A Work Project, presented as part of the requirements for the Award of a Master Degree in Finance from the NOVA – School of Business and Economics.

MCDONALD'S INC. – LEADING THE QSR INDUSTRY AT ALL VELOCITY

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Abstract

After the former CEO exit and quarterly disappointing results, McDonald's stock went down 10.7% of its all-time high of $221.93 (Aug 19). We provide an in-depth DCF valuation analysis explaining the main assumptions behind our BUY recommendation. We propose a price-target of $225.91, mainly driven by the re-franchising success – that is boosting operating margin; and by same-store sales – which have been benefiting from further implementations of the Velocity Growth Plan. Moreover, we looked further to strategy, shareholders and capital's structure, making sure that McDonald's comparables were considered in order to provide a relative valuation and benchmark our DCF valuation.

Keywords

McDonald's, Turnaround, Re-franchising, McDelivery

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McDONALD'S INC.

COMPANY REPORT

QUICK-SERVICE RESTAURANTS

6TH JANUARY 2020

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Leading the QSR Industry

AT ALL VELOCITY

- After the prior CEO Steve Easterbrook exit and the quarterly disappointing results, below analysts' estimates, McDonald's stock went down 10.7% from its all-time high of $221.93 a share, registered in August, to $197.61, in 31th December 2019.
- We rate the stock with a BUY recommendation, and we estimate a total expected return of 17.3% in the following 12-month period, already considering cash gains from dividends and buybacks.
- The re-franchising target continues with a long-term goal of the company to be 95% franchised, which we estimate to be achieved in 2024, driving operating margin even further upwards.
- Half of the systemwide restaurants, as of two thirds of the US restaurants are already re-modelled under *"The Experience of the Future",* improving customer experience and guest counts.
- McDelivery is expected to represent $4 billions of the sales in 2019 and is now available in over 60% of the company's restaurants worldwide.
- In 2019 McDonald's acquired Apprente and Dynamic Yield, AI platforms which promise to disrupt customer experience. Dynamic Yield is already incorporated in 9,500 drive-thru in US.

Company description

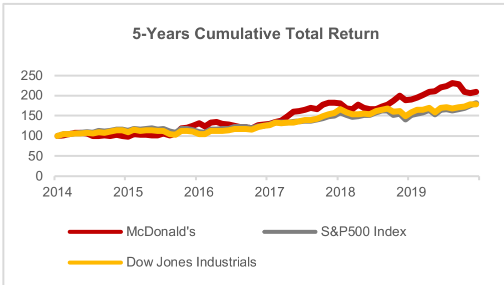
McDonald's Corporation is a 79 years old originally American company operating through 37,855 stores (2018) in QSR segment of the Restaurant industry. At year-end 2018, 93% of the business was franchised. The company is organized into four main segments: US, International Lead Markets, High Growth Markets and Foundational Markets & Corporate.

Recommendation:	**BUY**
Price Target FY17:	**225.91 $**
Price (as of 31-Dec-19)	**197.61 $**

Bloomberg: MCD US Equity

52-week range (€)	173.41-221.93
Market Cap (€m)	149.241
Outstanding Shares (m)	753.09
P/E Ratio	25.00

Source: Bloomberg



Source: Bloomberg

	2017	2018E	2019F
Revenues (million $)	21 025	21 249	21 156
EBITDA (million $)	10 450	11 014	11 180
EBIT (million $)	8 968	9 478	9 596
Operating Margin (%)	42.7%	44.6%	45.4%
Net Profit (million $)	5 924	5 654	5 571
EPS ($)	7.7	7.4	7.3
CAPEX (million $)	2 742	2 364	2 248
Net Debt (million $)	30 420	34 983	35 512
Dividend Payout Ratio (%)	55%	49.5%	44.3%
ROIC (%)	15%	15.7%	15.5%
Core FCF (million $)	6 156	5 998	6 310

Source: Company Reports and Analysts Estimations.

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McDonald's in Context

Fig. 1. McDonald's Initial Menu.

Ray Krok is the mastermind behind McDonald's empire, the iconic brand recognized worldwide, counting 37,855 stores in more than 120 geographies [year-end 2018], close to 210,000 employees, over $96.1 billion in systemwide sales (franchised and company-operated sales) of which $21 billions represents company's revenues (company-operated sales plus rents, royalties and fees charged to franchisees). McDonald's has been disrupting the informal eating out segment of the Restaurant industry, impacting the way we live our lives today. The provision of a highly efficient quick service with a uniform pattern, either in the tastiness, either in the time record methodology was the turning point of a whole sector. Although McDonald's owes its worldwide success to Ray Krok, the original concept came from the McDonald's brothers, Richard and Maurice, who set up the very first "McDonalds's Bar-B-Que" in San Bernardino, California, and then in 1940, later relaunched as "McDonald's". In 1948, the brothers created the "Speeded Service System" organizing the kitchen as an assembly line. Later, they ended up selling their equity to Krok.

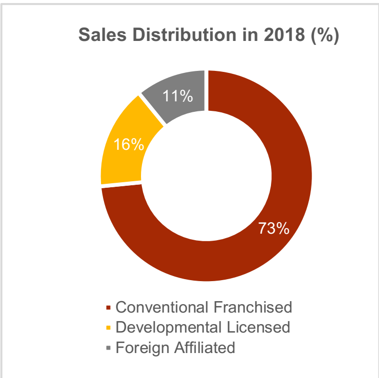

Fig. 2. Sales Distribution in % of Annual Sales.
Source: Company Report.

Sales Distribution (%)	2016	2017	2018
Conventional Franchised	80%	76%	73%
Developmental Licensed	13%	16%	16%
Foreign Affiliated	7%	8%	11%

Fig. 3. Sales Distribution in % of Annual Sales.
Source: Company Report.

Throughout the years the company has been developing and improving its franchised business model, turning out to become primarily a franchisor with 93% of the restaurants operating under this model [2018 year-end]. The company organizes the contracts into: Conventional Franchise, Development License or Affiliate (figure 2). Under the first, McDonald's holds the real estate infrastructures and/or secures a long-term lease for the location and the franchisee pays for the facilities, i.e. *equipment, signs, seating and décor* (2018's Annual Report). Franchisees are also required to reinvest capital in the business; however, if necessary, the company co-invests to enhance further improvements. Typically, this model lasts for 20 years and cash flows for the main company comes in the form of rent payment, royalties - upon a percentage of the sales, with minimum specified rent payments, and initial fees to be paid upon the opening or the provision of a new grant. Under the second, licensees enter with the real estate and with the facilities, are required to manage, operate the business, develop and open new brunches. The cash-flows are returned in the form of initial fees in the same circumstances described above, and as royalties upon a sales' percentage. To note that Affiliate arrangements represent a small portion of the whole model, since its only used in a limited number of foreign markets. Also, the share of the net results in this last format are recorded in Unconsolidated affiliates, since it requires equity investment from the company. According to the annual report of 2018, the company owned approximately 50% of the land and approximately 80% of the buildings of its restaurants in consolidated markets at year-end 2018 and 2017.

Fig. 4. Turnaround Plan Scheme.
Source: *Company Report.*

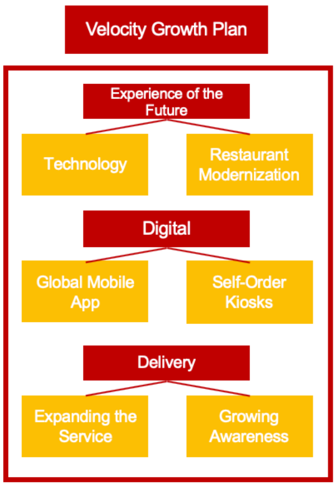

Fig. 5. Velocity Growth Plan Scheme.
Source: Company Report.

Fig. 6. Self-Order Kiosks.

The Strategy

Steve Easterbrook, previous McDonald's' CEO, launched two leading strategic plans: The Turnaround Plan (2015) and The Velocity Growth Plan (2017).

I. Turnaround Plan

After 5 years (2010 – 2014) of unsatisfactory performance the company decided to reorganize international operations by maturity and growth potential, namely: US, International Lead Markets (established markets), High Growth Markets (high potential restaurant growth), and Foundational Markets & Corporate (the remaining markets and company corporate operations), replacing the previous regional segmentation: Us, Europe, Asia/Pacific, Middle East and Africa. Moreover, improving operational growth became an urgency forcing the company rethinking menu offerings and quality, by removing some sandwiches, while adding premium key ingredients. According to Business Insider, the menu grew 42.4%, between 2007 and 2015, from 85 to 121 items, and drive-thru waiting time achieved 3 minutes (the longest average time in 15 years). Refining ingredients' quality become a "top priority" for Easterbrook after the food safety scandal in Asia, which triggered public distrust over the company and lead to a 15% loss in sales, in 2014. At the time, franchisors relationships were at all-time low levels, with 81% of the company business model under the franchise scheme. Moreover, the company set the target to become 95% franchised in the long-term. This plan was a huge success, driving the company's stock from \$118, year-end 2015, to \$172, year-end 2017, an increase of 45.8% in 2 years.

II. The Velocity Growth Plan (VGP)

The Velocity Growth Plan has been the guide to pursuit a customer-centric strategy, as it was designed to drive sustainable guest count growth supported by three main growth accelerators: retaining existing customers, regaining and converting casual to comitted customers. In order to strenght those drivers, the company identified three main pillars:

1. **Experience of the Future (EOTF)**

The EOTF is deeply tied to the digital strategy of the company and consists on the modernization of all McDonald's restaurants in terms of design, customer interaction and technological transformation. This concept introduces "Restaurant Guest Experience Leader", table service and curb-side pick-up aiming to provide a better experience, driving incremental visits and increasing average checks. Under this format, McDonald's' was able to improve the options for customers to interact with the brand, either when ordering, paying or collecting, and also adding "on table" service. At year-end 2018, there were already 17,000 restaurants with self-order kiosks, more than 21,000 restaurants with digital menu boards and over 22,000 restaurants allowed for "Mobile Order and Pay".

2. Digital

Fig. 7. McDonald's App.

The Digital has been the fuel of the transformation by converting restaurants into what McDonald's believes to be the *"Experience of the Future"* while contributing to further integration through the mobile application. At year-end 2017, over 20 million users were registered in the App, only in the US. The global mobile app become a key component in McDonald's strategy since it allows direct customer interaction, bringing convenience i.e. "Mobile Order & Pay" and also advertising promotions and discounts, while rewarding repetead purchases through a system of points. Each customer is identified by a QR code allowing the company to monitor its journey while refining efficiency and gathering data.

3. Delivery

Fig. 8. McDelivery Staff.

McDonald's partnered with Grab (Asia), Grub Hub, DoorDash and Uber Eats, being this last already available in 12,000 restaurants across 60 locations worldwide in 2018 (July 19th, Business Insider). McDonald's realized that extending its services would be the way to increase convenience, while allowing the company to pierce other layers of the market. As of 2018's year-end, delivery was available in half of the systemwide outlets and is still expanding. In 2019, 23,000 restaurants in over 80 countries are able to provide the service. According to the company's former CEO, in the 2019's Q3 Earnings Call, there was an average of 10 McDelivery orders per second, 864,000 orders a day, 26 million orders a month and 315 million orders a year. As of 2019 year-end, the sales through delivery are expected to account 4% systemwide sales ($4 billion), achieving the $5 billion in 2020. Customer satisfaction indexes have been rising, boosted by the service extent while the company have been benefiting by higher average checks (in compassion with non-delivery transactions), higher re-order rates and average checks are 1.5 to 2 times higher.

III. Discounts and Coupons

Fig. 9. McDonald's Promotions.

In the last couple of years, companies in the QSR industry have been fighting for market share resulting in a aggressive price competition. In order to remain competitive, McDonald's launched "$1 $2 $3 Dollar Menus", "McPick 2 for $5", "Buy One Get One for $1" and others discount campaigns. Even though it had started in the US, where competition is fierceless, it is already in the remaining geographies. This strategy have been driving the increase in guest counts up as it acts as an invitation for customers to visit McDonald's stores more often.

Fig. 10. McCafé.

IV. McCafé

Taking advantage of the pre-existent infrastructures, the company has been working to improve its offer through a specialized coffee shop with fair price points. Breakfast and coffee markets are very competitive with major players like Starbucks or Dunkin' Donuts. According to Euromonitor International[1], in 2017 McCafé owned 8% of the market share in Western Europe and 19% of the market share in Australasia, regarding the specialist coffee shop category. Still, in order to gain more market share, McDonald's is betting on sustainability and value deals i.e. The company expects 100% of their coffee to be 100% from sustainable sources in 2020. Sustainability is good, but allied with value deals like $2 for a small McCafé drink or $1 for a drip coffee definitely is inviting for customers on a budget. According to Euromonitor, McCafé is leader in Germany, Australia and Brazil and number two in China and Italy for the coffee category.

Fig. 11. McDonalds's Acquisitions: Dynamic Yield and Apprente.

V. Technology

McDonald's is testing provisioning with automated voiced and personalized service in the drive-thru for some restaurants to decrease waiting lines in drive-thru and to provide a better experience for the customer. In 2019, McDonald's acquired Dynamic Yield for $300 million and Apprente for an undisclosed amount. The first is a platform that uses data and real-time information to personalize the experience of the customer and the second is a start-up that has been building conversational agents that can automate voice-based ordering in multiple languages. With the new technology McDonald's could personalize user experience as deep as offering discounts based on purchased items, weather or geographic location. As of the end of the third quarter of 2019, dynamic yield technology was already incorporated in 9,500 US drive-thru and the objective is to further implement this technology in the mobile app and self-ordering kiosks.

