FIN 5215: Securities Analysis & Portfolio Management

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McDonald's Security Analysis Project

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Section 1: Business Environment

Firm's Business Lines

McDonald's was founded in the year 1955 by Ray Kroc. McDonald's is a fast food restaurant chain that began in the United States and now has expanded to global market.

MCD revenue streams are broken up into seven business segments:

1. U.S.
    a. Franchised and affiliated
    b. Company-Operated
2. International Lead Markets
    a. Company-operated
    b. Franchised and affiliated
3. High Growth Markets
    a. Company-operated.
    b. Franchised and affiliated.
4. Foundational Markets & Corporate
    a. Company-operated.
    b. Franchised affiliated.
5. Other Countries & Corporate
    a. Latin America restaurants.
    b. Canada restaurants.
    c. Other Countries restaurants.
6. APMEA
    a. Franchised and affiliated restaurants.
    b. Company-operated restaurants.
7. Europe
    a. Franchised and affiliated restaurants.
    b. Company-operated restaurants.

McDonald's Revenue by Segment

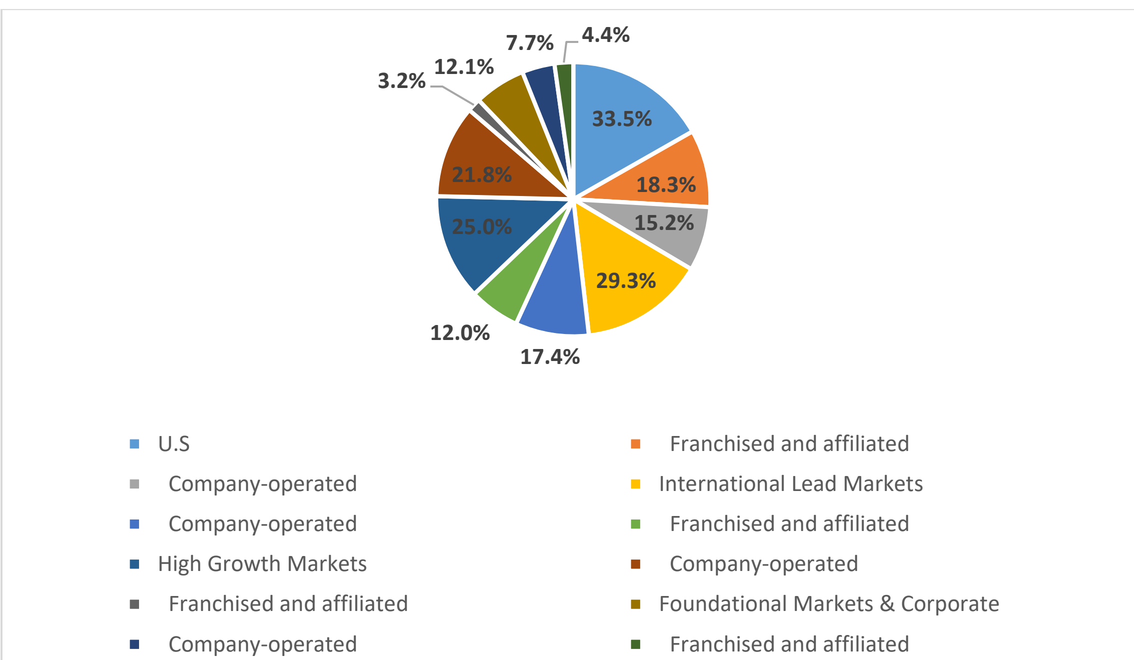


Figure 1: MCD Revenue Breakdown

Macro-Economic Analysis

McDonald's conducts business in over 100 countries, so it must be aware of economic factors all over the world. Per the IMF's World Economic Outlook Update of January 2018, Global growth forecasts for 2018 and 2019 have been revised upward by 0.2 percentage point to 3.9 percent. The revision reflects increased global growth momentum and the expected impact of the recently approved U.S. tax policy changes. This is good news for a company with the global presence that MCD has.

The five main geographical areas that MCD operates in are the United States, Europe, Asia/Pacific, Canada and Latin America. As of 2015, MCD started operating under a new organizational structure with the following four segments that combine markets with similar characteristics, challenges, and opportunities for growth. These markets include the U.S. market, international lead markets, high growth markets, and foundational markets. The greatest portion of MCD restaurants and revenues can be attributed to the U.S (accounting for roughly 31.5% of revenue). Following the U.S. is Japan, China, Germany, France, the U.K., and Canada. As a collection, European countries rival the amount of business in the U.S. The Asian market is also a very big source of MCDs revenue. China is currently the fastest growing consumer market. MCD plans to double its number of restaurants in China over the next 5 years.

With the most restaurants and revenue coming from the U.S., the condition of the American economy is very important. The Federal Reserve's Beige Book report from January 2018 explains that the "outlook for 2018 remains optimistic for a majority of contacts across the country." Employment has grown at a reasonable and steady rate since the Federal Reserve's last report. The unemployment rate has fallen each of the past 3 years. Wages were also reported to be increasing at "a modest pace" and consumer confidence is up. The U.S. GDP has risen over the past 3 years. Real gross domestic product (GDP) increased 3.2 percent at an annual rate in the third quarter of 2017. This was likely due to, positive contributions from consumer spending, inventory investment, nonresidential fixed investment, exports, federal government spending, and state and local government spending that were partly offset by a negative contribution from residential fixed investment.

