	25.46	22.00	18.90	28.63	25.80	23.61
Price/Sales (P/S)	7.72	0.93	2.64	3.74	5.90	1.91
Earnings Yield	3.93%	4.35%	5.28%	3.49%	3.87%	4.23%
Debt/Equity	-5.71	0.94	0.72	-2.72	-1.30	0.01
Cash Flow (\$/share)	10.78	1.53	6.92	4.12	3.77	2.77
Growth Score	C	-	-	A	C	A
Hist. EPS Growth (3-5 yrs)	11.79%	7.71%	10.68%	15.73%	0.29%	NA
Proj. EPS Growth (F1/F0)	8.26%	8.30%	7.59%	5.96%	11.98%	6.07%
Curr. Cash Flow Growth	5.63%	7.69%	10.81%	5.49%	-9.66%	8.02%
Hist. Cash Flow Growth (3-5 yrs)	1.40%	6.24%	8.78%	12.19%	-11.09%	NA
Current Ratio	0.98	0.63	1.22	0.68	1.57	1.37
Debt/Capital	NA%	61.12%	42.99%	NA	NA	0.76%
Net Margin	28.59%	3.14%	11.69%	13.81%	20.88%	8.05%
Return on Equity	-79.57%	8.47%	17.33%	-62.51%	-11.69%	21.63%
Sales/Assets	0.45	1.17	0.55	1.26	1.18	1.40
Proj. Sales Growth (F1/F0)	2.76%	3.14%	4.12%	5.74%	4.76%	6.50%
Momentum Score	A	-	-	D	D	D
Daily Price Chg	0.81%	-0.57%	0.36%	-1.01%	-0.03%	-2.24%
1 Week Price Chg	-0.35%	-0.35%	-1.09%	-1.70%	-0.40%	-11.23%
4 Week Price Chg	7.66%	0.00%	-0.22%	-3.93%	4.34%	-10.44%
12 Week Price Chg	11.96%	0.05%	4.08%	4.75%	6.96%	1.10%
52 Week Price Chg	20.92%	1.03%	16.06%	25.98%	13.43%	20.71%
20 Day Average Volume	3,500,430	219,498	1,808,632	7,613,605	1,776,804	2,906,782
(F1) EPS Est 1 week change	0.08%	0.00%	0.00%	-1.64%	0.00%	0.00%
(F1) EPS Est 4 week change	0.10%	0.00%	0.00%	-1.59%	-0.60%	0.45%
(F1) EPS Est 12 week change	-0.28%	0.31%	-0.09%	-1.61%	-0.60%	0.45%
(Q1) EPS Est Mthly Chg	0.24%	0.00%	0.00%	-10.58%	-0.08%	1.75%

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	A
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.

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