VI. Sustainability

The company has identified five critical areas: packaging and recycling, climate action, beef sustainability, youth opportunity and commitment to families. In 2018, McDonald's re-launched its sustainability platform with "Better M" initiative, in which the company set the goal to reduce/remove plastic usage from restaurants, while increasing recyclability without compromising the packaging recognized worldwide. For example, only in France, 1,200 tonnes of plastic would be saved by introducing fibre lid in all beverage's cups, while, in Germany, customers are encouraged to bring reusable bottles to the restaurants under the "ReCup"

[1] *"McDonald's Corp in Consumer Foodservice (World)",* by Stephen Dutton

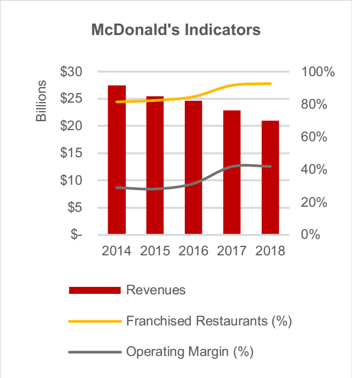

Fig. 12. Franchised Revenues and Operating Margin as % Revenues.
Source: Company Reports.

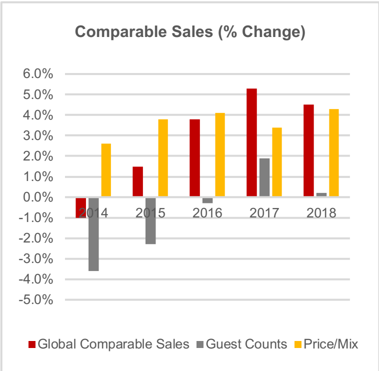

Fig. 13. McDonald's Comparable Sales, Price Mix and Guest Counts Evolution.
Source: Company Reports.

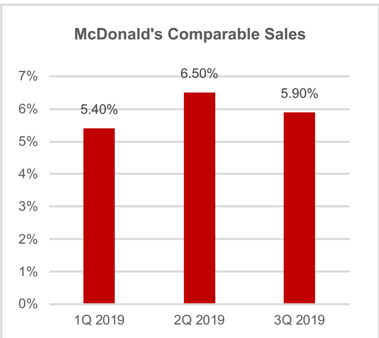

Fig. 14. Reported Comparable Sales Evolution.
Source: Company Report.

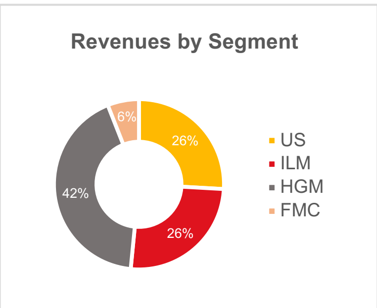

Fig. 15. Revenues by Segment.
Source: Company Report.

programme. McDonald's, together with Starbucks, also makes part of the "Next Generation Cup Consortium" encouraging innovation in cups development. "Scale for Good" or efforts on "Edible Packaging" are other initiatives tackling customer concerns on health and on sustainability. This echoes the brand strategy in building deeper ties with its customers, more than simply offering convenience and tastiness. McDonalds is committed into developing a sustained relationship between the customer and the brand.

Financials

For the last couple of years Easterbrook's plans have been a success: (1) The percentage of franchised restaurants increased from 82%, in 2014, to 93%, in 2018; (2) Operating margin increased from 29% to 42% driven by more franchised restaurants with better operating margins; (3) The number of restaurants increased by 1,597 (net), as a result of 5,541 additional franchised stores and a decrease of 3,944 in company-operated restaurants, for the same period of analysis; (4) Systemwide sales increased 9.5% ($8,361 billion) enhanced by franchising, which alone improved 24% ($16,517 billion) from 2014 to 2018; (5) Comparable sales improved from -1%, in 2014, to 4.5%, in 2018, having been 5.90% in the last Q3 of 2019 (figures 13 and 14). This means that, not only the company was able to open more stores, but also each store is selling more with a higher price/mix. Note that comparable sales have been driven by price mix's upward trend since 2014, even though the number of guests is also experiencing an upward trend since VGP has been implemented.

Even though total revenues decreased $6.416 billions, in the period of analysis (figure 12), the portion coming from franchised restaurants increased $1.74 billions - explained, in part, by the re-franchising program which has been contributing to the increase of the share coming from franchisees, while revenue from company operated stores has been reducing as a consequence of the decrease in the number of company-operated stores. Still, Revenue decrease has been partially offset by the increase in the number of total stores and positive comparable sales.

From the four segments – United States (US), International Lead Markets (ILM), High Growth Markets (HGM) and Foundational Markets & Corporate (FMC) - the most represented in number of stores is the US, which has 37% of total stores, while HGM is the revenues leader, having contributed with 42% of total revenues (figure 15). The four segments have different franchising percentages, as of 2018 year-end, US was 95% franchised, ILM was 88% franchised, HGM was 83% franchised and FMC was 98% franchised. As the long-term objective is to be

95% overall franchised, meaning that some segments are already at that point, while others will continue re-franchising.

Economic Outlook

Ranking top ten on FT's Top 100 Global Brands and Forbes' World's Most Valuable Brands, in 2019, McDonalds is undoubtfully one of the most global companies worldwide. Taking advantage of the company extended presence, in 1986, The Economist launched the Big Mac Index as an attempt to access purchasing power parity disparities across regions, using the price of the Big Mac as the benchmark. However, even though the scale is crucial for the business, being international at this extent echoes operational, reputational and economic risks. McDonald's is exposed to local economic swings, currency fluctuations, infrastructures quality levels, domestic policies and cultural sensibility.

In a global scenario, growth is in a synchronized slowdown, forecasted to be 3% in 2019, the slowest pace since 2008's Financial Crisis (IMF, Oct 19). Moreover, US-China trade war is estimated to cumulatively reduce the global GDP by 0.8 p.p., already in 2020. Political tensions in emerging markets such as in Latin America - Chile, Bolivia, Brazil and Argentina, and in Middle East, still living under frictions, threat growth prospects in the regions.

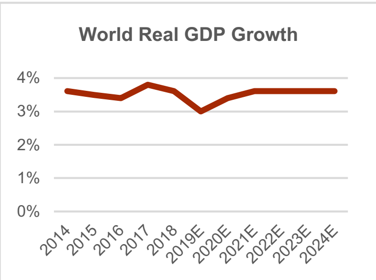

Fig. 16. Real GDP Growth and forecasts
Source: International Monetary Fund.

Additionally, according to Damodaran, the Restaurant Industry had a beta levered of 0.8, between 2015 and 2019, meaning that there's a positively strong correlation between the industry and uncontrollable events. However, when looking to McDonald's peers, from 2014 until 2019, the beta levered falls in between 0.47 and 1.24, being 0.42 for McDonald's (figure 17). This strengthens the company position regarding adverse scenarios, since it is 5 basis points below the second well positioned peer. Moreover, the company strategy regarding franchising ends up transferring part of the risks in each location, while allowing for a deeper adaptability to local markets.

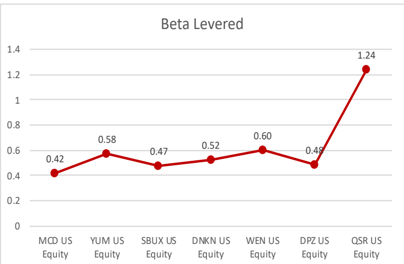

Fig. 17. McDonald's Comparables Levered Beta.
Source: Bloomberg and Analysts estimates.

In developed economies, low productivity growth and aging demographics exposes the company to monetary policy decisions and to target inflation expectations.

In the beginning 2019, Easterbrook, previous CEO, signed a letter to UK parliament warning the rise in food prices would be unavoidable in a context of a Brexit, enhancing to investors that "*Consumer uncertainty is growing, from France to China to the UK and elsewhere across the globe in response to tightening economies and shifting political environments*". Brexit consequences are unknown, complicating the situation for McDonald's, which owes part of its success in Europe to its UK restaurants. According to Bernstein Research, early 2016, UK represented 7% of McDonalds sales, while 28% of the sales were originated in Europe. Under EOTF transformation, International Lead Markets, segment in which the UK is inserted, saw an increase of 5.2% in comparable sales, however, political environment may compromise the way company operates in the location.

Additionally, the fight over climate change, which already has been discussed at a decision level, presents multiple challenges to the company. McDonald's is struggling regarding plastic usage and its disposable packaging model in an increasingly conscious eco-friendly global economy. According to Financial Time's, McDonald's, together with Starbucks, already spent $15 million in a partnership with Closed Loop Partners to pursue sustainable investments.

Industry Outlook

In generic terms, the Restaurant Industry is divided into three main categories: Quick Service Restaurants (QSR) – fast food service, low-cost food at fair quality, up to $8, Casual Dining Restaurants (CSR) – differentiated quality, enjoyable atmosphere, price ranging from $15, and the Quick/Fast Casual Restaurants (QCR), which lies in between. McDonald's Corporation owns, by operating and franchising, restaurants in the QSR Industry targeting the Informal Eating Out[2] (IEO) layer of the market.

In a very competttive market, scale matters. At a time in which the number of guest counts are at low rates, global fast-food companies have beeen intaking aggressive discount strategies, despite rising labour costs and commodity inflation. This strategy has been attracting new layers of the market like low-income consumers, while industry oversupply and rising concerns regarding health care have been shifting Millenials to other options in the Fast Casual segment. The global QSR Industry is expected to grow at 7.61% CAGR, between 2019 and 2026, according to Big Market Research, boosted by delivery, digital and consumer data.

Also, the Restaurant Finance Monitor Index, which improved 16% year-to-date (June 2019), surpassed the 15% of the S&P composite index driven by heavily weighted companies of the sector such as McDonalds, Starbucks, Chipotle, which have been benefiting from the momentum in stock market, rather than company-specifics (Bloomberg Intelligence).

US, Canada, Australia, UK, Hong Kong/China, Japan and New Zealand were the top markets, in per capita value spending, in the QSR industry for the year of 2018, according to Euromonitor. Households spent, on average, between $500 to

[2] The IEO includes: "casual dining full-service restaurants, street stalls or kiosks, cafés, delivery/ takeaways providers, specialist coffee shops, self-service cafeterias and juice/smoothies' bars". – Passport Euromonitor

$800. The market size for QSR is forecasted to grow at 3.6% CAGR in Eastern Europe, 2% CAGR in Western Europe, 2.6% CAGR in Australasia and 4% CAGR in Latin America, between 2017 and 2022 (*Source: Statista)*.

Technology has been allowing chains to curb the practice of deep dicounting and, more than that, to superior data collection regarding consumers preferences. Mobile Apps, self-order kiosks, order platforms and payment aplications have been helping chains to address customer needs, bring convenience and improving their satisfaction (figure 18).

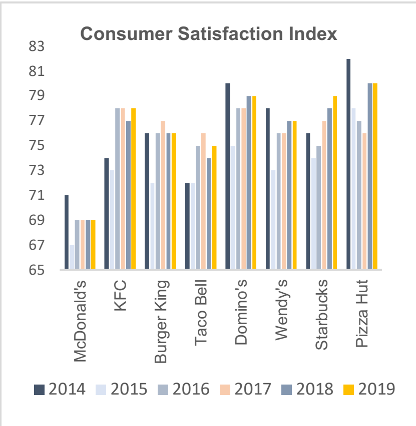

Fig. 18. American Customer Satisfaction Index Scores for Limited Services Restaurant Chains in the US.
Source: Statista.

Delivery has been driven by partnerships to accelerate the process, however, even though this strategy allows for rapid organic growth, the typical fee structure is still very narrow (between 20%-30%) not being sustainable in the long term. Moreover, the lack of company control to elevate the brand over deliveries is almost none, as proven in a study conducted by SeeLevel Hx where 51% of the inquirees alleged to have negative experiences with deliver. Still, as we can see from figure 19, home delivery is a growing industry and McDonald's is well positioned to take a major steak of the cake.

United States

North America is undoubtedly the strongest market for fast-food industry, both in fast-food meals and in cafeteria services, with a respective CAGR of nearly 2.5% in meals and 3% in coffee shop services, with sales volume above $260 billions in food and $26 billions in cafeteria. Also, according to Zion Market Research, the QSR industry in the US was capped in nearly $540 billion, in 2016, and it is expected to achieve $690 billion in value in 2022, which corresponds to a CAGR of nearly 4.20% over 2016-2022. In order to increase in-store traffic, as well as to capture other segments of the market such as low-income consumers, more sensitive to the price, fast food chains had entered in a massive price war in which McDonalds followed the trend launching in January 2018 the dollar menu. Taco Bell, KFC and Wendy's are some of the names within the competitors. In a context in which there is customer demand for new approaches to in-store experiences, reengineering facilities with user-technology to bring brand excitement as well as to increase efficiency becomes a priority. Delivering convenience through traffic management in a margin squeeze context highlighted the need of transformation in the industry. Moreover, concerns regarding food quality over millennials and public health alarms rang the bell to reinforce premium-sandwiches, such as shack-and-shack, as local casual dining is evolving.

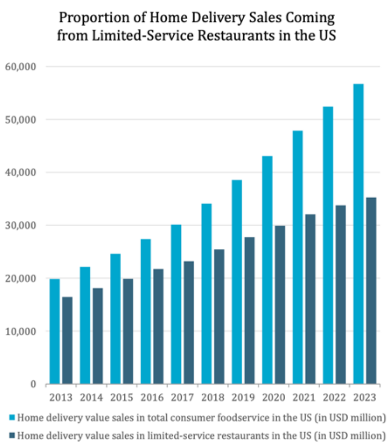

Fig. 19. Home Delivery sales from Limited Service Restaurants in US
Source: Statista.

