

What's interesting about McDonald's is...you can not use Return on equity to assess profitability

Case Study



A. Stotz
ACADEMY

Andrew Stotz, PhD, CFA

🌐 My name is Andrew Stotz,
let's get started!

McDonald's sells 9m pounds of fries everyday

- ★ Over 68m people eat McDonald's everyday
- ★ 1 of 8 Americans have worked at McDonald's

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COMPANY BACKGROUND



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This is not a recommendation
or investment advice.

McDonald's all over the world



115 countries



**40,275
restaurants**

I'm lovin' it

BEST SELLERS



McDonald's

Top 3 products



Fries



Big Mac



Wrap

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5%

of restaurants are
company-owned



95%

of restaurants are
franchisee-owned

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Breakdown of US\$23bn of revenue



Revenue from
company-operated
restaurants

38% 

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Revenue from franchised restaurants

60% 



64%
Rent



35%
Royalties



<1%
Initial fee

Revenue breakdown by segment



40%
U.S.



50%
International
operated markets



10%
International
developmental
licensed markets

The "Big Five" international markets



France



Canada



Germany



U.K.



Australia

COMPETITIVE STRATEGY



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McDonald's - US - Founded 1955

Cons. Disc. sector, 150,000 employees, US\$23bn revenue

Main segments/products/divisions/brands

- Big Mac (signature burger)
- French fries (popular side item)
- Happy Meal (children's meal with toy)

Its competitive advantage

*Competitive advantage lies in its strong brand recognition, global presence, and **efficient operations**.*

How it achieved its competitive advantage

*It achieved this by **standardizing** its menu, ensuring consistent quality and service, and implementing effective supply chain and franchising systems, allowing for cost control and rapid expansion into new markets.*



Ray Kroc (1902-1984) The visionary force behind McDonald's, that revolutionized the industry

- ★ From humble beginnings as a struggling milkshake machine salesman, Kroc took the helm and transformed a small burger joint into a global phenomenon
- ★ His innovative ideas, like the assembly-line system and franchising model, propelled McDonald's to unprecedented success
- ★ Kroc purchased McDonald's when he was 59 years old, proving that age is no barrier to entrepreneurial triumph



McDonald's Speedee System has had a significant impact on the fast-food industry

- ★ Richard and Maurice McDonald in the 1940s were dissatisfied with slow and erratic service common in drive-ins, they developed a methodical approach to food preparation
- ★ In 1948, the brothers streamlined operations and featured 15-cent hamburgers as a key element of the new system
- ★ McDonald's was founded on the Speedee System and has evolved into one of the world's most iconic and influential brands



Key innovations of the Speedee System

- ★ Simplified menu
 - Streamlined menu of limited items, only burgers, shakes, and fries, for simplicity and efficiency
- ★ Kitchen assembly line
 - Assembly-line production system to optimize workflow and speed up food preparation
- ★ Focus on quick service
 - Delivery within minutes of ordering
- ★ Meticulous standardization
 - Standardized operations to ensure consistency

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An incredible net profit margin of 25-30%

- ★ According to my calculation, the average net profit margin of companies worldwide is 6%
- ★ McDonald's generates an incredible net profit margin of 25-30%
 - **This is more than 2x the already high 12-17% profit margins at Starbucks**
- ★ This makes the company one of the most profitable in the world
 - **Apple is up there too, generating a massive 30% net profit margin**

