

McDonalds stock essay



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McDonald's Corporation Stock Analysis FI 560 Securities Analysis Company

Overview McDonald's has been in business since 1940, and now employs over 400, 000 people worldwide. The company has restaurants all throughout North and South America, Europe, Australia and Asia, but are only thinly represented in the Middle East and Africa. The primary food products the company serves are hamburgers, cheeseburgers, chicken meals, french fries, coffee and milkshakes, but McDonald's is beginning to offer healthier products like wraps and salads. McDonald's serves 64 million customers each day.

McDonald's sells its products in 117 countries and operates 32, 737 restaurants as of the end of 2010. Of the restaurants, 80% are franchised or licensed, and the remaining 20% are operated by the company. Under their franchise arrangement, franchisees provide a portion of the capital required by initially investing in the equipment, signs, seating and decor of their restaurant businesses, and by reinvesting in the business over time. The Company owns the land and building or secures long-term leases for both Company-operated and conventional franchised restaurant sites.

This maintains long-term occupancy rights, helps control related costs and assists in alignment with franchisees (MCD, 2010). The Company's revenues consist of sales by Company operated restaurants and fees from restaurants operated by franchisees. Revenues from conventional franchised restaurants include rent and royalties based on a percent of sales along with minimum rent payments, and initial fees. Revenues from restaurants licensed to affiliates and developmental licensees include a royalty based on a percent

of sales, and generally include initial fees. Life Cycle Analysis McDonald's is a Classic-Growth company.

The one issue most investors worry about with a Classic-Growth company is that it will peak and move into the declining stage. McDonald's is currently doing reasonable not as high as more aggressive growth companies but provides dependable returns. One reason McDonalds could move to declining status is if it saturated the U. S. market. McDonald's domestic growth has been 5% in recent years and its international growth has been 10-15%. McDonald's and its franchisees started investing in the business at a time when diners are reacting to economic volatility by carefully managing their spending.

The strategy has helped McDonald's win market share from rivals that are smaller and have less financial heft. The company has been making its restaurants in Europe and the United States more modern and inviting. That effort is boosting sales and making service faster and more efficient (MCD Growth, 2011). I believe the introduction of new product lines such as McCafe beverages and frappes and smoothies have also helped to increase market share. Industry Forces McDonald's believes it is important to be an industry leader in all aspects especially when it comes to being socially responsible.

The most recent challenge facing the company has been the Sparboe allegations. The company recently announced they will no longer accept eggs from one of the country's, biggest egg companies, Sparboe Farms. The decision comes after Sparboe was cited by the FDA for significant and

serious violations in the production of eggs. In response McDonald's released the following statement, " Regarding the undercover videos, the behavior on tape is disturbing and completely unacceptable. McDonald's wants to assure our customers that we demand humane treatment of animals by our suppliers.

We take this responsibility - along with our customers' trust - very seriously. " (Sparboe, 2011). Competition As well as Industry Forces, McDonalds has competitive forces as well. McDonald's main competitors are Burger King Corporation, Wendy's International, Inc. , Jack in the Box Inc. , Sonic Corporation, White Castle System, Inc. , and YUM! Brands, Inc. Even with all these competitors and even during the 1980's through today McDonalds has always maintained a steady growth and continued to capture more market share (FundU, 2011). Analysis of Return on Equity, ROE ROE has been increasing during the last 10 years (see Graph 1 below).

This I feel is primarily due to McDonald's reorganization strategy. Since its reorganization in 2002 McDonalds has been focused on existing domestic store growth with limited expansion and the payment of debt and equity reacquisition. This combined with an increased focused earnings and a decrease in outstanding equity becomes the perfect storm for a good ROE.

Graph 1: McDonald's 10 Year Historic ROE (Lovin, 2011) Analysis of Required Rate of Return Given the calculations below the required rate of return for McDonald's being 4. 1% this makes this a better return for the risk.

Given that analysts are projecting returns between 10% - 13% and are currently on track to meeting those expectations the return for the required

risk is most favorably acceptable. Variables for calculation: Risk Free Rate = 2.07%, per US Treasury 10 Year Bond as of 12/9/11 Market Risk Premium = 5.5%, (MRP, 2011) Beta = .36, Per Yahoo Finance, MCD Required return = risk free rate + (market risk premium)(beta) Required Return = .0207 + (.055)(.36) = 4.1% Intrinsic Valuation Based on the high dividend growth rate I'm unable to calculate the intrinsic value of McDonald's using the dividend discount model.

Over the past five years McDonald's has been able to increase its dividend by approximately 20% annually. The most recent increase was from .61 to .70 per quarter, which represents a nearly 15% increase. Analysts expect that over the long term, this rate will need to decrease to the lower double digits and eventually to the high single digits. This growth rate obviously exceeds the required return for the stock making the dividend discount model impossible to use. Using the current EPS, 5.10, and P/E ratio of 19.23, McDonald's intrinsic value is \$98.07 which is in line with where it closed on December 9, 2011.

Recommendation I recommend going long on McDonald's, given the strong history of dividend growth and its recent ability to increase market share in Europe and China. The company's fundamentals are strong and they are the leader in the fast food restaurant industry. A P/E ratio of 19 is still attractive for this industry. References 1. McDonald's 2010 Annual Report (MCD, 2010); Retrieved from McDonalds Corporation http://www.aboutmcdonalds.com/mcd/investors/annual_reports.html 2. McDonald's Analysis: I'm Still Lovin' It (Lovin, 2011); Retrieved from The Dividend Pig <http://www.thedividendpig.com/?p=1106> Published March 17, 2011 3. McDonalds <https://assignbuster.com/mcdonalds-stock-essay/>

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