

Disnat GPS Report

McDonald's (MCD, U\$166.48)



November 1, 2017

Company Description

McDonald's has more than 375,000 employees and 37,000 restaurants in over 120 countries, making it the largest and most influential fast food company in the world. Of these 37,000 establishments, 32,000 are operated as franchises. In fact, McDonald's is the number 1 player in all major world markets, with the exception of China.

After several challenging years, Stephen Easterbrook, the new CEO appointed in 2015, has introduced some major changes, such as the all-day breakfast, order terminals and table service. These have been very successful and will continue to contribute to the growth of the company as these changes are rolled out to more and more restaurants.

It is also important to realize that in a world where new technologies will dramatically change the face of fast food, McDonald's has the resources and expertise to stay at the forefront of these changes.

In an effort to help support revenue growth and stability, McDonald's has announced its intention to continue to launch franchised restaurants, but will also franchise restaurants that are currently corporate-owned.

In its latest annual report, the company reminds us that 75% of the population in its major markets lives less than five kilometers from a McDonald's!

With this in mind, the introduction of a fast and inexpensive delivery service for a McDonald's meal, whether with Uber, as currently being tested or – even better! – using drones where possible, could quickly become a valuable source of additional revenue.

At Disnat GPS, we believe that over the next few years, enormous changes could transform the fast food industry. The products and ways of doing things will change, but we believe that the great champions of the industry will remain the same as before, with McDonald's at the forefront.

This is the first Disnat GPS report published on McDonald's.

Financial Health

Fiscal Year	2014	2015	2016
Long term debt (in billions of dollars)	15	24	26
Debt/equity ratio	1.17	3.40	n.a.

To us, the financial health of McDonald's seems particularly solid under the circumstances. Debt/equity is irrelevant since the value of equity is currently negative. We therefore look at real debt to get a better picture of the situation.

The increase in debt over the past year has been relatively stable and moderate, rising from \$24 billion to \$26 billion.

In addition, this increase in debt has helped the company continue its growth as well as increase its dividend and repurchase its shares.

In summary, McDonald's debt is of little concern because it is administered based on an informed management choice about the best capital structure to adopt.

In addition, franchises provide McDonald's with recurring and stable royalties which have no impact on its current financial health, but allow it to believe that its stock will continue to be chosen as a result of strategy rather than obligation.

In Disnat GPS's investment philosophy, financial health is a key factor, and in spite of a few difficult years in terms of growth, McDonald's has continued to show very good financial health.

Growth

Compound Yield	1 year	3 years	5 years	10 years
Earnings	-3%	-4%	-2%	1%
Earnings per share	13%	-1%	0.06%	6.8%

Over the past 10 years, income and EPS growth has been weak and chaotic.

This is understandable given the increased competition (i.e. take-out meals in grocery stores and convenience stores) and the enormous changes that the fast food industry has witnessed (shift toward health).

In the early 2010s, McDonald's was on the wane, but the company seems to be in better shape today.

Measures implemented by the new President, in particular the "all-day breakfast menu", have been very successful and should continue to fuel revenue growth.

Management's willingness to increase the proportion of franchisees will also help growth, as it will allow the company to retain a large portion of its revenues without having to invest large sums, which also contributes to profits.

At Disnat GPS, we are pleased with the changes made by McDonald's and are confident that they will continue to impact future financial results.

Governance

Fiscal Year	2012	2013	2014	2015	2016
Earnings per share (\$)	5.36	5.55	4.82	4.80	5.44
Dividend (\$)	2.87	3.12	3.28	3.44	3.61
Number of shares (mil)	1,020	1,006	986	945	861

McDonald's pays its shareholders a dividend that it has increased in each of the last 40 years.

Over the past five years, the McDonald's dividend has grown by an average of 5% per year.

In addition, the company regularly returns a portion of its profits to investors in the form of share repurchases. Over the past five years, McDonald's has repurchased more than 15% of its outstanding shares.

In terms of business management, increasing the percentage of restaurants operated by franchisees is expected to make revenues more stable.

This possible stability makes it possible to be even more optimistic about the continuation of the dividend and share repurchase policies now in place.

A steady increase in dividends and share redemptions represent in our view the basis for good governance. McDonald's is therefore the perfect example of the kind of company we want to include in our Disnat GPS portfolios.

Valuation

Key Ratios	MCD	MCD (5 yr avg)	S&P 500
Price/earnings	27.4	19.7	22.0
Forward price/earnings	23.7	n.a.	20.6
Dividend yield	2.3%	3.2%	2.0%

In terms of valuation, it is important to understand that price-earnings ratios and future price-earnings ratios, which are usually very useful and widely used, are less appropriate for analyzing a stock that is going through a major reorganization such as McDonald's.

At Disnat GPS, we usually prefer securities that are clearly discounted in terms of price/earnings relative to the S&P500 as well as their own five-year average.

In the case of McDonald's, however, the changes made inspire confidence. In our view, these are sufficient reasons for accepting to pay a "quality premium".

Obviously, we will monitor the company's progress, both in terms of revenues and profits. We will also keep an eye on other changes that management will make – mobile orders, automation, etc. – and the speed at which it will put them in place.

McDonald's stock is currently a bit expensive. However, if the changes already made and those to come are successful, the current ratios could soon be seen as providing an excellent entry price into a superior company!

Explanatory Notes

Disnat GPS reports contain five separate sections, each followed by comments from the Disnat GPS Portfolio Strategist regarding the following:

1. Company Description
2. Financial Health
3. Growth
4. Governance
5. Valuation

At Disnat GPS, we believe that the topics, ratios and other financial figures presented here are particularly important.

However, for reasons of space, we can not publish all available data. We therefore invite you to read the additional financial information on the Disnat website.

Furthermore, this report is an analysis of the condition of a company today, with a medium to long term view. It is in no way an adequate tracking of daily activities of the stock market in general or of this particular company.

For a more regular monitoring of this and other securities held in one of our portfolios, please to subscribe to Disnat GPS now.

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