Europe

The region is shifting from the tradition dinning culture to convenient and flexible options. Even though the differences in market size, predictable growth, size of the economy and country-specific characteristics, the food landscape in Europe has been affected by the same trends as North America. Also, it is important to bear in mind that 44% of the restaurant sales in US are absorbed by fast food chains, in Europe the share falls between 5% to 13%. To note that European main market are UK, Germany, Netherlands, France, Belgium, Italy, Portugal and Spain, where burgers are the most popular category and where there's a collective demand for quality and premium. Moreover, according to Aaron Allen Global Restaurants Consultants, only in Western locations, fast-food market is expected to increase $10.3 billion in the next three years.

China

As income is rising in China, the region became a trend setter in foodservice market in which chicken-based meals are preferable to the beef-based menu, McDonalds's speciality. International chains have been struggling in a market where domestic supply is prepared to fulfil demand. Still, since the beginning, McDonalds was never capable of surpassing YUM! Brands, namely KFC and Pizza Hut, that benefited from early-move competitive advantage. Western influence in the region has boosted demand for fast food: according to ACMR-IBISWorld, in 2019, China is expected to generate $178 bn, an increase of 7.8% in comparison with 2018. Moreover, for the next five years, the revenue of the industry is expected to growth at 8.9% CAGR, over the 2.4 million restaurants.

McDonald's Comparables

Fig. 20. McDonald's Logo.

McDonald's is primarily a franchisor with 93% of the stores under this scheme, in 2018's year-end, with the remaining 7% (equivalent to 2,770 million stores) remaining under company operations, aiming to achieve 95% franchising structure in the long-term. The company had a market cap of nearly $149 billion, as year-end 2018, with an average price per share of $194. The brand value is estimated to be $130 millions (2019, *Statista*), placing McDonald's as one of the most valuable brands worldwide. In 2018 fiscal year, the company billed $96.14 billion in Sales in more than 37,000 stores over 100 locations. US, alone, contributed for nearly 40% of the results, being the company most consolidated market.

RBI

Fig. 21. Burger King Logo.

Restaurants Brands International operates in the QSR industry, counting more than 26,000 outlets in over 100 locations. The company operates under three independent brands: Burger King (1954), Tim Hortons (1964, Canada) and Popeyes (1972, US). Burger King has a fully franchised business model directly competing with McDonald's either in the products offering, target audience and price mix. As of March 2019, the company accounted $32 billion systemwide sales.

Starbucks

Fig. 22. Starbucks Logo.

Founded in 1971, and public since 1992, Starbucks is the world's leading coffeehouse chain, counting 30,000 stores over 80 markets (2019, June). The company's offers handcrafted premium beverages and coffees, merchandise and fresh bakeries driven by high quality and price point. At year-end 2018, 70% of the sales were from beverages, while 20% from food. Company achieved $5.7 billion in Revenues, owning 100% of US operations, while partially franchising in other geographies.

Yum! Brands

Fig. 23. Yum! Brands Logo.

Yum was created as a spin-off of PepsiCo in 1997. It is composed by three main restaurant brands: KFC - chicken-specialized products, Pizza Hut - casual dining ready-to-eat/delivery pizza and Taco Bell - Mexican-style food products. The group manages 49,000 restaurants worldwide, 98% franchised with over $49 billion in systemwide sales (2018). In numbers, the group is the closest competitor to McDonald's, however this is only possible due to the sum of the parts.

Wendy's

Fig. 24. Wendy's Logo.

Founded in 1969, Wendy's is the third largest quick-service restaurant company in the hamburger sandwich segment. The company has 6,700 restaurants (year-end 2018), with 95% franchised, over 30 countries. Systemwide sales were around $10.5 billions in year-end 2018, equivalent to one tenth of McDonald's sales. Although the considerably lower dimension, the products/services' offering and business model (95% - 5% McDonald's target), makes it a suitable comparable.

Domino's Pizza

Fig. 25. Domino's Pizza Logo.

Domino's Pizza, Inc. is the leading pizza delivery company and the second largest pizza franchise after Yum!. The business is organized into US, international franchise and supply chain. The company is primarily a franchisor owning 15,900 stores, from which 10,038 were internationally franchised. As year-end 2018, Domino's was in 85 markets. In 2018, the company billed $3.4 billion, reflecting its investments efforts in technology to improve customer experience.

Dunkin' Brands

Fig. 26. Dunkin' Brands Logo.

Dunkin' Brands is an American multinational coffee/donut company founded in 1948 that operates under: Dunkin' and Baskin-Robins brands, specialized in ice-cream. The company offers a wide variety of coffee beverages and baked goods in more than 20,900 outlets over 60 countries worldwide, 100% franchised. As of 2018's fiscal year, 76% of systemwide sales ($8.8 billion) were from US, while the remaining $2.2 billion came primarily from the Asian and the Middle East's franchises.

In the table below we can observe additional key financial information for McDonald's and its peers:

	McDonald's	Yum! Brands	Starbucks	Wendy's	Restaurant Brands International	Dunkin' Donuts	Domino's Pizza
Revenues (m$)	21025,2	5688,0	24719,5	1589,9	5357,0	1321,6	3432,9
EBITDA (m$)	10450,2	2433,0	5189,2	378,8	2097,0	456,9	625,4
Net Income (m$)	5924,3	1542,0	4518,3	460,1	612,0	229,9	362,0
Market Cap (m$)	170504,1	28706,8	79894,6	3696,0	23970,2	5296,1	11535,0
EPS ($)	7,7	4,8	3,3	1,9	2,5	2,8	8,7
D/E (%)	8%	34%	1%	64%	47%	48%	30%
% Franchised (%)	93%	98%	48%	95%	100%	100%	98%
EPS	7,7x	5,0x	3,5x	2,0x	2,4x	2,8x	8,8x
EV/Revenues	8,7x	6,8x	3,3x	3,8x	6,6x	5,9x	4,0x
EV/EBITDA	17,6x	15,8x	15,5x	16,0x	16,8x	17,0x	22,2x
EV/EBIT	20,5x	16,8x	20,7x	24,2x	18,4x	18,9x	24,3x
EV/NETINCOME	31,0x	25,0x	17,8x	13,1x	57,5x	33,8x	38,4x
P/E	28,8x	18,2x	18,7x	7,8x	21,5x	22,8x	28,3x
P/S	8,1x	4,9x	3,4x	2,3x	2,5x	4,0x	3,0x

Fig. 27. McDonald's and Comparable company's financial information and multiples.
Source: Bloomberg and Company Report.

Valuation

We believe that 2025 will be the year in which the VGP will mature, as by then, the 3 pillars will be already established in McDonald's system, for at least 1 or 2 years (management expects to have EOTF systemwide in 2022). With the Turnaround Plan in 2015 the company set a long-term objective of having 95% of the stores franchised, which, according to our forecasts is expectable to happen in 2024. Additionally, until the target is accomplished, company-operated stores are expected to decrease, on average, 4% until 2024, either because of re-franchising or closing. From 2024 onwards, we predicted modest growth (about 1%) while maintaining the ratio of 95% franchised to 5% company-operated. As we expect comparable sales to be lower in the future, revenues will then depend more on the growth of number of stores, and not so much on sales per store. Therefore, for clarification purposes, in order to value the company, one considered two key metrics: number of stores and sales per store. In order to forecast the number of stores and comparable sales for the future we took into account historical performance, management prespectives and available information on each segment.

Revenue

Franchised sales do not have a direct conversion to franchised revenues, since those last depend on contract terms which are different on the type of franchise, on the country and on the type of agreement between the two parts.In our analysis, we took into consideration two effects: the historic percentage of revenues over sales per segment and the percentage of franchised stores. First, we believe that sales is the best driver for franchised revenues because rent and royalties depend on sales. Second, the historic percentage of revenues over sales for the past is a fair enough estimator available in this context. Looking to the history, the higher the percentage of franchised restaurants in the segment, the lower the revenues of those restaurants as percentage of sales. Taking this into account, we used historical values for segments that were 95% franchised and discounted the ones that weren't yet 95% franchised until they reach the long-term objective.

Sales per Store

Systemwide sales represent all the sales within the system (company-operated and franchised), which, according to the company Annual Report, is expected to grow 3% to 5% in the long-term. For the next six years (until 2024) we forecasted systemwide sales to grow, on average, 3.5% mainly driven by HGM, which are expected to increase 5.6%, whereas ILM and FMC will grow around 3.9% and US 1.7%.

Sales per Store (SpS) were estimated based on the previous year SpS adjusted for the current year comparable sales. Note that comparable sales correspond to the annual sales variation of each store opened by more than 13 months[3], and it represents the combination of guests counts and price mix. For clarification purposes: "Guest Counts" are the change in the number of transactions compared with the previous period and "Price Mix" is the difference in average money spent, per transaction, compared with the previous year.

Millions of $	2018	2019E	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E
Systemwide Sales	**87 786**	**82 714**	**85 002**	**90 910**	**96 147**	**101 263**	**104 831**	**108 372**	**111 600**	**114 841**	**118 018**
US Revenues	7 666	7 871	7 965	8 073	8 183	8 307	8 432	8 534	8 637	8 741	8 845
ILM Revenues	7 600	7 540	7 270	7 179	7 055	7 074	7 284	7 443	7 568	7 656	7 745
HGM Revenues	3 989	3 755	3 509	3 356	3 226	3 069	2 840	2 942	3 046	3 136	3 227
FMC Revenues	1 771	2 083	2 411	2 755	3 107	3 464	3 839	3 960	4 045	4 090	4 136

Fig. 28. Systemwide Sales and Segment Revenues in millions of dollars.
Source: Company Report and Analysts Estimates.

Sales per Store (m$)	2018	2019E	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E
US Company	3,9	4,0	4,0	4,1	4,1	4,1	4,2	4,2	4,2	4,3	4,3
US Franchised	2,7	2,8	2,8	2,9	2,9	2,9	3,0	3,0	3,0	3,0	3,0
ILM Company	4,9	5,2	5,4	5,6	5,7	5,8	6,0	6,1	6,1	6,1	6,2
ILM Franchised	3,4	3,6	3,7	3,9	3,9	4,0	4,1	4,2	4,2	4,3	4,3
HGM Company	2,6	2,7	2,8	2,9	3,0	3,0	3,1	3,1	3,2	3,2	3,2
HGM Franchised	1,9	2,0	2,0	2,1	2,1	2,2	2,2	2,2	2,3	2,3	2,3
FMC Company	3,0	3,2	3,3	3,4	3,6	3,7	3,8	3,9	3,9	3,9	4,0
FMC Franchised	1,9	1,9	2,0	2,1	2,2	2,2	2,3	2,4	2,4	2,4	2,4

Fig. 29. Sales per Store by Segment in millions of dollars.
Source: Company Report and Analysts Estimates.

[3] In this context it was assumed the growth to be equal for every store, by default.

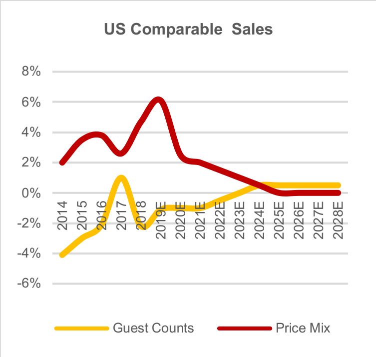

Fig. 30. US Comparable Sales Evolution.
Source: Bloomberg and Analysts Estimates.

United States

In 2018, the US segment surpassed the company long-term objective by being 95,1% franchised. The number of stores have been decreasing 200, on average, per year, since 2015, driven by the decrease in company-operated stores. Still, in the long term, in order to succeed, and in accordance with the company "convenience" purpose, we believe McDonald's will continue to slowly expand the number of stores for the segment, either by openning solely pick-up stores or indepent McCafé brunches. Guest counts have been ranging from -4% to 1%, since 2014, with the exception being 2017 (figure 30), evidenciating a negative tendency in the number of transactions. However, by 2024, we believe this tendency will invert with all the company efforts to encourage repetead purchases under the Velocity Growth Plan. Moreover, fierce competition in the QSR industry forced McDonald's to engage in promotions and meals at affordable prices, still price/mix has been unterruptly expanding, mainly driven by the increases in menu prices and by delivery higher average check. We can also observe on figure 31 that consumers are spending more on the QSR industry, which can also explain the increases in the price/mix. Even so, we believe its will peak in 2019 and will decrease afterwards, stabilizing after 2025. The reason for our expectation is *momentum*: as the company launched delivery, there was an increasing hype; but as the number of stores offering delivery stabilizes and as peers will take more attention to the potencial of delivery, the hype will also decrease, competition will increase and price/mix will slowdown.

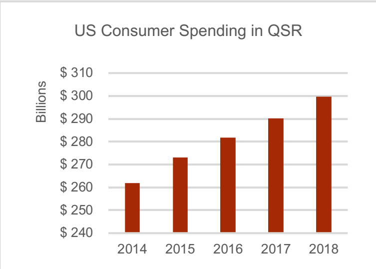

Fig. 31. US Consumer Spending in QSR.
Source: Statista

International Lead Markets

International Lead Markets represents countries where McDonald's is already well established. McDonald's is market leader in the UK, France, Germany, Australia and number two in Canada. We consider to maintain its leadership, as well as to meet the company's franchising long-term target, there will be incentives to continue to expand even further the number of stores. Only in France, the company expects to open around 400-500 stores, by 2025. As of year-end 2018, McDonald's operated 816 stores and franchised 6,171 stores, which corresponds to a 88.3% structure franchised. We believe the company will be able to meet its target in 2023, mainly driven by the reduction in company-operated stores (at an average rate of 14% until 2023) while slightly increasing the number of franchisees, at an average rate of 2%, for the same period of analysis (figure 32). Furthermore, as EOTF reaches all the stores, the hype over the new restaurants will fade away and competitiors most problably also will add self-order kiosks, revamp their stores, so, in the long-term, comparable sales will most likely lower.

Fig. 32. ILM Stores.
Source: Bloomberg and Analysts Estimates.