United States' corporations have just received a huge tax cut under the Trump administration. The tax rate has been set at 21%, as compared to the previous 35%. This is very appealing to corporations in the United States. MCD effective tax rate has recently averaged between 31-33% and they will therefore likely benefit from the cut. There is also current discussion around another interest rate hike in the United States. If interest rates were to increase, it could decrease business and consumer spending. Although, with restaurants that cater to people at low price points, MCD likely would not feel too great of an effect on that end. However, this could affect MCD recent effort to leverage more debt as the cost of borrowing would be greater.

After the U.S., the European region is the next biggest source of revenue. Although unemployment is down, wage growth has been sluggish in many parts of Europe. However, The European recovery is strengthening and broadening appreciably. Real GDP growth is projected at 2.4 percent in 2017, up from 1.7 percent in 2016, before easing to 2.1 percent in 2018.

The vote of the U.K. to leave the European Union occurred in 2016. The “Brexit” will occur in 2019. This could potentially affect companies like MCD due to factors such as currency exchange impacts that would have an impact on costs and profits. Other hurdles could arise such as access to labor, tariffs on imports, and effects on the supply chain.

In MCDs most recent 10-K filing, it is stated that: A significant part of the Company's operating income is generated outside the U.S., and about 35% of its total debt is denominated in foreign currencies. Accordingly, earnings are affected by changes in foreign currency exchange rates, particularly the Euro, British Pound, Australian Dollar and Canadian Dollar. Collectively, these currencies represent approximately 70% of the Company's operating income outside the U.S. This shows how Brexit could have a significant impact on MCDs financials.

China and Japan collectively have a large impact on the global economy. Due to an aging population in China, there is more of a focus on a “transition from an investment-led growth model to a consumption-oriented one. China and Japan have experienced better-than-expected growth. The IMF projects a 6.6% increase in the real GDP for China in 2018. For Japan, only a 1.2% growth in real GDP is expected. McDonald’s has recently seen a decrease in the number of restaurants in Japan. This can be attributed to higher costs, Japan’s slowed economic growth, and the trend of consumers in Japan being more health-conscious.

Overall, The U.S. has seen strong and steady growth in the past 3 years. GDP has risen, unemployment has lowered, wages and stock prices have increased, and consumer confidence and spending is up. In the near future, this makes for a favorable condition of the U.S. economy and stock market. Although there is uncertainty regarding Brexit and Japan’s slowed growth, the overall European and Asian economies currently hold favorable conditions for consumers and businesses as well.

Industry Outlook

McDonald’s is a part of the restaurant industry. Weak restaurant industry sales, driven by oversupply, may improve in the first half of 2018 on easier comparisons even as labor and input costs continue to rise. Tax overhaul may provide additional tailwinds to sales and could boost M&A activity. Consumer incomes that have been pinched by rising health care and other costs will dictate value-focused offers. Optimizing the use of technology and new revenue via catering and delivery will remain in focus.

With the passing of the new tax bill by President Trump corporations are enjoying the luxury of a new corporate tax rate. The bill changes the corporate tax rate from as high as 35 percent to a flat rate of 21 percent. The most significant benefit to MCD and the restaurant industry is the five-year bonus depreciation that can be applied to business purchases, such as kitchen equipment, dining room fixtures, furniture, remodeling materials, and even landscaping and parking lots

MCD introduced in 2015, its turnaround plan. It represented a significant step change in how McDonald's operates and a recommitment to putting customers first. With an aspiration of being recognized by customers as a modern and progressive burger company, the Company prioritized fewer, more strategic initiatives that focused on running better restaurants, driving operational growth, returning excitement to the brand and enhancing financial value.

Recently, MCD has traded at an all time high with growth looking to continue. From teaming up with UberEATS to new Signature Crafted recipes, the fast food giant has been trying to adapt to a world where healthy, organic food seems to be dominating. MCD also plans to invest $2.4 billion into existing locations by adding more kiosks and technology tailored to delivery and digital ordering.

With advances in technology restaurant chains have to adopt new methods for ordering, payment, and loyalty programs to offer convenient and intuitive applications for customers. Analysts foresee creative uses for Google Glass, such as glass-wearing servers using face recognition technology to quickly locate patrons in crowded bars. Data from Apple Pay and other electronic wallet solutions will also make it easier to personalize customer experience.

To get a clear viewpoint of McDonalds' outlook, take a look at how MCD compares to the other fast food brands worldwide. The figure shown displays the brand value of the ten most valuable fast food brands across the world in 2017. The graphic exhibits how sizeable a gap it is between McDonald's and the rest of the pack. McDonald's has an estimated brand value of $97.7 billion U.S. dollars which is more than double than the second highest in Starbucks at $44.23 billion.