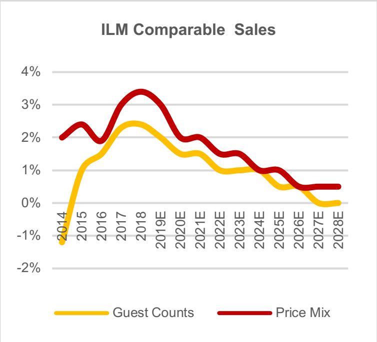

Fig. 33. ILM Comparable Sales.
Source: Bloomberg and Analysts Estimates.

The price mix has been high for International Lead Markets (figure 33), mostly due to the expansion of the delivery in Europe and Australia, fueled by the partnership with UberEats. In the Annual Report of 2018, the company stated that France and the UK had double digit sales increase in delivery, also mentioning that those purchases have 1.5 to 2 times higher average price per transaction. As a significant part of the orders are done late at night, it was observerd that consumers are willing to spend more, thus contributing to the increase in price mix. Moreover, concerns regarding food quality and sustainability are expected to increase and quality will be most likely to be reflected into menu's price increase. We believe price mix will continue to be positive but at a slower pace, as the company needs to accommodate quickly consumers requests, in a context where there isn't a consolidated delivery system besides outsources like Uber Eats and where environmental issues regarding the menu are not solutioned yet. Also, the idea of catching up high segments made the company launch "McDonalds Signature" offering premium burgers with more quality at higher prices. As demand for premium burgers increases in Europe, this leads to an average higher price mix. However, as the excitement of digital goes by and delivery reaches all the markets, we believe that price mix will slow down.

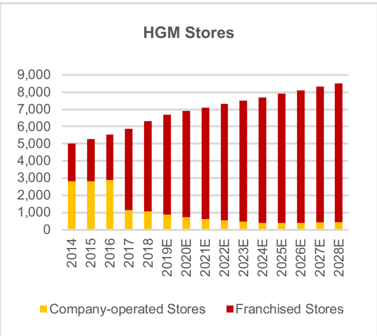

Fig. 34. HGM Stores.
Source: Bloomberg and Analysts Estimates.

High Growth Markets

High Growth Markets are composed by countries in which McDonald's isn't yet fully established, being the main markets China, Italy, Korea, Netherlands, Poland, Russia, Spain, Switzerland, and related markets. Only 82.7% of the restaurants are franchised in the segment and we expect that the target of 95% to be achieved in 2024 (figure 34). Between 2013 and 2018, McDonald's sales historic CAGR have been around 3.8% in Western Europe, 7.8% in Latin America, 10% in Middle East and Africa and around 5.3% in Asia Pacific (Euromonitor). Also, according to the same source, China is forwarded to be McCafé's largest contributor to growth as the proliferation of coffee consumption in China's middle class is expanding. We believe that this growth can only be sustained by the constant increase in the number of stores, mainly franchisings, while repassing company-operated restaurants. The number of stores have been growing close to 5.5% per year (320 stores/year). In 2019, half of the total stores that the company expected to open were located in China, meaning that we should observe an aggressive increase in 2019, compared with the previous years. Therefore we estimated 400 new net stores, in 2019, for this segment.

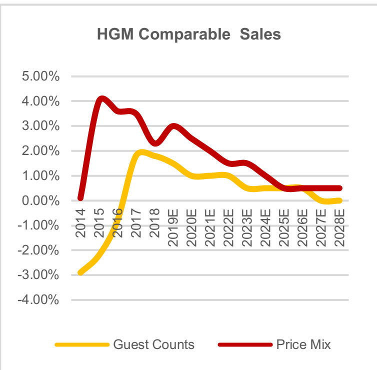

Fig. 35. HGM Comparable Sales.
Source: Bloomberg and Analysts Estimates.

With the delivery success across HGM, specially in China, and with the integration of the app WeChat, we believe that price mix will be 2.5% in 2020 (figure 35) and will start decreasing as EOTF and digital become more common not only in the McDonald's stores but also in its peers.. In terms of guest count, it has been negative in the past with a sudden recovery in 2017. From 2014 to 2016, guest counts have been negative, increasing by 1.8%, in 2017 and 2018. Specially in Asia, coffe shops have a lot of traffic and McDonald's is able to leverage McCafé to drive guest counts higher while revamping stores to increase visits.

Foundational Markets and Corporate

This segment is composed by dispersed markets, in which the most relevant are Brazil, Japan, Taiwan, Phillippines and also where the firm reports corporate activity. In 2018 this segment was already 98% franchised, unlike the others, making us believe that this value will revert to the 95% in the long-term (figure 36).

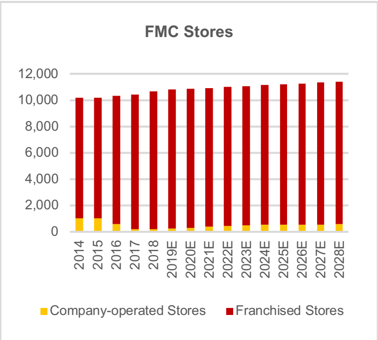

Fig. 36. FMC Stores.
Source: Bloomberg and Analysts Estimates.

The number of stores have been increasing slightly and we believe it will continue that way because this segment is neither the high growth and neither the stablished market, it is composed by fragmented markets that are not expected to grow much. Guest counts increased to positive territory in 2016 due to the effectiveness of the velocity growth plan.

Brazil responded very well to the EOTF and self-ordering kiosks, specially because it happened after the crisis, in 2014, where people had to spend with caution and McDonald's appeared with affordable and convenient meals. Also, in Phillippines McDonald's launched NXTGEN stores that feature modern design, self-ordering kiosks and cashless payments. The success was obvious and there are more stores opening in the following years. All of this contributes to positive guest counts.

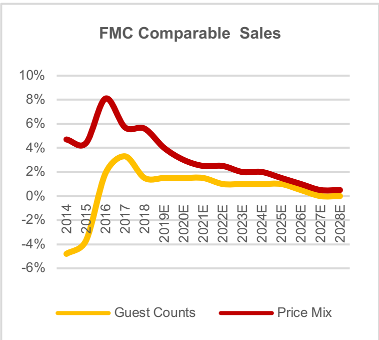

Fig. 37. FMC Comparable Sales.
Source: Bloomberg and Analysts Estimates.

Price mix has been very high since 2014 (figure 37), even before the effect of the Turnaround Plan in 2015. This puts the baseline very high and much above the baseline of the other segments. This may be explained by the sales per store which is only \$1.89 million in 2018 versus \$3.57 million in HGM, for example. We believe that, as delivery expands to more markets and as the digital app gets to more customers, there will be higher spending per visit. It also makes sense that sales per store converges with other segments and for that to happen, comparable sales have to be higher than the other segments.

Operating Margin Analysis

In order to analyse the cost structure of the company it is important to look to company-operated and franchised restaurants separately, since both have different margins structure. Still, there are cost such as SG&A that affect both the company-operated and franchised restaurants. In company-operated restaurants there are 3 types of costs (figure 38): "Food and Paper", "Payroll and Employee

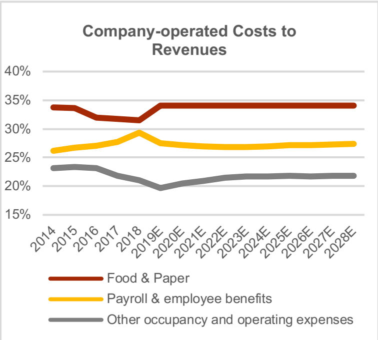

Fig.38. Cost as % of Revenues Evolution.
Source: Company Reports and Analysts Estimates.

	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Crude oil, avg	-12%	-3%	2%	2%	2%	2%	2%
Coffee, Arabica	-4%	2%	2%	2%	2%	2%	2%
Coffee, Robusta	-13%	3%	3%	3%	3%	3%	3%
Wheat, US, HRW	-5%	2%	2%	2%	2%	2%	2%
Meat, beef	8%	-1%	-1%	-1%	-1%	-1%	-1%
Meat, chicken	-11%	1%	1%	1%	1%	1%	1%
Cocoa	0%	2%	2%	2%	2%	2%	2%
Sugar	2%	3%	3%	3%	3%	3%	3%

Fig. 39. Commodities nominal growth rate.
Source: World Bank.

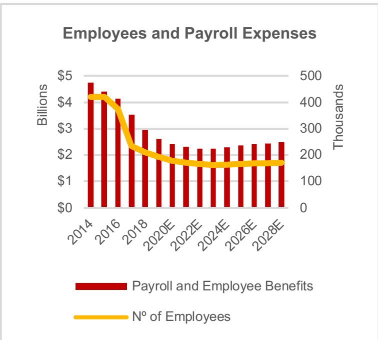

Fig.40. Payroll and Number of Employee evolution.
Source: Company Report and Analysts Estimates.

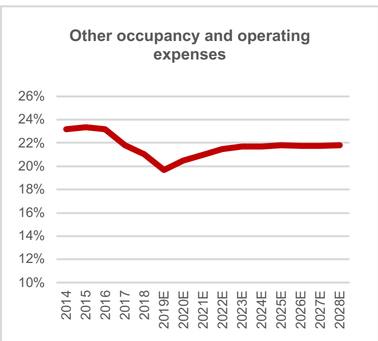

Fig. 41. Company-Operated Occupancy Expenses as % of Revenues.
Source: Company Reports and Analysts Estimates

benefits" and "Other Occupancy and Operating Expenses", while, for franchises, there are only "Occupancy Expenses" (figure 41).

Food and Paper

Food and Paper costs are tied with a basket of 10 commodities that represent 75% of those costs. We gathered data from World Bank on some commodities that we believe to be representative of the costs of McDonald's (figure 39). We can observe that in 2019 most of the commodities are expected to go down, however, the company announced in the quarterly reports that Food and Paper are expected to increase around 2% to 3% in 2019. We believe that the change behind this increase is the beef price, which is expected to increase 8%, in 2019. From 2019 onwards the commodities increase at around 2% but beef, one of the main commodities, decreases at 1% a year, on nominal prices. Taking into account that revenues increase already takes into account inflation (through price/mix), we expect Food and Paper, as percentage of company-operated Revenues, to be constant from 2019 onwards.

Payroll and employee benefits

In order to estimate Payroll and employee benefits we related this cost with the number of employees working for the company (figure 40). The number of employees is mainly related with company-operated restaurants and that's why it has been decreasing over the last years and we still forecast a further reduction until the company becomes 95% franchised. We also forecasted the payroll and employee benefit per employee to increase slightly in the future because of competitive labour market and pressures on wage increases. According with the Financial Times article *"Rising global labour costs poised to hit equity markets"*, by Steve Johnson, global unemployment has fallen to its lowest level since 1970; Due to this fact, the labour market has become increasingly competitive and the growth in productivity is no longer higher than the growth in wages like it used to be in the past. The trend we are observing now is more share of GDP going towards employees and less share of GDP going towards companies. Hence, we believe that in the long-term this trend will continue and raise the payroll costs.

Other occupancy and operating expenses

Other occupancy and operating expenses are related with depreciation, lease expenses and other occupancy costs that company-operated restaurants incur. Briefly, in order to forecast these costs, we compared them on a per store level over the past years and we forecasted what those per store costs would be in the future. In figure 41, we observe that these costs have been decreasing, but we expect them to go up as percentage of company-operated revenues, since we

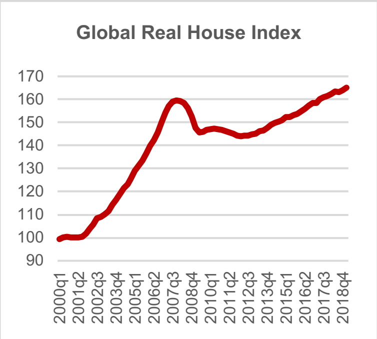

Fig. 42. Global Real House Index.
Source: IMF.

believe the decrease was artificially generated in response to high number of closed company-operated stores, which is expected to return to previous levels in the long term. Also, as we can observe on figure 42, the global real house index has been increasing which mean that the tendency is for lease expenses to continue to go up as real estate also gets more expensive, especially in big cities.

Franchised occupancy expenses

From McDonald's perspective, franchised restaurants only have one associated cost: the occupancy expense. In this line it is included depreciation from franchised restaurants, leases expense and other occupancy operating expenses. We compared these costs with the revenue from franchised restaurants in order to understand how the margin has changed (figure 43). We can see that these costs represent about 15% to 16% of franchised revenues and we estimate that, in the long run, these costs will increase slightly in relative terms. Additionally, according to the International Monetary Fund (figure 42), the real house index has been increasing in the past years and we believe this trend will continue, especially on less developed countries, leading occupancy costs to increase and thus decrease McDonald's margins.

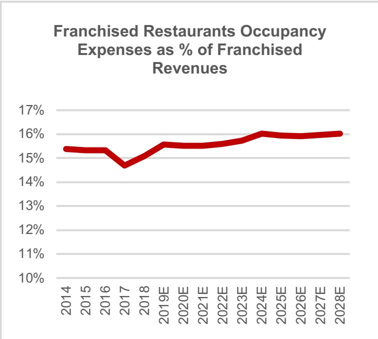

Fig. 43. SG&A as percentage of total revenues.
Source: Company Reports and Analysts Estimates

Selling, General and Administrative (SG&A)

The company refers in its annual reports that SG&A should be benchmarked with total revenues (figure 44) because it relates with both company-operated and franchised restaurants. We forecasted these costs to increase slightly in the following years as a percentage of total revenues since we believe the company will continue its strategy of acquiring new digital companies such as Apprente and Dynamic Yield (which are registered in SG&A). According to former CEO Steve Easterbrook, the next step after the investment in EOTF restaurants is to use software to improve the customer experience. This means that the EOTF provided the infrastructure necessary to create a bridge to the age of the digital, and the objective is to use this bridge to further improve the customer relationship with the brand. Furthermore, continuous investment in digital products and companies is the way to get the most benefit from the infrastructure already built, but that also requires extra spending which is registered on SG&A.

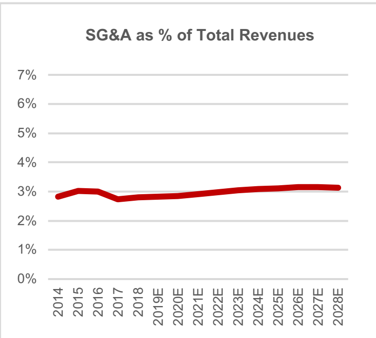

Fig. 44. SG&A as percentage of total revenues.
Source: Company Report and Analysts Estimates.

Capital Expenditures

In the last couple of years, the structure of the capital expenditure of the company has been changing. There are two main forms of capital expenditures: the growth capex, which represents the investment in new units, and the maintenance capex, which represents the investment on current stores (including the EOTF re-modelling).

From 2014 until 2018, it is observable in figure 45 that the majority of the capex switched from growth to maintenance capex, as a result of the high investment need to re-model all the restaurants for "*The Experience of the Future*". We believe that, in the short-term, the maintenance capex will continue to be higher, as the company continues to re-model its restaurants. In the long run we believe that growth capex will catch up with maintenance capex since we believe that the company will continue to invest in its restaurants and implement new features and more technology, while also growing the number of restaurants across the system.

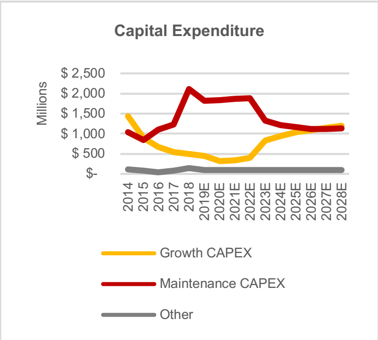

Fig. 45. Capital Expenditure Evolution.
Source: Company Report and Analysts Estimates

Working Capital

Comparing to its peers, McDonald's seems to be doing very well in terms of working capital. If we look to figure 46 and 47, we conclude that while the comparable companies have an average of 25 days of cash conversion cycle, in 2018, McDonald's has -7 days, meaning that they receive from clients 7 days before paying to suppliers. We believe that the reason for this to happen is related with the bargaining power of the company in result of their operations' volume. It is also observable, in figure 47, that both collecting period and payable period has been increasing over the period of analysis.

Year of 2018	WEN US Equity	DNKN US Equity	SBUX US Equity	DPZ US Equity	QSR US Equity	YUM US Equity
Collecting Period	25	35	6	47	22	33
Holding Period	1	1	10	77	4	2
Payable Period	5	14	9	68	6	13
Cash Conversion Cycle	**21**	**21**	**7**	**56**	**20**	**22**

Fig. 46. Cash Conversion Cycle.
Source: Bloomberg and Analyst Estimates.

We believe that, one of the possible reasons for receivables have been increasing over time is because, while the company re-franchises, the clients stop being the consumers and start being the franchisees, meaning that instead of receiving right on the spot, the company is now receiving in the form of rents and royalties that have a specific period in which they can be paid. The payable period had also increased, and we believe the reason for this to happen behind is even more bargaining power over suppliers. Although there are more franchised restaurants now, it is still the parent company who chooses suppliers; this might be giving an edge to company-operated restaurants for better terms on the payable period. This way, we believe that in the future McDonald's will continue to outperform its peers on the cash conversion cycle, following the results achieved in 2018.

	2014	2015	2016	2017	2018	2019E	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E
Collecting Period	16	18	21	28	38	38	38	38	38	38	38	38	38	38	38
Holding Period	3	3	2	2	2	2	2	2	2	2	2	2	2	2	2
Payable Period	21	23	24	30	47	47	47	47	47	47	47	47	47	47	47
Cash Conversion Cycle	**-2**	**-2**	**-1**	**0**	**-7**	**-7**	**-7**	**-7**	**-7**	**-7**	**-7**	**-7**	**-7**	**-7**	**-7**

Fig. 47. Cash Conversion Cycle.
Source: Company Reports and Analyst Estimates.

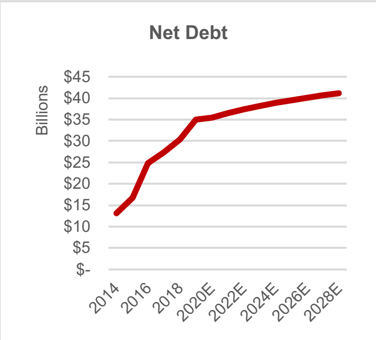

Fig. 48. McDonald's Net Debt.
Source: Company Report and Analysts Estimates

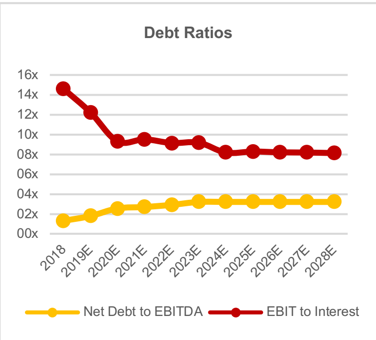

Fig. 49. McDonald's Debt Ratios.
Source: Company Report and Analysts Estimates

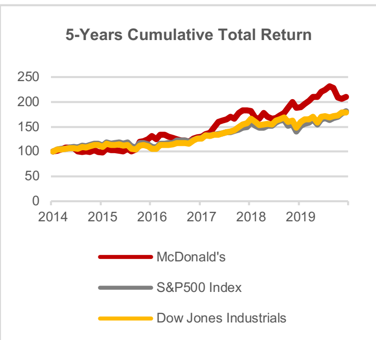

Fig. 50. Cumulative Return.
Source: Company Report.

Long-Term Debt

In the past few years McDonald's has been loading on debt, mainly using it for stock repurchasing and dividend payments. Even though the company generates enough cash flow to return cash to shareholders, it doesn't generate enough for the amount of stock that the company has been repurchasing. From figure 48 it is observable that net debt almost tripled from $13 billions, in 2014, to $30 billions, in 2018. Although this aggressive strategy has been paying up, raising the stock price from $94 a share, in January 2014, to nearly $180, in December 2018, is something that we consider dangerous, since the debt has been mainly used to return cash to shareholders and not to grow the business (through even more investment). In November 2015 Moody's downgraded the rating of McDonald's from A3 to Baa1 after the company announcement that it would return $30 billions to shareholders from 2014 until 2016, where previous shareholder return targets were around $20 billions. Moody's also described that ratios of debt to EBITDA below 3.25x and EBIT to interest above 6x would result in a future upgrade to the rating. On the other hand, a level below 3.75x debt to EBITDA and EBIT to interest close to 4x would result in a further downgrade to the rating. We believe that, in the long-term, the company will meet the ratios required to return to its previous rating (A3), and therefore We fixed the debt to EBITDA in 3.21x level. Consequently, the interest coverage ratio is expected to be around 8x (figure 49). The debt to EBITDA ratio of 3.21x is the expected for 2019 taking into account the target of $25 billions that the company should be returning to its shareholders from 2016 until 2019 through stock repurchases and dividends. The debt ratios target that we estimated will, however, require less future stock buybacks. Even so, we believe that the board of McDonald's wouldn't allow for such a prestigious company to be downgraded to a junk bond.

Shareholder Structure

As of 2019's January 31, the number of shareholders of record and beneficial owners of the Company's stock was estimated to be 2,150,000. Due to its sizable market cap, volume in operations and international character of revenues, McDonald's assumes a significant role in the industry integrating some of the most relevant indexes: the Dow Jones Industrial/Composite Average (DJIA/DJCA), S&P 100, S&P 500 and S&P 500 Consumer Discretionary. McDonald's stock clearly outperforms the S&P 500 and DJIA, from 2014 to 2019 (figure 49), which can be explained, in part, by the company efforts on returning money to shareholders either through dividends payment on common stock, either from stock repurchasing, increasing in value of the company's shares. In 2019 it was already announced a further rise of 8% to the quarterly dividend (to $1.25 per share, totalizing $5 annually).

	2014	2015	2016	2017	2018
Shares Repurchased (milions)	33,1	61,8	92,3	31,4	32,2
Shares Outstanding at year-end (milions)	963	907	819	794	767
Dividend per share	$ 3,28	$ 3,44	$ 3,61	$ 3,83	$ 4,19
Dividends Paid (million $)	$ 3 216	$ 3 230	$ 3 058	$ 3 089	$ 3 256
Treasury stock purchased (million $)	$ 3 175	$ 6 182	$ 11 142	$ 4 651	$ 5 247
Total Returned to shareholders	**$ 6 391**	**$ 9 412**	**$ 14 200**	**$ 7 740**	**$ 8 503**

Fig. 51. Cumulative Return.
Source: Company Report.

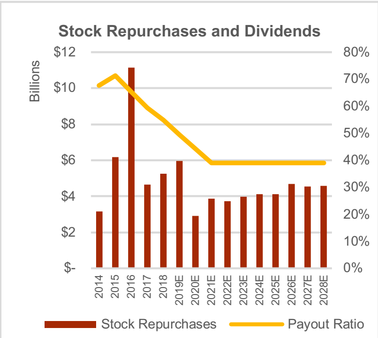

Fig. 52. Dividends and Stock Repurchases.
Source: Company Report and Analysts Estimates

Dividends and Stock Repurchases

As said before, the company has been leveraging up in order to further repurchase more of its own stock. In figure 52, we can observe that, since 2017, the company has been repurchasing at an upward pace, being expectable to do the same in 2019, up to $6 bn. To note that this decision regarding stock repurchasing not only contributes to the increase of the value per share, but also contributes for the reduction of the number of shares (and thus the dividends that the company pays). McDonald's has increased its dividend for 43 consecutive years and stop would be a bad sign to the market and deteriorate investors' expectations. Therefore, with this strategy pursuit by the company, it was possible to reduce the payout ratio from 70%, in 2015, to 55%, in 2018, while still increasing the dividend. In the following years, we believe that stock repurchases will be lower in order for the company to preserve its credit rating and even upgrade it back to Moody's A3 rating. In terms of the dividend payout, we think it will continue to decrease until it meets peers average payout ratio, which is currently on 39%. As the company has been announcing the money it returns to shareholders on a 3-year period basis, we consider important to also analyse it. With our forecasts, it is expected that around $17.5 billions will be returned to shareholders from 2020 until 2022, $19.3 billions from 2023 until 2025 and, finally, $21.5 billions from 2026 until 2028 (figure 53).

In Billions of $	Money Returned to Shareholders
2014 - 2016	30 004
2017 - 2019E	25 000
2020E - 2022E	17 496
2023E - 2022E	19 297
2026E - 2028E	21 572

Fig. 53. Money returned to shareholders by 3-year periods.
Source: Company Reports and Analysts Estimates

Weighted Average Cost of Capital

McDonald's Cost of Equity

The cost of equity represents the return that shareholders require in order to pursue an investment. In order to estimate McDonald's cost of equity we resorted to a simple Capital Asset Pricing Model (CAPM) regression.

We estimate the risk-free rate to be equal to 1.78% (as of 29th Nov. 19) based on the yield to maturity of a 10-year US treasury bond (US Generic Govt 10 Year Yield). We decided to use 10Y US treasury because: (1) the company is based in the United States and owns a considerable part of its business there; (2) the country has low default risk; and (3) 10 years is the maturity that best aligns with the cash flow streaming being valued.

The market-risk premium estimated is equal to 5%, obtained by subtracting the expected return of the MSCI World Index (that includes large and mid-caps across 23 market representations) and the risk-free rate mentioned above. In 2018, 36% of the company's revenues came from the US, while the remaining 64% came from the rest of the world, reflecting material international exposure and being the developed markets the ones that weight the most. This way, we believe that MSCI World Index is the best index and the one that better reflects McDonald's risk profile.

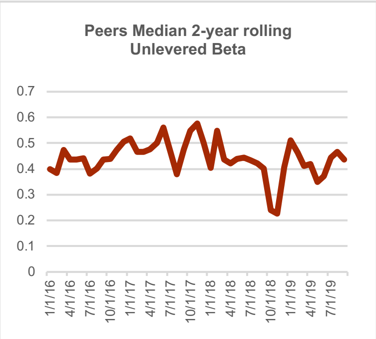

Fig. 54. Peer Median 2-Year Rolling Beta. *Source: Bloomberg and Analysts Estimates.*

In order to estimate the Beta of McDonald's we took into account different information: (1) Levered Beta of 0.43 obtained through the CAPM regression on monthly data for the last 6 years and respective 95% confidence interval equal to]0.16 ; 0.71[; (2) Peers average 2-year rolling unlevered beta (figure 54), which ranged from 0.32 to 0.60; (3) The average of Peers unlevered beta, through CAPM regression, with monthly data of the last 6 years, which resulted in an average Unlevered Beta of 0.51.

The outcome was similar in the three methods, so we decided to use the last one, resulting in a Beta of 0.58 after re-leveraging for the company capital structure. Finally, after applying the CAPM formula, the result is a cost of equity equal to 4.76%.