Worldwide Fast Food Brand Value

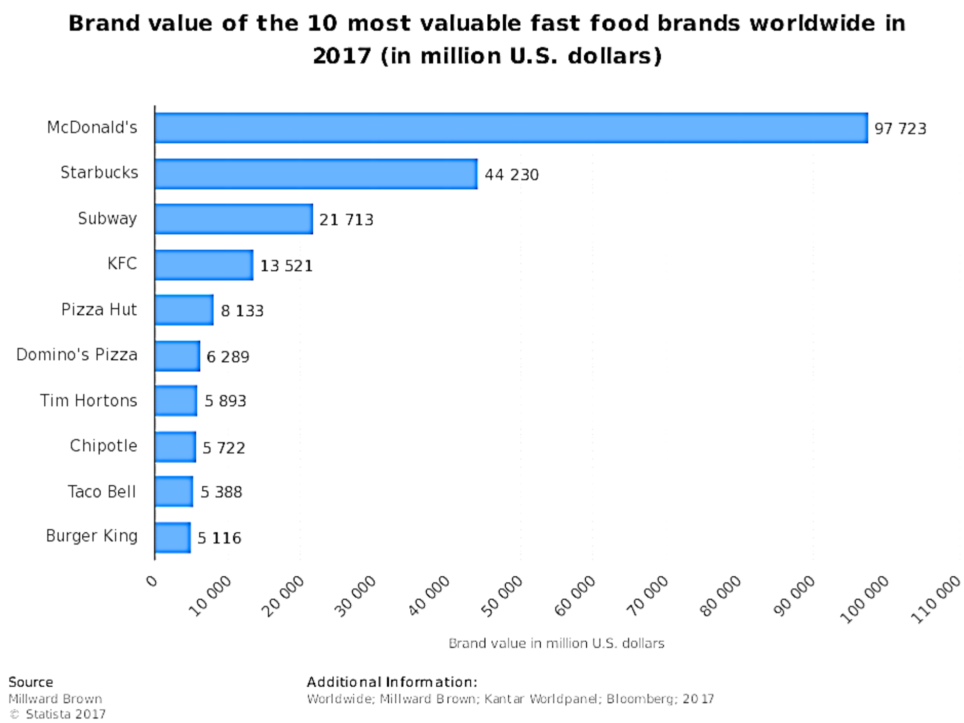


Figure 2: Worldwide Brand Value, Statista.

Value Line (below) forecasts that MCD stock will reach as high as $195 by 2020-2022, a 15% increase from the current price of $168. The below chart shows that MCD has experienced constant growth since 2005.

MCDONALD'S CORP. NYSE-MCD

RECENT PRICE	P/E RATIO		RELATIVE P/E RATIO	DIV'D YLD	
168.11	25.1	(Trailing: 26.4 Median: 17.0)	1.28	2.4%	VALUE LINE

TIMELINESS	1	Raised 10/27/17
SAFETY	1	New 7/27/90
TECHNICAL	4	Lowered 11/17/17

BETA .80 (1.00 = Market)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
High:	44.7	63.7	67.0	64.8	80.9	101.0	102.2	103.7	103.8	120.2	132.0	170.9
Low:	31.7	42.3	45.8	50.4	61.1	72.1	83.3	89.3	87.6	87.5	110.3	118.2

Target Price Range
2020 | 2021 | 2022

2020-22 PROJECTIONS

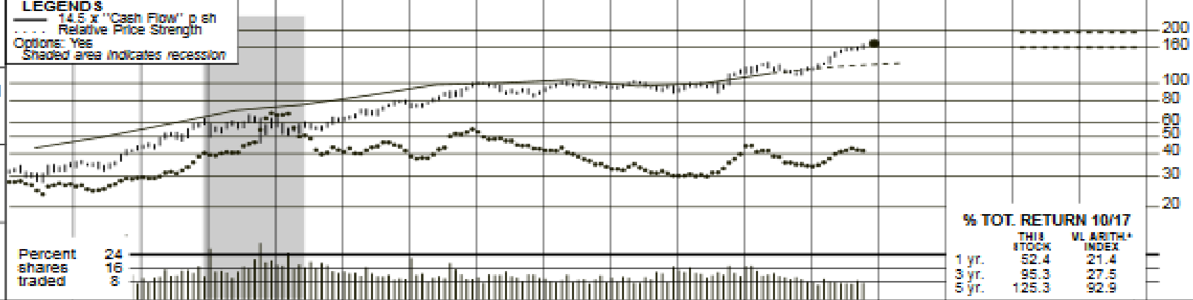
	Price	Gain	Ann'l Total Return
High	195	(+15%)	6%
Low	160	(-5%)	2%

Insider Decisions

	J	F	M	A	M	J	J	A	S
to Buy	0	0	1	0	0	0	0	0	0
Options	0	10	1	1	0	0	4	2	0
to Sell	0	0	1	1	0	0	4	2	0

Institutional Decisions

	4Q2016	1Q2017	2Q2017
to Buy	689	642	639
to Sell	717	797	847
Hld's(000)	559965	608286	609760