McDonald's Cost of Debt

The cost of debt was estimated based on the yield to maturity of McDonald's 10-year Corporate Bond in US Dollars, on the probability of default and on the loss given default of the company. Based on market values, the YTM of McDonald's Corporate Bond 10Y is 2.65%. Furthermore, the rating associated to McDonald's is Baa1 according to Moody's, which corresponds to a probability of default of 2.17%[4] (based on Cumulative Issuer-Weighted Global Default Rates for Baa1 rating modifier on a 10 year horizon) and loss given default of 40.1%[3] (based on the Recovery Rate for Corporate Bonds Sr. Unsecured). After multiplying the probability of default and loss given default, we obtain an expected credit loss of 0.87%. The cost of debt estimated based on the values mentioned above is 1.78%

Capital Structure

In order to analyse the capital structure of the company we estimated the book value of debt, the market value of equity and the value of operating leasing's. We

[4] **Source:** Annual Default Study: Corporate Default and Recovery Rates, 1920 - 2017 by Moody's Investors Service

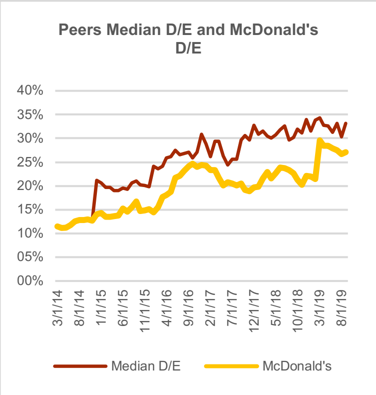

Fig. 55. McDonald's D/E Peers' Median.
Source: Bloomberg, Company Reports and Analysts Estimates.

believe that the company is under a significant amount of contractual operating leasing's and, based on leases' expense, on the usual life of those leasing's and on the cost of debt, we estimated operating leasing's to be $21.435 billions. For the value of debt, we subtracted the cash and cash equivalents from the book value of debt reported in the balance sheet of the annual report of 2018, hence obtaining a net debt of $30.209 billion. Finally, in order to estimate the market value of equity we multiplied the number of outstanding shares (*Bloomberg*, 31th Dec. 2019) by our estimated price per share of $225.91, resulting in a market value of equity equal to $170.133 billions.

In figure 55, we can observe the evolution of debt-to-equity ratio for McDonald's and its peers over the last 5 years. Although there is a clear positive trend for McDonald's and its peers, we believe that in the future the levels of debt will stagnate for McDonald's based on the motives mentioned on the previous chapter.

Taking this into account, we believe that the capital structure of McDonald's is close to what it is today, meaning that debt, operating leases and equity represent 13%, 10% and 77% of the enterprise value, respectively.

WACC Calculation

With all the ingredients in place, we were finally able to calculate the weighted average cost of capital adjusted for leases. Assuming that operating leases are equivalent to debt, after applying the WACC formula, we obtained an after-tax cost of debt of 1.41% with a weight of 23% and a cost of equity of 4.7% with a weight of 77%, resulting in a WACC of 3.94%. We considered this value to be constant in the future for valuation purposes.

Discounted Cash Flow Valuation

Return on Invested Capital

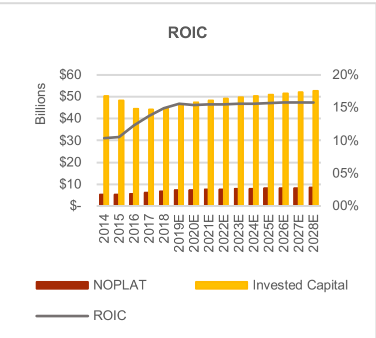

Fig. 56. McDonald's ROIC.
Source: Analysts Estimates

The return on invested capital measures how much profit is being generated on the investments made by the company. As it is observable on figure 56, the ROIC of McDonald's increased from around 10%, in 2014, to 15%, in 2018, and we believe it will go further to around 16% in perpetuity. Below we decomposed ROIC in order to understand what the drivers of the change are:

ROIC Breakdown	2014	2015	2016	2017	2018	2019E	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E
(1) EBIT/Revenues	30,7%	30,7%	33,4%	38,4%	42,7%	44,6%	45,4%	46,2%	46,6%	46,8%	46,4%	46,1%	46,0%	45,9%	45,8%
(2) Revenues/Invested Capital	54,6%	52,7%	55,5%	51,5%	46,8%	46,1%	44,9%	44,5%	44,1%	44,2%	44,7%	45,1%	45,5%	45,6%	45,7%
(3) 1 - Tax Rate	61,8%	64,8%	66,2%	69,3%	74,9%	76,3%	75,9%	75,9%	75,9%	75,9%	75,9%	75,9%	75,9%	75,9%	75,9%
ROIC = 1*2*3	10,35%	10,49%	12,30%	13,70%	14,96%	15,68%	15,47%	15,60%	15,61%	15,69%	15,73%	15,79%	15,89%	15,89%	15,89%

Fig. 57. ROIC decomposition.
Source: Analysts Estimates.

It is clear from the figure above that the re-franchising and the tax reductions in the US were the key variables impacting ROIC. The re-franchising strategy affected ROIC because operating margin increased substantially (from 30.7%, in

2014, to 42.7%, in 2019) as revenues and operating costs decreased 23% and 37%, respectively, from 2014 until 2018. The tax reform in the US was the other contributor, being one of the main policies the diminution of statutory tax-rate in 14%, from 35% to 21%, which also led the operating cash taxes to decrease substantially and thus increasing ROIC. Taking this into account, we believe that, in the long-term, ROIC will be 15.89%, slightly above of the 14.96% registered in 2018. The reason for this is that in 2018 the company is only 93% franchised, meaning that operating margin is expected to increase further, translating in higher return on invested capital. The choice of this ROIC for the long-term, much higher than the WACC, is based on the impressive dimension of the company that allows huge economies of scale and a tremendous bargaining power with suppliers and a brand that is recognized worldwide and one of the most powerful in the world.

Growth Rate

In order to estimate the growth rate of the company in perpetuity we looked into the growth rate of NOPLAT, the growth rate of the Core Free Cash Flow and the growth rate attained through the fundamental approach (figure 58). For the fundamental approach we multiplied the long-term investment rate, which is around 7.1% (according to our estimates), by the ROIC obtained, which is around 15.89%, reaching a growth rate close to 1.1%, from 2024 to 2028, as we can see below in figure 58. The NOPLAT growth rate also stabilizes around 1.1% to 1.18%, in 2027 and 2028, respectively, while the core free cash flow stabilizes around 0.8%, for the same period of analysis. Consequently, we believe the growth rate lies somewhere in between 0.8% and 1.2%, thus we decided use 1% as reference, for valuation purposes. Nevertheless, we also provide below a sensitivity analysis for this parameter.

	2019E	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E
NOPLAT growth		0,73%	2,80%	1,96%	1,89%	1,40%	1,48%	1,68%	1,10%	1,18%
Core FCF growth		5,20%	4,04%	2,49%	5,81%	2,69%	2,00%	2,01%	0,80%	0,82%
Fundamental approach - growth rate	2,67%	2,07%	1,92%	1,85%	1,33%	1,15%	1,08%	1,04%	1,08%	1,13%

Fig. 58. Growth Analysis.
Source: Analysts Estimates.

Enterprise Value

After using all the parameters and cashflows estimated, we were finally able to calculate the terminal value of the company and discount the cashflows to the present value. After doing so, we arrived at a $225.885 billions enterprise value. Then, the net financial assets were subtracted, and non-core assets added to get a value of $170.134 billions of equity. Dividing this value by the 753.090 million outstanding shares (according to Bloomberg at year-end 2019), we arrived at a value of $225.91 per share.

Sensitivity Analysis

In order to make our analysis more robust, we decided to make a sensitivity analysis to ROIC and the growth rate. It is observable in figure 59 that the valuation of McDonald's is much more sensitive to the growth rate rather than to the ROIC. Assuming a growth rate of 0.3%, the share price would be around $190, while at a growth rate of 1.7%, the share price would be between $260 and $293.

	ROIC				
Growth Rate	9,89%	12,89%	15,89%	18,89%	21,89%
0,3%	$187,8	$189,1	$190,0	$190,5	$191,0
0,8%	$207,2	$211,4	$214,0	$215,8	$217,1
1,0%	$216,8	$222,4	$225,9	$228,3	$230,0
1,2%	$227,7	$235,0	$239,5	$242,6	$244,9
1,7%	$263,6	$276,3	$284,1	$289,5	$293,4

Fig. 59. Sensitivity Analysis.
Source: Analysts Estimates.

Scenario Analysis

Our estimates and forecasts can be somewhat different from what we observe in reality, therefore, we made a scenario analysis to the forecasts of revenues and restaurant-related costs in order to understand how much the stock is susceptible to move with those variables. For example, in a bad scenario, if the revenues are lower 4% than our estimates, from 2019 onwards, and if restaurant related costs are higher 4%, the stock value would be $180.6. In a good scenario, if revenues are higher 4% than estimated and restaurant-related costs are lower 4%, the stock would be worth $271.2 (figure 60).

	Change in Restaurant Related Costs				
Change in Revenues	-4,0%	-2,0%	0,0%	2,0%	4,0%
-4,0%	$205,9	$199,6	$193,3	$186,9	$180,6
-2,0%	$222,3	$215,9	$209,6	$203,2	$196,9
0,0%	$238,6	$232,3	$225,9	$219,6	$213,2
2,0%	$254,9	$248,6	$242,2	$235,9	$229,5
4,0%	$271,2	$264,9	$258,5	$252,2	$245,8

Fig. 60. Scenario Analysis.
Source: Analysts Estimates

Relative Valuation

The quick service restaurants (QSR) exist for almost 100 years and therefore the market is well established through well-known fast food companies. Taking this into account we believe that we should make a relative valuation in order to understand how our price-target benchmarks with the relative valuation.

In this analysis we took into account the 6 comparable firms mentioned above and calculated the multiples for P/E, EV/Net Income, EV/EBITDA and

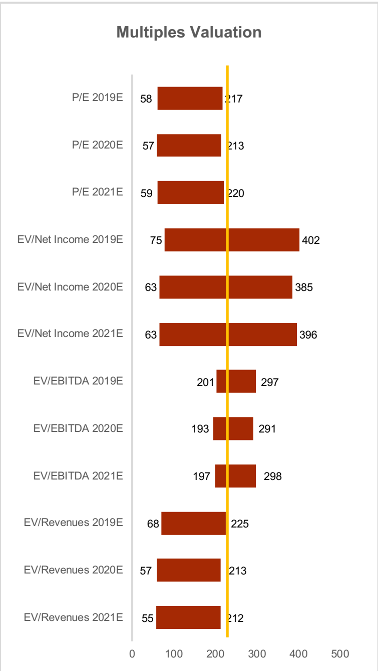

Fig. 61. Relative Valuation.
Source: Bloomberg and Analysts Estimates

EV/Revenues, which are the most common in this type of analysis. Then, as we can observe in figure 61, we applied the multiples estimated in 2018 to the forecasted EPS, net income, EBITDA and Revenues in order to estimate the price ranges in 1,2 and 3 years. This chart is called a football field and it shows what are the minimum and maximum share price considering the minimum and maximum multiple of the comparable companies. Considering our price target of $225.91 per share we can conclude that it is in the high-end of the range of the P/E and EV/Revenues, on the low-end of the EV/EBITDA and almost in the middle for the EV/Net Income. We believe that overall the relative valuation strengths our price target and that the intrinsic value of the company is close to it.

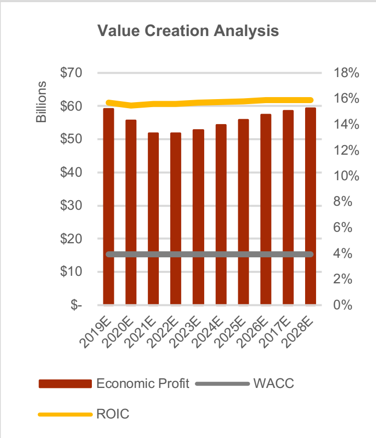

Fig. 62. Value Creation Analysis.
Source: Analysts Estimates

Value Creation Analysis

A value creation analysis was made in order to analyse the economic profit being originated per year. The economic profit is the spread between the *Return on Invested Capital* and *Weighted Average Cost of Capital* times the *Invested Capital* in that period of analysis. The objective of this measure is to estimate the value being created to shareholders per period, which in this case is represented in dollars. In figure 62, we can conclude that the Economic Profit is expected to be between $50 and $60 billion per year, which can be interpreted as the value being generated to shareholders.