% TOT. RETURN 10/17

	THIS STOCK	VL ARITH.* INDEX
1 yr.	52.4	21.4
3 yr.	95.3	27.5
5 yr.	125.3	92.9

2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	© VALUE LINE PUB. LLC	20-22
11.61	12.15	13.58	15.01	16.20	17.93	19.55	21.09	21.12	22.85	26.44	27.49	28.38	28.50	28.03	30.05	***29.30***	***27.10***	Revenues per sh	***31.80***
2.23	2.16	2.36	2.88	2.98	3.43	4.06	4.85	5.22	5.92	6.77	6.93	7.24	6.65	6.89	7.86	***8.60***	***9.00***	"Cash Flow" per sh	***10.95***
1.38	1.32	1.43	1.93	1.97	2.30	2.91	3.67	3.98	4.60	5.27	5.36	5.55	4.82	4.97	5.71	***6.52***	***7.00***	Earnings per sh A	***9.00***
.23	.24	.40	.55	.67	1.00	1.50	1.63	2.05	2.26	2.53	2.87	3.12	3.28	3.44	3.61	***3.83***	***4.10***	Div'ds Decl'd per sh B ▪	***5.20***
1.49	1.58	1.04	1.12	1.27	1.45	1.67	1.92	1.81	2.03	2.67	3.04	2.85	2.68	2.00	2.22	***2.20***	***2.20***	Cap'l Spending per sh	***2.65***
7.41	8.11	9.50	11.18	11.99	12.84	13.11	12.00	13.03	13.89	14.09	15.25	16.16	13.35	7.82	d2.69	***d3.60***	***d3.35***	Book Value per sh C	***d3.05***
1280.7	1268.2	1261.9	1269.9	1263.2	1203.7	1165.3	1115.3	1076.7	1053.6	1021.4	1002.7	990.40	962.90	906.80	819.30	***775.0***	***745.0***	Common Shs Outst'g D	***660.0***
20.9	18.3	14.1	14.4	16.2	16.0	17.6	15.8	14.4	15.4	15.9	17.3	17.5	20.0	20.2	21.1	*Bold figures are*		Avg Ann'l P/E Ratio	***19.5***
1.07	1.00	.80	.76	.86	.86	.93	.95	.96	.98	1.00	1.10	.98	1.05	1.02	1.11	*Value Line*		Relative P/E Ratio	***1.20***
.8%	1.0%	2.0%	2.0%	2.1%	2.7%	2.9%	2.8%	3.6%	3.2%	3.0%	3.1%	3.2%	3.4%	3.4%	3.0%	*estimates*		Avg Ann'l Div'd Yield	***2.9%***
						22787	23522	22745	24075	27006	27567	28106	27441	25413	24622	***22700***	***20200***	Revenues ($mill)	***21000***
						22.3%	32.5%	34.2%	35.6%	35.9%	35.7%	35.9%	35.0%	35.1%	39.0%	***43.8%***	***47.0%***	Operating Margin	***50.5%***
						1214.1	1207.8	1216.2	1276.2	1415.0	1488.5	1585.1	1644.5	1555.7	1516.5	***1340***	***1215***	Depreciation ($mill)	***1275***
						3522.6	4201.1	4405.5	4961.9	5503.1	5464.8	5585.9	4757.8	4693.3	4920.2	***5315***	***5495***	Net Profit ($mill)	***5940***
						1.4%	31.8%	30.4%	29.3%	31.3%	32.4%	31.9%	35.5%	30.5%	31.7%	***32.0%***	***32.0%***	Income Tax Rate	***32.0%***
						15.5%	17.9%	19.4%	20.6%	20.4%	19.8%	19.9%	17.3%	18.5%	20.0%	***23.4%***	***27.2%***	Net Profit Margin	***28.3%***
						d916.6	979.7	427.6	1443.8	893.8	1519.0	1880.1	1437.6	6692.6	1380.3	***1500***	***1500***	Working Cap'l ($mill)	***1000***
						7310.0	10186	10560	11497	12134	13633	14130	14990	24122	25879	***28000***	***28000***	Long-Term Debt ($mill)	***28000***
						15280	13383	14034	14634	14390	15294	16010	12853	7087.9	d2204	***d2800***	***d2500***	Shr. Equity ($mill)	***d2000***
						16.4%	18.8%	18.8%	19.8%	21.6%	19.8%	19.4%	18.1%	16.1%	22.7%	***23.0%***	***23.5%***	Return on Total Cap'l	***24.5%***
						23.1%	31.4%	31.4%	33.9%	38.2%	35.7%	34.9%	37.0%	66.2%	NMF	***NMF***	***NMF***	Return on Shr. Equity	***NMF***
						11.5%	17.8%	15.5%	17.5%	20.1%	16.8%	15.4%	12.0%	20.6%	NMF	***NMF***	***NMF***	Retained to Com Eq	***NMF***
						50%	43%	51%	49%	47%	53%	56%	68%	69%	62%	***59%***	***59%***	All Div'ds to Net Prof	***58%***

CAPITAL STRUCTURE as of 9/30/17
Total Debt $28618.4 mill. **Due in 5 Yrs** $9717 mill.
LT Debt $28402.6 mill. **LT Interest** $1210 mill.
(LT interest earned: 9.1x; total interest coverage: 9.1x) (114% of Cap'l)
Leases, Uncapitalized Annual rentals $1303 mill.

No Defined Benefit Pension Plan
Pfd Stock None

Common Stock 797,185,588 shs.

MARKET CAP: $134 billion (Large Cap)

CURRENT POSITION ($MILL.)	2015	2016	9/30/17
Cash Assets	7685.5	1223.4	2671.2
Receivables	1298.7	1474.1	1569.0
Inventory (FIFO)	100.1	58.9	54.2
Other	558.7	2092.2	495.9
Current Assets	9643.0	4848.6	4790.3
Accts Payable	874.7	756.0	685.2
Debt Due	--	77.2	215.8
Other	2075.7	2635.1	2839.2
Current Liab.	2950.4	3468.3	3740.2

ANNUAL RATES of change (per sh)	Past 10 Yrs.	Past 5 Yrs.	Est'd '14-'16 to '20-'22
Revenues	6.5%	5.5%	1.5%
"Cash Flow"	9.5%	5.5%	7.5%
Earnings	11.0%	4.5%	9.5%
Dividends	20.0%	10.5%	7.0%
Book Value	1.5%	-1.0%	NMF

Cal-endar	QUARTERLY REVENUES ($ mill.) E Mar.31	Jun.30	Sep.30	Dec.31	Full Year
2014	6700	7181	6987	6572	27441
2015	5958	6497	6615	6341	25413
2016	5904	6265	6424	6029	24622
2017	5676	6050	5755	***5219***	***22700***
2018	***4825***	***5175***	***5250***	***4950***	***20200***

Cal-endar	EARNINGS PER SHARE A E Mar.31	Jun.30	Sep.30	Dec.31	Full Year
2014	1.21	1.40	1.09	1.12	4.82
2015	1.01	1.26	1.40	1.30	4.97
2016	1.23	1.45	1.62	1.43	5.71
2017	1.47	1.70	1.76	***1.59***	***6.52***
2018	***1.55***	***1.80***	***1.88***	***1.77***	***7.00***

Cal-endar	QUARTERLY DIVIDENDS PAID B ▪ Mar.31	Jun.30	Sep.30	Dec.31	Full Year
2013	.77	.77	.77	.81	3.12
2014	.81	.81	.81	.85	3.28
2015	.85	.85	.85	.89	3.44
2016	.89	.89	.89	.94	3.61
2017	.94	.94	.94	1.01	

BUSINESS: McDonald's Corporation operated, franchised, or licensed 36,976 fast-food restaurants in the United States, Canada, and overseas under the *McDonald's* banner (as of 9/30/17). About 91% are operated by franchisees or affiliates, with the remainder under the control of the company. Foreign operations contributed 66% of systemwide sales and 51% of consolidated operating income in 2016. The company sold a stake in *Pret A Manger* in 2008. Spun off *Chipotle Mexican Grill* in 2006 and *Boston Market* in 2007. Has about 375,000 employees. Officers/directors own less than 1% of common stock (4/17 Proxy). CEO: Steve Easterbrook. Inc.: DE. Address: One McDonald's Plaza, Oak Brook, Illinois 60523. Telephone: 630-623-3000. Internet: www.mcdonalds.com.

McDonald's recently released third-quarter results. The financials were decent, to be sure, but with the stock recently trading at an all-time high and the figures lacking the upside surprise that the company delivered in the previous quarter, the issue's gains were modest. As expected, third-quarter revenues fell from a year earlier due to management's strategic refranchising initiatives (see below). The top line was down 10% on a year-over-year basis, to $5.755 billion, slightly ahead of our $5.724 billion forecast. Global comparable-store sales rose 6.0% and reflected positive guest counts in all segments. The U.S. market delivered the most modest comp increase, at 4.1%. However, this was still a better-than-expected showing and came in the face of hurricane-related headwinds. The gain was driven by *McPick 2* and national beverage promotions. Continued demand for *Signature Crafted* premium sandwiches also helped. Same-store sales were up 5.7% in the International Lead segment; 6.2% in the High Growth segment; and 10.2% in Foundational markets. The strong comp performance enabled expense leverage and improvements in franchised margin dollars. Combined with a lower share count, adjusted earnings rose 9% from a year earlier but were a penny below our estimate.

McDonald's recently completed the refranchising of its businesses in China and Hong Kong. This latest deal enabled leadership to reach its goal of refranchising 4,000 restaurants a year ahead of schedule. The shift should provide for more stable revenues and higher returns on invested capital.

We expect the company to keep delivering solid results. However, margins may be uneven in the near term due to investments in technology and labor to support mobile order/pay, fresh beef, delivery, curbside pickup, etc. Promotions should continue to drive traffic, as well.

This timely stock is not cheap, but it is high quality, and we think it can push higher still. Stock buybacks and dividend payments (the quarterly distribution was recently increased 7%, to $1.01 a share) enhance its total return potential. All told, MCD stock is worthy of consideration by a variety of investors, in our view.

Matthew Spencer, CFA *November 24, 2017*

(A) Based on diluted shares. Excl. nonrecur. gain/(loss): '02, (55¢); '03, (25¢); '04, (6¢); '05, 3¢; '06, 53¢; '07, (93¢); '08, 9¢; '09, 13¢; '10, (2¢); '15, (17¢); '16, (27¢); '17, 56¢. Excl. cum. effect of accting change: '02, (7¢); '03, (3¢); '04, (8¢). Incl. tax benefit: '04, 7¢. Excl. tax benefit '05, 4¢. Next egs. report due 1/30/18.
(B) As of 3/08 div'ds paid mid-Mar., Jun., Sep., Dec. ▪ Div'd. reinvestment plan available.
(C) Incl. intang. At 12/31/16: $2,336.5 mill., $2.85/share. (D) In mill., adj. for splits.
(E) May not sum due to rounding.

Company's Financial Strength	A++
Stock's Price Stability	100
Price Growth Persistence	55
Earnings Predictability	85

Firm's Position and Economic Advantage

MCD is ranked number 112 on the Fortune 500 list. MCD is the largest fast-food restaurant chain in the world, with over 35,000 locations in 119 countries. McDonald's has staked its claim in the industry through its affordable food and unmistakable golden arches branding.

With a new chief executive officer (CEO), McDonald's looks to improve its operations, including refranchising 4,000 locations by the end of 2018 and reducing its selling, general and administrative (SG&A) expenses by $500 million per year. Management also believes the company can increase its franchisee penetration in China to 20 to 25%, which will bring in margins closer to long-term assumptions.