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Appendix

I. Consolidated Statement of Income

Consolidated Statement of Income

In millions	2014	2015	2016	2017	2018	2019E	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E
Sales by Company-operated restaurants	18 169	16 488	15 295	12 719	10 013	9 490	8 910	8 627	8 399	8 322	8 485	8 678	8 843	8 969	9 097
Revenues from franchised restaurants	9 272	8 925	9 327	10 102	11 013	11 759	12 245	12 736	13 173	13 592	13 910	14 201	14 452	14 654	14 857
Total revenues	**27 441**	**25 413**	**24 622**	**22 820**	**21 025**	**21 249**	**21 156**	**21 364**	**21 572**	**21 914**	**22 395**	**22 879**	**23 295**	**23 623**	**23 953**
Food & paper	6 130	5 552	4 897	4 034	3 154	3 233	3 035	2 939	2 861	2 835	2 890	2 956	3 012	3 055	3 098
Payroll & employee benefits	4 756	4 400	4 134	3 529	2 938	2 608	2 419	2 321	2 255	2 236	2 288	2 359	2 402	2 445	2 489
Occupancy & other operating expenses	4 403	4 025	3 668	2 848	2 174	1 937	1 893	1 876	1 872	1 871	1 907	1 959	1 989	2 021	2 055
Company-operated restaurant expenses	**15 288**	**13 977**	**12 699**	**10 410**	**8 266**	**7 778**	**7 346**	**7 135**	**6 987**	**6 941**	**7 085**	**7 274**	**7 403**	**7 522**	**7 643**
Company-Operated Gross Margin	*15,9%*	*15,2%*	*17,0%*	*18,2%*	*17,4%*	*18,0%*	*17,6%*	*17,3%*	*16,8%*	*16,6%*	*16,5%*	*16,2%*	*16,3%*	*16,1%*	*16,0%*
Franchised restaurants-occupancy expenses	**1 697**	**1 647**	**1 719**	**1 790**	**1 974**	**2 147**	**2 222**	**2 303**	**2 384**	**2 469**	**2 560**	**2 599**	**2 637**	**2 678**	**2 720**
Franchised restaurants Gross Margin	*81,7%*	*81,5%*	*81,6%*	*82,3%*	*82,1%*	*81,7%*	*81,9%*	*81,9%*	*81,9%*	*81,8%*	*81,6%*	*81,7%*	*81,8%*	*81,7%*	*81,7%*
Total Gross Profit	**10 456**	**9 789**	**10 205**	**10 621**	**10 786**	**11 325**	**11 587**	**11 926**	**12 201**	**12 503**	**12 750**	**13 007**	**13 255**	**13 423**	**13 591**
Total Gross Margin	*38,1%*	*38,5%*	*41,4%*	*46,5%*	*51,3%*	*53,3%*	*54,8%*	*55,8%*	*56,6%*	*57,1%*	*56,9%*	*56,8%*	*56,9%*	*56,8%*	*56,7%*
Selling, general & administrative expenses	**2 488**	**2 434**	**2 385**	**2 231**	**2 200**	**2 233**	**2 381**	**2 452**	**2 538**	**2 652**	**2 758**	**2 863**	**2 936**	**2 990**	**3 032**
Other operating (income) expense, net	**19**	**209**	**76**	**-1 163**	**-237**	**-112**	**-147**	**-147**	**-147**	**-147**	**-147**	**-147**	**-147**	**-147**	**-147**
EBIT	**7 949**	**7 146**	**7 744**	**9 553**	**8 822**	**9 203**	**9 353**	**9 621**	**9 810**	**9 998**	**10 139**	**10 291**	**10 466**	**10 581**	**10 706**
Operating Margin	*29,0%*	*28,1%*	*31,5%*	*41,9%*	*42,0%*	*43,3%*	*44,2%*	*45,0%*	*45,5%*	*45,6%*	*45,3%*	*45,0%*	*44,9%*	*44,8%*	*44,7%*
Interest expense-net of capitalized interest	576	638	885	921	981	1 032	1 162	1 180	1 214	1 240	1 266	1 291	1 312	1 334	1 350
Nonoperating (income) expense, net	1	-49	-6	58	25	-59	16	18	20	22	24	26	24	24	24
EBT	**7 372**	**6 556**	**6 866**	**8 573**	**7 816**	**8 230**	**8 175**	**8 423**	**8 576**	**8 736**	**8 849**	**8 975**	**9 130**	**9 223**	**9 333**
EBT Margin	*27%*	*26%*	*28%*	*38%*	*37%*	*39%*	*39%*	*39%*	*40%*	*40%*	*40%*	*39%*	*39%*	*39%*	*39%*
Provision for income taxes	2 614	2 026	2 180	3 381	1 892	2 576	2 604	2 669	2 715	2 761	2 795	2 833	2 578	2 606	2 637
Effective Tax Rate	36%	31%	32%	39%	24%	27%	27%	27%	27%	27%	27%	27%	24%	24%	24%
Net income	**4 758**	**4 529**	**4 686,4**	**5 192**	**5 924**	**5 654**	**5 571**	**5 754**	**5 861**	**5 975**	**6 054**	**6 142**	**6 553**	**6 617**	**6 696**
Profit Margin	*17%*	*18%*	*19%*	*23%*	*28%*	*27%*	*26%*	*27%*	*27%*	*27%*	*27%*	*27%*	*28%*	*28%*	*28%*

II. Consolidated Balance Sheet

Consolidated Balance Sheet

In Millions of USD except Per Share	2014	2015	2016	2017	2018	2019E	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E
Current assets															
Cash and equivalents	2 078	7 686	1 223	2 464	866	274	254	246	228	210	212	212	214	216	219
Accounts and notes receivable	1 214	1 299	1 474	1 976	2 442	2 232	2 223	2 244	2 266	2 302	2 353	2 404	2 447	2 482	2 516
Inventories, at cost, not in excess of market	110	100	59	59	51	48	45	44	43	43	44	45	46	47	47
Prepaid expenses and other current assets	762	559	565	828	695	604	601	607	613	623	636	650	662	671	681
Assets of businesses held for sale	0	0	1 527	0	0	0	0	0	0	0	0	0	0	0	0
Total current assets	4 164	9 643	4 849	5 327	4 053	3 159	3 123	3 142	3 151	3 178	3 245	3 310	3 369	3 415	3 463
Other assets															
Investments in and advances to affiliates	1 005	793	726	1 086	1 203	1 265	1 318	1 371	1 424	1 480	1 511	1 542	1 573	1 605	1 638
Goodwill	2 988	2 274	2 062	2 312	3 101	3 101	3 101	3 101	3 101	3 101	3 101	3 101	3 101	3 101	3 101
Miscellaneous	1 153	1 336	1 051	1 695	1 162	1 134	1 130	1 141	1 152	1 170	1 196	1 221	1 243	1 261	1 279
Total other assets	**5 145**	**4 403**	**3 839**	**5 093**	**5 465**	**5 500**	**5 548**	**5 612**	**5 677**	**5 750**	**5 807**	**5 864**	**5 918**	**5 967**	**6 017**
Property and equipment															
Property and equipment, at cost	39 126	37 692	34 443	36 626	37 194	39 557	41 805	44 094	46 453	48 695	50 939	53 227	55 519	57 878	60 305
Accumulated depreciation & Amortization	-14 569	-14 575	-13 186	-14 178	-14 351	-15 886	-17 470	-19 110	-20 807	-22 558	-24 397	-26 283	-28 202	-30 154	-32 143
Net property and equipment	24 558	23 118	21 258	22 448	22 843	23 671	24 335	24 984	25 646	26 137	26 543	26 943	27 318	27 724	28 162
Total assets	**33 867**	**37 164**	**29 945**	**32 868**	**32 361**	**32 330**	**33 006**	**33 738**	**34 474**	**35 065**	**35 595**	**36 117**	**36 604**	**37 106**	**37 642**
Current liabilities															
Accounts payable	860	875	756	925	1 208	1 003	947	920	900	894	913	938	954	970	985
Income taxes	167	155	267	266	228	242	245	252	257	262	266	270	274	277	280
Other taxes	330	309	266	275	254	268	271	279	285	290	294	298	303	307	310
Accrued interest	234	233	248	278	297	234	236	237	239	240	241	243	244	245	247
Accrued payroll and other liabilities	1 157	1 379	1 159	1 146	987	902	835	800	776	762	765	781	789	797	805
Current maturities of long-term debt	0	0	77	0	0	0	0	0	0	0	0	0	0	0	0
Liabilities of businesses held for sale	0	0	880	0	0	0	0	0	0	0	0	0	0	0	0
Loss carryforwards, net of taxes	1	-97	-125	92	625	99	99	99	99	99	99	99	99	99	99
Total current liabilities	**2 749**	**2 853**	**3 529**	**2 983**	**3 599**	**2 748**	**2 634**	**2 588**	**2 556**	**2 548**	**2 579**	**2 628**	**2 664**	**2 695**	**2 727**
Long-term debt	14 936	24 122	25 879	29 536	31 075	34 983	35 512	36 548	37 340	38 117	38 849	39 491	40 154	40 633	41 155
Long-term income taxes	0	0	0	2 371	2 081	1 784	1 487	1 189	892	595	297	0	0	0	0
Deferred revenues - initial franchise fees	0	0	0	0	628	644	654	663	671	680	687	694	701	709	716
Other long-term liabilities	2 066	2 074	2 064	1 154	1 096	1 096	1 096	1 096	1 096	1 096	1 096	1 096	1 096	1 096	1 096
Net Deferred Income Tax Liabilities	1 263	1 027	678	92	140	104	106	109	111	113	114	116	118	119	121
Shareholders' equity (Deficit)															
Common stock	17	17	17	17	17	17	17	17	17	17	17	17	17	17	17
Additional paid-in capital	6 239	6 533	6 758	7 072	7 376	7 660	7 944	8 229	8 513	8 797	9 081	9 366	9 650	9 934	10 218
Retained earnings	43 295	44 595	46 223	48 326	50 487	53 342	56 448	59 958	63 532	67 177	70 870	74 616	78 613	82 649	86 733
Accumulated other comprehensive income	-1 520	-2 880	-3 093	-2 178	-2 610	-2 766	-2 903	-3 007	-3 079	-3 117	-3 123	-3 129	-3 135	-3 140	-3 146
Common stock in treasury, at cost	-35 177	-41 177	-52 109	-56 504	-61 529	-67 282	-69 987	-73 650	-77 175	-80 957	-84 872	-88 778	-93 274	-97 606	-101 995
Total shareholders' equity (deficit)	12 853	7 088	-2 204	-3 268	-6 258	-9 029	-8 481	-8 455	-8 192	-8 084	-8 028	-7 909	-8 130	-8 147	-8 173
Total liabilities and shareholders' equity (deficit)	**33 867**	**37 164**	**29 945**	**32 868**	**32 361**	**32 330**	**33 006**	**33 738**	**34 474**	**35 065**	**35 595**	**36 117**	**36 604**	**37 106**	**37 642**

III. Consolidated Statement of Cash Flows

Consolidated Statement of Cash Flows

In millions	2014	2015	2016	2017	2018	2019E	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E
NOPLAT	5207	5061	5452	6074	6714	7231	7284	7488	7634	7779	7888	8005	8139	8228	8325
Depreciation	1645	1556	1517	1363	1482	1535	1584	1640	1697	1751	1839	1887	1918	1952	1989
Operational Cash-Flow	**6851**	**6617**	**6969**	**7437**	**8196**	**8767**	**8868**	**9127**	**9331**	**9530**	**9727**	**9892**	**10057**	**10181**	**10314**
Change in Operational Cash	0	20	8	18	18	-64	20	8	18	18	-2	1	-2	-2	-3
Change in Accounts and notes receivable	0	-84	-175	-502	-465	209	10	-22	-22	-36	-51	-51	-44	-34	-35
Change in Inventories, at cost, not in excess of market	0	10	41	0	8	3	3	1	1	0	-1	-1	-1	-1	-1
Change in Accrued payroll and other liabilities	0	222	-220	-13	-160	-85	-67	-35	-24	-13	3	16	8	8	8
Change in Accounts Payable	0	15	-119	169	283	-205	-56	-27	-19	-6	19	24	17	15	16
Change in Deferred revenues - initial franchise fees	0	0	0	0	628	16	10	9	9	8	8	7	7	7	7
Change in Income taxes	0	-12	112	-1	-38	14	3	7	5	5	4	4	5	3	3
Change in Other taxes	0	-21	-43	9	-22	14	3	8	5	5	4	4	5	3	4
Investment in NWC and Others	**0**	**149**	**-395**	**-321**	**252**	**-98**	**-74**	**-51**	**-28**	**-18**	**-17**	**5**	**-5**	**0**	**-1**
Capital expenditures, net of disposals	0	-116	344	-2554	-1876	-2364	-2248	-2289	-2359	-2242	-2245	-2287	-2293	-2359	-2427
Change in Investments in capitalized operating leases	0	261	2364	1896	-299	-245	-184	-170	-163	-95	-122	-120	-121	-122	-123
Change in Investments in and advances to affiliates	0	212	67	-360	-117	-62	-53	-53	-54	-55	-31	-31	-31	-32	-32
Net Investment	**0**	**357**	**2775**	**-1018**	**-2292**	**-2671**	**-2484**	**-2512**	**-2575**	**-2392**	**-2398**	**-2439**	**-2445**	**-2512**	**-2582**
Investment Cash-Flow	**0**	**506**	**2380**	**-1339**	**-2040**	**-2769**	**-2558**	**-2563**	**-2603**	**-2411**	**-2415**	**-2434**	**-2450**	**-2513**	**-2583**
Core Free Cash Flow	6851	7123	9349	6098	6156	5998	6310	6565	6728	7120	7311	7457	7607	7668	7731
Nonoperating income after taxes	-1963	-1527	-249	1996	-197	40	11	42	73	104	135	133	135	135	134
Nonoperating taxes	604	956	948	-102	314	-294	-293	-293	-293	-293	-293	-293	4	4	4
Operational Cash-Flow	**-1358**	**-571**	**699**	**1893**	**117**	**-254**	**-282**	**-251**	**-220**	**-189**	**-159**	**-161**	**139**	**139**	**139**
Change in Prepaid expenses and other current assets	0	201	-6	-264	134	92	3	-6	-6	-10	-14	-14	-12	-9	-9
Change in Assets of businesses held for sale	0	0	-1527	1527	0	0	0	0	0	0	0	0	0	0	0
Change in Miscellaneous	0	-184	281	-645	533	30	5	-11	-11	-18	-26	-26	-22	-17	-18
Change in Goodwill	0	713	212	-250	-788	0	0	0	0	0	0	0	0	0	0
Change in Loss carryforwards, net of taxes	0	-99	-27	217	533	-526	0	0	0	0	0	0	0	0	0
Change in Liabilities of businesses held for sale	0	0	880	-880	0	0	0	0	0	0	0	0	0	0	0
Change in Other long-term liabilities	0	8	-10	-910	-58	0	0	0	0	0	0	0	0	0	0
Change in Long-term income taxes	0	0	0	2371	-290	-297	-297	-297	-297	-297	-297	-297	0	0	0
Investment Cash-Flow	**0**	**640**	**-195**	**1165**	**64**	**-702**	**-290**	**-314**	**-314**	**-325**	**-337**	**-337**	**-34**	**-27**	**-27**
Nonoperating Cash flow	**-1358**	**69**	**503**	**3058**	**181**	**-956**	**-572**	**-566**	**-534**	**-515**	**-495**	**-497**	**105**	**112**	**112**
Cash Flow available to investors	**5493**	**7192**	**9852**	**9156**	**6338**	**5042**	**5738**	**5999**	**6194**	**6605**	**6816**	**6960**	**7712**	**7780**	**7843**