The company's 2017 growth plan focuses on enhancing digital capabilities and the use of technology to elevate and modernize the customer experience at its restaurants. McDonald's also plans to redefine its customer convenience through delivery. The company's technology investment will help fund new self-serve kiosks at many restaurants and expand the reach of McDonald's smartphone ordering app. MCD also plans to continue to improve the quality and value of its food. In 2017 the company began experimenting with using fresh beef instead of frozen patties for its Quarter Pounders.

In 2017, McDonald's spent close to $2 billion to win back some of its customers it had lost to competitors since 2012, which included refranchising 4,000 restaurants and adopting a new restaurant design featuring sleek furniture and self-serve kiosks. McDonald's stock has jumped 80% since Easterbrook was named CEO in 2015, outperforming a 36% rise in the S&P 500.

McDonald's Share Buybacks

MCD has a strong history of delivering increased value for shareholders in the form of stock buybacks. These have helped improve financial metrics and increase each shareholders' relative ownership stake in the company, due to fewer shares outstanding and holding the same number of shares.

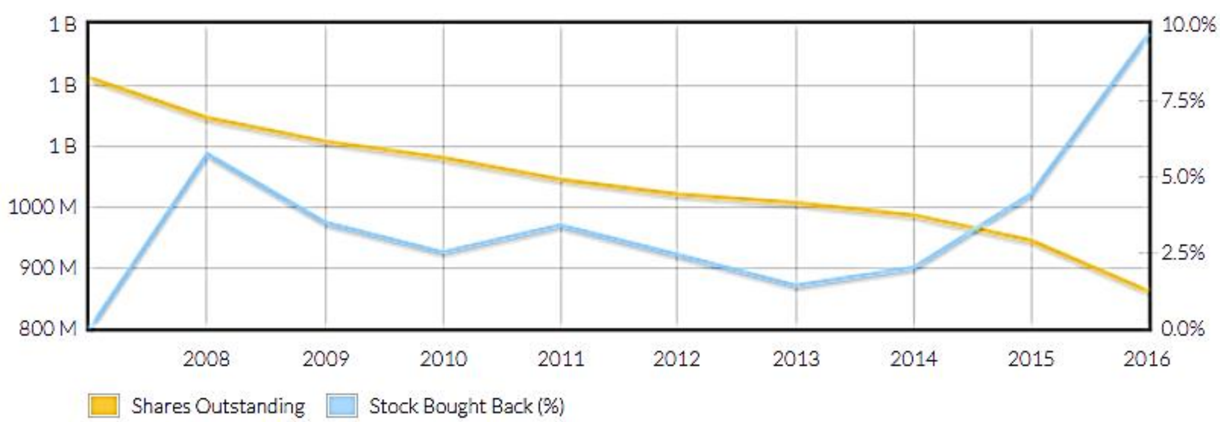


Figure 3: McDonald's Share Buybacks, Vuru.co

Dividend History

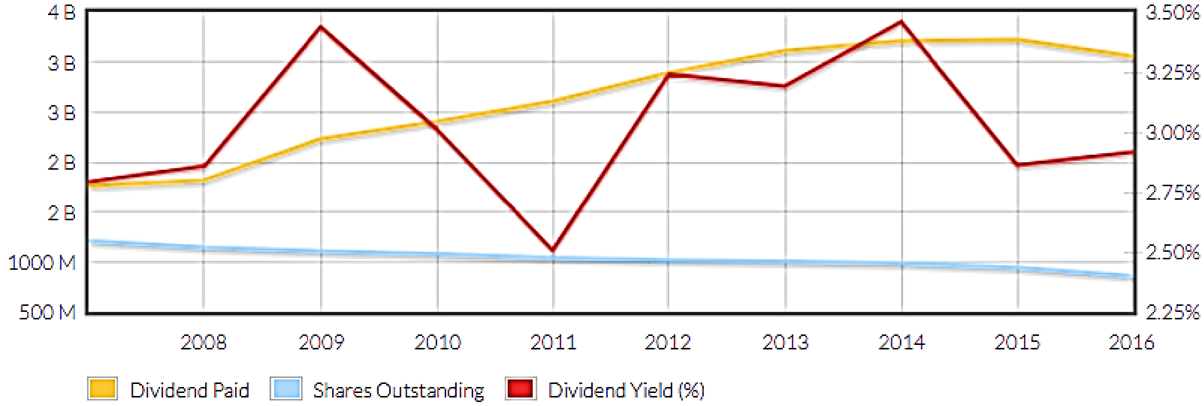


Figure 4: McDonald's Dividend History, Vuru.co

MCD has consistently distributed a dividend for at least the past 10 years. Such a long dividend history suggests MCD is very established in its market and that its dividend distribution is likely to continue for a significant period of time.

McDonald's Dividend Per Share

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Dividend Paid Per Share	1.46	1.59	2.02	2.23	2.50	2.84	3.10	3.26	3.42	3.55

Figure 5: MCD Historic Dividend Per Share.

Porter's Five Forces

Threat of New Entrants

High – Economies of scale do exist but are limited due to market saturation. Low switching costs. Not much product variation on hamburgers and chicken nuggets.

Bargaining Power of Suppliers

Low – The market has a large number of fast food chains with thousands of suppliers. Customers can switch easily. If firm buys large portion of supplier revenue then power is severely limited.

Bargaining Power of Buyers

High – Minimal to zero switching cost, customer preference change quickly. In 2015, the quick service *restaurant* sector generated 273.0 billion U.S. dollars in consumer spending. 25% of the U.S. population eat fast food daily.

Threat of Substitute Goods

High – Grocery stores, deli's and in-house cafeterias, instant food like chicken, sandwiches, pizza, and coffee. The biggest threats coming from organic and fresh food alternatives, artisan sandwiches, and mobile food delivery services.

Intensity of Rivalry

High – MCD has faced severe competition from independent restaurants as many Americans (especially Millennials) are focused on fresh and healthy fast foods. Major industry participants compete to maintain or increase market share. Competition is primarily based on price due to constant demand.

Section 2: ROE and Ratio Analysis

Decomposition of Firm's ROE

McDonald's Decomposition						
Year	ROE	Tax-Burden Ratio	Interest Burden	Operating Profit Margin	Total Asset Turnover	Leverage Ratio
		Net Profit/Pretax Profit	Pretax Profit/EBIT	EBIT/Sales	Sales/Assets	Assets/Equity
2016	191.93%	0.68	0.89	31.48%	0.71	14.12
2015	45.43%	0.69	0.91	28.31%	0.70	3.62
2014	32.97%	0.65	0.93	28.99%	0.77	2.46

The tax burden ratio increased from 2014 to 2015 and then slightly decreased in 2016. This ratio shows the net profit as a percentage of total pretax profit. McDonald's has therefore paid a lower percentage of taxes on their profits in the two years following 2014. The interest burden has decreased each of the past 3 years by about 0.02 per year. This means that McDonald's has increased its use of debt and/or financial leverage and therefore, its interest expense has increased as well.

Operating margin decreased slightly from 2014 to 2015, but then increased by over 3 percentage points in 2016. Asset turnover significantly decreased from 2014 to 2015 (which means less dollars in sales made per dollar of assets), and then slightly increased in 2016. Lastly, the leverage ratio increased by 1.16 from 2014 to 2015, and then made a huge jump from 3.62 to 14.12 in 2016. This significant increase is due to a strategic move by McDonald's to use more debt instead of equity to fuel its growth and help see greater ROE for shareholders.

Decomposition of Industry's ROE

Wendy's (WEN)			
DuPont Analysis	**FY 2014**	**FY 2015**	**FY 2016**
Adjusted ROE	5.30	11.59	15.86
Interest Burden	78.74	73.12	63.73
Tax Burden	63.07	68.83	64.27
EBIT Margin	12.24	17.12	22.05
Asset Turnover	0.47	0.45	0.36
Leverage	2.33	3.34	6.28

Source: Bloomberg

Restaurant Brands (QSR)			
Ratios	**FY 2014**	**FY 2015**	**FY 2016**
Adjusted ROE	-11.63	14.72	24.47
Interest Burden	-863.95	58.25	71.81
Tax Burden	157.01	15.42	28.80
EBIT Margin	2.45	28.54	40.30
Asset Turnover	0.09	0.20	0.22
Leverage	8.00	12.37	12.35

Source: Bloomberg

Jack in the Box (JACK)			
DuPont Analysis	**FY 2014**	**FY 2015**	**FY 2016**
Adjusted ROE	28.77	87.60	-
Interest Burden	89.87	90.29	86.35
Tax Burden	60.66	61.00	62.40
EBIT Margin	10.99	12.83	14.40
Asset Turnover	1.15	1.20	1.21
Leverage	3.55	9.40	-

Source: Bloomberg

Sonic (SONC)			
DuPont Analysis	**FY 2014**	**FY 2015**	**FY 2016**
Adjusted ROE	68.49	150.49	-
Interest Burden	74.40	78.50	77.59
Tax Burden	64.96	70.30	96.26
EBIT Margin	17.95	19.28	19.66
Asset Turnover	0.84	0.95	0.96
Leverage	9.36	15.87	-

Source: Bloomberg

Yum Brands! (YUM)			
DuPont Analysis	**FY 2014**	**FY 2015**	**FY 2016**
Adjusted ROE	81.58	84.76	-
Interest Burden	-	-	-
Tax Burden	73.65	102.54	122.84
EBIT Margin	-	-	-
Asset Turnover	1.56	0.79	0.94
Leverage	81.58	84.76	-

Source: Bloomberg

Analysis of Firms Financial Ratios

MCD Ratios	2009	2010	2011	2012	2013	2014	2015	2016	2017
P/E:	15.53	13.96	20.51	-12.21	19.73	1.52	15.85	-6.57	21.47
Profit Margin:	19.58	20.64	20.37	19.84	19.87	17.43	18.42	19.94	22.25
ROE:	33.2	34.51	37.92	36.82	35.69	32.97	45.43	191.93	-208
Asset Turnover:	0.78	0.77	0.83	0.81	0.78	0.77	0.7	0.71	1.47
Debt/Equity:	75.38	78.62	86.87	89.14	88.26	116.2	340.33	-11.78	-8.23
Cash Conversion Cycle:	2.39	-0.26	-1.77	-2.38	-3.53	-1.56	0.22	1.87	0.88

Source: Bloomberg

Being in a highly cyclical industry it's no surprise that MCD P/E ratio has been historically volatile. With the large $30 billion share buyback, dividends, and reinvestments in innovation and technology has distorted the company's debt and equity structure. This activity has effectively caused the distortion of their ROE and Debt/equity.