Financial Income	-1038	-1085	-1329	-1274	-1386	-1444	-1569	-1590	-1627	-1655	-1683	-1710	-1733	-1757	-1775
Increase in operating tax liabilities	0	-236	-349	-586	48	-36	1	3	2	2	2	2	2	1	1
Change in Cash and equivalents	0	-5628	6454	-1258	1580	656	0	0	0	0	0	0	0	0	0
Change in Prepaid expenses and other current assets	0	3	-1	1	0	-1	0	0	0	0	0	0	0	0	0
Change in Miscellaneous	0	1	4	2	0	-3	0	0	0	0	0	0	0	0	0
Change in Accrued interest	0	-1	14	31	19	-63	2	2	2	1	1	1	1	1	1
Change in Current maturities of long-term debt	0	0	77	-77	0	0	0	0	0	0	0	0	0	0	0
Change in Capitalized Operating Leases	0	-261	-2364	-1896	299	245	184	170	163	95	122	120	121	122	123
Change in Long-term debt	0	9186	1756	3658	1539	3908	529	1037	791	777	732	642	663	480	522
Flow to Debt Holders	**-1038**	**1979**	**4263**	**-1400**	**2098**	**3262**	**-853**	**-379**	**-669**	**-779**	**-826**	**-944**	**-946**	**-1153**	**-1128**
Change in Operating deferred-tax liabilities (assets)	0	-236	-349	-586	48	-36	1	3	2	2	2	2	2	1	1
Cash Dividends	-3216	-3230	-3058	-3089	-3256	-2799	-2466	-2244	-2286	-2331	-2361	-2396	-2556	-2581	-2612
Repurchased (issued) shares	-3175	-6182	-11142	-4651	-5248	-5956	-2907	-3866	-3727	-3984	-4117	-4108	-4699	-4534	-4591
Share-based compensation	113	110	131	118	125	119	119	119	119	119	119	119	119	119	119
Stock option exercises and other	312	368	303	452	402	367	367	367	367	367	367	367	367	367	367
Adoption of ASC 606	0	0	0	0	-450	0	0	0	0	0	0	0	0	0	0
Adoption of ASU 2016-16	0	0	0	0	-57	0	0	0	0	0	0	0	0	0	0
Flow to Equity Holders	**-5967**	**-9171**	**-14115**	**-7756**	**-8436**	**-8304**	**-4885**	**-5620**	**-5525**	**-5826**	**-5990**	**-6016**	**-6766**	**-6627**	**-6715**
Cash Flow available to investors	**-7005**	**-7192**	**-9852**	**-9156**	**-6338**	**-5042**	**-5738**	**-5999**	**-6194**	**-6605**	**-6816**	**-6960**	**-7712**	**-7780**	**-7843**

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Buy	Expected total return (including expected capital gains and expected dividend yield) of more than 10% over a 12-month period.
Hold	Expected total return (including expected capital gains and expected dividend yield) between 0% and 10% over a 12-month period.
Sell	Expected negative total return (including expected capital gains and expected dividend yield) over a 12-month period.

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MCDELIVERY IN THE ONLINE FOOD DELIVERY INDUSTRY

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A Project carried out on the Master in Finance Program, under the supervision of:

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Abstract

Online Food Delivery was worth $83 billion in 2018 and is expected to grow to $200 billion by 2025. McDonald’s partnered with Uber Eats and others to create the McDelivery, service that is expected to represent $4 billion in sales at year-end 2019. In this report there is an in-depth analysis to the advantages and disadvantages of providing this new service that has proven to be a rewarding challenge for McDonald’s. The geographic growth opportunities in delivery are also analyzed and compared with McDonald’s restaurant coverage of those areas, responding on how those opportunities can turn a profit.

Keywords

McDelivery, Delivery, Growth, McDonald’s

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McDelivery in the Online Food Delivery Industry

Nowadays we live in the era of the digital, where everything we seem to know and take for granted is constantly changing and there are new services, new technologies and new consumer preferences. Delivery appeared as consumers sought convenience and platforms like Uber Eats created a response for those needs. According to an article published by Sarwant Singh (from Frost & Sullivan) in the Financial Times, the Online Food Delivery (OFD) industry was estimated to be around $83 billions in 2018 worldwide, and set to more than double by 2025, backed by a cumulative annual growth rate of 14%. These numbers can be double-checked with Appendix 1, where we observe that OFD revenues are in an upward trend. According to Statista, users for this service are also on the rise, being 1 billion worldwide in 2018 and expected to be around 1.6 billion in 2023.

McDelivery

According to CNBC, McDonald's filled for the trademark "McDelivery" (McDonald's delivery system) in 1993. The company has tried to create its own Restaurant-to-Consumer delivery system to complement its offerings, but never quite made it. Instead, the company decided to make partnerships with the main platforms of each region in order to provide this new service to their customers. Kevin Ozan, Executive Vice President and CFO of McDonald's announced, on the third quarter earnings call of 2019, that McDelivery was already present in over 23,000 restaurants worldwide in over 80 countries, having been registered 10 delivery calls per second, on average, worldwide, which represents close to 26 million orders a month. Moreover, these orders amount to two times the average check in restaurants, on average, globally. As it is observable in Appendix 2, the price/mix, which represents the percentage change in the average check per order, has been incredibly high, driven by menu price increases but mainly due to the double average checks seen in the McDelivery. In terms of size, the McDelivery is expected to represent 4% of global systemwide sales in 2019, which is equivalent to $4 billions. If we compare this number with the forecasted $108 billions of market size for the online food delivery industry in 2019, it represents a market-share of 3.7% (globally).

I. Advantages

The main advantage for McDonald's is enhanced revenues through (i) Higher average check; (ii) New customers: Steve Easterbrook commented on the fourth quarter earnings call of 2018 that delivery showed an incrementality around 70%, meaning that 70% of delivery sales wouldn't happen if the service didn't exist. Also, 60% of the online delivery orders are made off-peak hours, which reinforces the idea that it is bringing new customers. (ii) Increased order frequency: the company also states in the annual report of 2018 that satisfaction and re-ordering ratio are high and that the likeliness of re-ordering for these customers is also high.

Apart from the revenues increase, the company also benefits from more customer interaction with the brand through the delivery platform, raises fidelity for customers that truly appreciate McDonald's and also raises an opportunity for McDonald's to do targeted discounts through delivery platforms.

II. Disadvantages

Although believing that McDelivery was a good decision for McDonald's and that it raised its intrinsic value, it also brings some disadvantages that are important to point out. According to an article written by Nathaniel Meyersohn in the CNN Business, Uber Eats partnerships can be dangerous for the restaurants: (i) Profitability: with so much competition in the food industry, especially on the quick-service restaurants, having to pay service fees of 15% to 30% to platforms can be unbearable, even more taking into account that when ordering, customers are less likely to ask for core menu items; (ii) Cannibalization: although McDonald's says that 70% of the orders are incremental, there is always a share that is cannibalization from restaurant revenues; (iii) Poor food quality: food in a package for too much time might result in cold and lower quality food, damaging the McDonald's brand; (4) Changing loyalties: when using a platform, the customer is interacting with the delivery service and not with McDonald's, meaning that it gives an incentive for the customer to change their loyalty from the brand itself to the courier's brand.

Geographic Opportunities

Considering the growth opportunities in the OFD market, it is important to analyse if McDonald's can take an advantage. Taking into account that around 70% of the McDelivery sales are incremental, as the OFD market grows, McDonald's sales will grow too.

At the end of 2018, McDonald's had 8,514 stores located in Europe, its second largest market by geography. This are good news as Europe is also one of the geographies where the compound annual growth rate (CAGR) is higher: 11.9% (Appendix 3). According to Statista, the UK is expected to have a CAGR equal to 9.3%, Germany equal to 9.6%, France equal to 13.7%, Spain equal to 14.1% and Italy equal to 11.7%. These 5 countries count to a total of 5,337 stores, meaning that McDonald's is well positioned to have sale increases there. However, this market is also very small compared with the others, amounting only $14 billions in delivery sales for the year of 2018. This means that although there is growth, the size of the market isn't big enough to have a huge impact on the McDonald's overall sales.

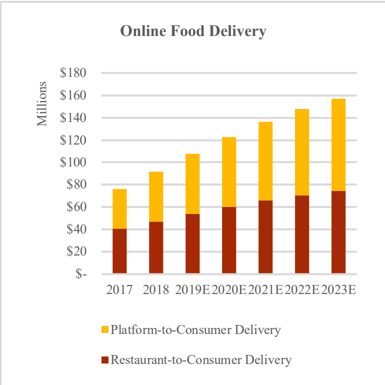
United States is the biggest country for McDonald's and the one that generates more revenues, representing 13,914 of the total McDonald's restaurants. In Appendix 4 we can observe that the US had a market size of around $20 billions in 2018 and is expected to grow at a CAGR of 7.1% until 2023. This might be the segment where incremental sales will increase more if McDonald's holds its market share in the Online Food Delivery industry because it has a decent volume and decent growth rate.

From the geographies analysed, China is the one that has less representation with only 3,002 stores. However, it is the market where Online Food Delivery shines, with a size of around $34 billions in 2018 and compound annual growth rate of 11.2% until 2023. (Appendix 5) McDonald's revealed that it expects to open around 600 stores in China in the year of 2019 (and a total of 1200 worldwide). Taking this into account, there is reason to believe that China sales will increase both because there are more stores and because there are more incremental sales, namely through delivery and its growth.

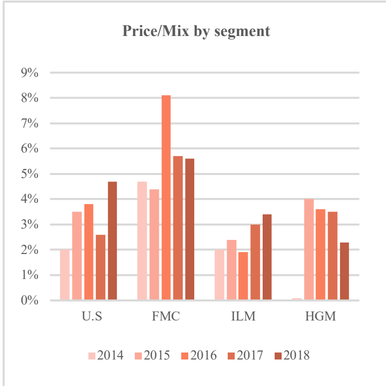
Conclusion

Taking into account the estimated market share of McDonald's in the OFD industry, which is equal to 3.7%, and the revealed incremental sales of 70% on delivery, we can estimate what are the incremental sales increase worldwide from 2019 until 2023 through delivery (Appendix 6). Assuming that McDonald's will keep its market-share over time in the Online Food Delivery industry in sales, McDelivery is expected to increase from $4 billions in 2019 to around $5.8 billions in 2023 (of which 70%, equivalent to $4 billion, represent incremental sales). It might not seem a lot taking into account that we are talking of a company with around $90-$100 billions in sales per year, but the magic word is "incremental". McDonald's doesn't want to grow their sales only with store counts. The breakfast items, McCafé, plant based Beyond Meat burgers and much more is proof that they want to attract new clients and make them stick around. Furthermore, delivery is one more step to grow the business and it is one of the main drivers of same-store sales nowadays. Finally, it is important to point out that awareness of McDelivery existence is still low and as the company invests more on customer awareness, it is likely that its share on the worldwide Online Food Delivery market grows as well. On the other side, McDelivery might also cause harm on the long-term perspective because it might deteriorate customers perspective on food quality, followed by the reasons presented before.

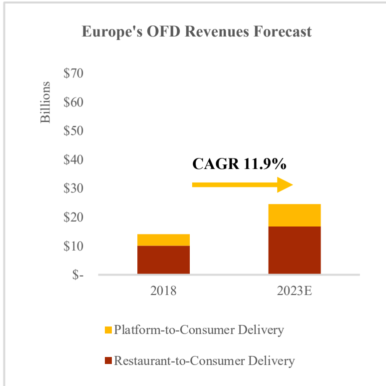
Appendix



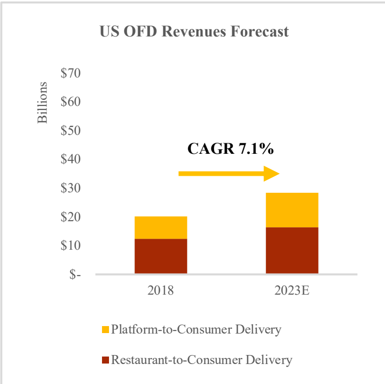
Appendix 1. Revenues and Forecasts for the OFD market.
Source: Statista



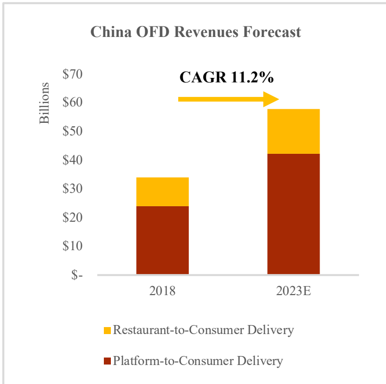
Appendix 2. Price/Mix by McDonald's Segments.
Source: Bloomberg



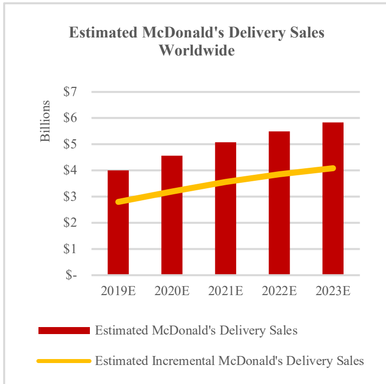
Appendix 3. Europe Online Food Delivery Revenue Forecast.
Source: Statista



Appendix 4. US Online Food Delivery Revenue Forecast.
Source: Statista



Appendix 5. China Online Food Delivery Revenue Forecast.
Source: Statista



Appendix 6. Estimated McDonald's Delivery Sales Worldwide.
Source: Statista and Analyst Estimate.

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