Asset turnover is typically low in the restaurant industry to reflect lower profits margins. MCD asset turnover historically has been sub-par averaging .7 in 2017 it doubled to 1.47. MCD alone generates $1.47 of revenue for every $1 in assets.

The increases to debt is reflected in the interest expense which increased 39% and 11% in 2016 and 2015, respectively, primarily due to higher average debt balances in connection with the Company's strategy to optimize its capital structure, partly offset by lower average interest rates. The Company generally borrows on a long-term basis and is exposed to the impact of interest rate changes and foreign currency fluctuations. Debt obligations at December 31, 2016 totaled $26.0 billion, compared with $24.1 billion at December 31, 2015. The net increase in 2016 was primarily due to net long-term issuances of $2.7 billion.

The cash conversion cycle or CCC is important for McDonald's and similar businesses, as their operations consist of buying inventories and selling them to customers. The cash conversion cycle illustrates how quickly a company can convert its products into cash through sales. The shorter the cycle, the less time capital is tied up in the business process, and thus the better for the company's bottom line. Based on MCD trend from positive to negative their management is running efficiently with a current CCC of .88, respectively.

Comparison of Ratios to Industry Ratios

Ratios	MCD	YUM	SONC	WEN	QSR	JACK	Restaurant Industry Ratios
P/E:	27.41	29.27	19.61	40.43	34.77	19.93	27.53
Profit Margin:	22.25	18.51	13.68	5.20	13.91	8.71	16.26
EV/EBITDA:	15.32	15.98	10.21	18.17	20.40	10.43	15.82
ROE:	-208%	19.13%	12.8	12.01	9%	-34.79	22.06%
Inventory Turnover:	181.95	23.26	88.25	189.62	23.26	127.6	22.40
Current:	1.40	3.45	1.81	1.80	3.45	1.08	1.08

Source: Bloomberg

With MCD trading at close at 27.41x is right at the value of what the restaurant industry benchmark ratios are trading at, 27.53x. In a comparison of MCD with Bloomberg's peer group in the relative valuation function, MCD is valued slightly better than its peer group that is trading at average of 28x. With MCD EV/EBITDA being 15.32 and the benchmark being 15.82, together with the P/E ratio indicates that MCD is not under or overvalued. MCD peer groups EV/EBITDA is averaged at 15.0. With a EV/EBITDA of 10.21 and trading at 19.61x SONC and JACK's EV/EBITDA is 10.43 and trading at 19.93x indicates that is valued much better with a

With a current ratio of 1.40, MCD is close running to running at efficient 1.50. In a comparison with the peer group MCD is not as efficient as the peer group averages 2.3. On the other hand, the industry as whole is not as efficient as the peer group either with a current ratio of 1.08. The industry benchmark can barely meets it liabilities obligations being marginally close to 1.

The profit margin for MCD 22.25 is much better than the peer group average of 12 and the industry benchmark of 16.26. In the fourth quarter, sales at restaurants jumped 5.5% worldwide and 4.5% in the U.S. This trend could potentially accelerate even more, as the company only recently rolled out the revival of its popular Dollar Menu earlier this month. The news comes as the company reported strong fourth-quarter sales Tuesday that highlighted the company's best same-store sales growth in six years. The boost was fueled by strong interest in its McPick 2 options, beverage deals, and a "strong consumer response" to its new Buttermilk Crispy Tenders, the company said

The inventory turnover is the most important ratio to reflect MCD profitability. MCD having such a high inventory turnover demonstrates their ability to generate strong sales. With profit margin of 22.25 accurately depicts MCDs high inventory turnover of 181.95. MCD peer group average of inventory turnover is 90.1 which accurately displays the peer groups low profit margins.

Analysis of Firm's Economic Advantage

MCD recently completed the refranchising of its businesses in China and Hong Kong. This latest deal enabled leadership to reach its goal of refranchising 4,000 restaurants a year ahead of schedule. The shift should provide for more stable revenues and higher returns on invested capital.

Expect the company to keep delivering solid results. However, margins may be uneven in the near term due to investments in technology and labor to support mobile order/pay, fresh beef, delivery, and curbside pickup. Promotions should continue to drive traffic, as well. Stock buybacks and dividend payments (quarterly distribution was recently increased 7%, to $1.01 a share) enhance its total return potential.

Looking ahead to quarterly numbers this year, the restaurant operator expects choppier results due to a slower pace of refranchising. Shares of McDonald's are down 3% on Tuesday. With plans to funnel a significant portion of its tax savings after President Trump's sweeping tax bill into remodeling stores in the U.S. and opening an additional 1,000 stores worldwide this year. The stock is worthy of consideration by a variety of investors.

The fast food giant also said it plans to invest $2.4 billion into existing locations by adding more kiosks and technology tailored to delivery and digital ordering. As expected, third-quarter revenues fell from a year earlier due to management's strategic refranchising initiatives. The top line was down 10% on a year-over-year basis, to %5.755 billion, slightly ahead of Value Lines estimate of $5.724 billion.

CEO Easterbrook said in a recent investors relations call, "the increased popularity of delivery and mobile ordering at self-service kiosks at some locations were among the factors behind the company's success." With management immediately responding by offering healthier options (such as more salads and grilled chicken sandwiches) and by trying to improve its technology has continue to solidify their competitive advantage.

Appendix

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