Quarterly results



(US\$ m)	2Q22	3Q22	4Q22	1Q23	2Q23	YoY (%)	6M23	23E	% of 23E
Revenue	5,718	5,872	5,927	5,898	6,498	13.6	12,395	24,110	51.4
Cost of sales	(2,416)	(2,426)	(2,518)	(2,584)	(2,767)	14.5	(5,351)	(9,644)	55.5
Gross profit	3,302	3,446	3,409	3,314	3,731	13.0	7,045	14,466	48.7
SG&A	(704)	(670)	(812)	(653)	(663)	(5.9)	(1,315)	(2,893)	45.5
Other (exp)/inc	46	(0)	(0)	(0)	0	(100.0)	(0)	0	(0.0)
EBIT	2,644	2,776	2,597	2,661	3,068	16.0	5,729	11,573	49.5
Finance cost	(291)	(306)	(323)	(330)	(330)	13.6	(660)	(1,245)	53.0
Other inc/(exp)	(34)	(40)	(32)	51	31	nm	82	(73)	(112.4)
Earnings before taxes	2,319	2,430	2,242	2,382	2,769	19.4	5,152	10,255	50.2
Income tax	(221)	(555)	(436)	(465)	(506)	129.0	(971)	(2,140)	45.4
Earnings after taxes	2,098	1,876	1,807	1,918	2,263	7.9	4,181	8,115	51.5
Equity income	20	37	25	39	34	68.3	73	106	68.3
Minority interest	-	-	-	-	-	na	-	-	na
Earnings from cont. operations	2,118	1,913	1,831	1,957	2,297	8.4	4,253	8,221	51.7
Forex gain/(loss) & unusual items	(930)	69	72	(155)	14	nm	(141)	(528)	26.6
Net profit	1,188	1,982	1,903	1,802	2,310	94.5	4,113	7,693	53.5
Recurring profit	1,970	1,928	1,845	1,925	2,299	16.7	4,224	8,105	52.1
EBITDA	3,126	3,279	3,085	3,191	3,594	15.0	6,785	13,511	50.2
Recurring EPS (US\$)	2.655	2.607	2.506	2.617	3.131	17.9	5.748	11.141	51.6
Reported EPS (US\$)	1.611	2.696	2.603	2.466	3.167	96.6	5.634	10.621	53.0
Profits (%)	2Q22	3Q22	4Q22	1Q23	2Q23	Diff (%)	6M23	23E	Diff (%)
Gross margin	57.7	58.7	57.5	56.2	57.4	(0.3)	56.8	60.0	3.2
Operating margin	46.2	47.3	43.8	45.1	47.2	1.0	46.2	48.0	1.8
Net margin	20.8	33.7	32.1	30.6	35.6	14.8	33.2	31.9	(1.3)

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- MCD reported 2Q23 recurring EPS of US\$3.13, which was +17.9% YoY and +19.7% QoQ
- The 6M23 result was 51.6% of our full-year forecast

Carlyle, Trustar plan partial exit from McDonald's China

on: July 13, 2023 In: Brief Tags: No Comments

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Carlyle Group and Trustar Capital are seeking a partial exit from McDonald's Corp.'s operations in Hong Kong and mainland China, people familiar with the matter said, in a deal that would raise \$4 billion, reports [Bloomberg](#). GIC Pte and Mubadala Investment, the Abu Dhabi sovereign wealth fund, have been approached about the deal that values the entire business at up to \$10 billion including debt, the people said. Shareholders have agreed to the plan, and the asset managers aim to finalize an agreement with investors in the fourth quarter, they said, asking not to be identified discussing private matters.



What's interesting about McDonald's is...you can not use Return on equity to assess profitability



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2022 revenue was down 9% from 2015, but profit was up 36%!

McDonalds (US\$bn)	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	25.4	24.6	22.8	21.3	21.4	19.2	23.2	23.2
Costs	(20.9)	(19.9)	(17.6)	(15.3)	(15.3)	(14.5)	(15.7)	(17.0)
Net profit	4.5	4.7	5.2	5.9	6.0	4.7	7.5	6.2
Revenue growth (%)	(7.4)	(3.1)	(7.3)	(6.8)	0.5	(10.1)	20.9	(0.2)
Net profit growth (%)	(4.8)	3.5	10.8	14.1	1.7	(21.5)	59.5	(18.1)
Net profit margin (%)	17.8	19.0	22.8	27.9	28.2	24.6	32.5	26.6



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2022 assets were up 33% from 2015, but liabilities were up 83%!

McDonalds (US\$bn)	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	25.4	24.6	22.8	21.3	21.4	19.2	23.2	23.2
Costs	(20.9)	(19.9)	(17.6)	(15.3)	(15.3)	(14.5)	(15.7)	(17.0)
Net profit	4.5	4.7	5.2	5.9	6.0	4.7	7.5	6.2
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Net profit margin (%)	17.8	19.0	22.8	27.9	28.2	24.6	32.5	26.6
McDonalds (US\$bn)	2015	2016	2017	2018	2019	2020	2021	2022
Assets	37.9	31.0	33.8	32.8	47.5	52.6	53.9	50.4
Liabilities	30.9	33.2	37.1	39.1	55.7	60.5	58.5	56.4
Asset growth (%)	10.8	(18.2)	9.0	(2.9)	44.8	10.8	2.3	(6.3)
Liability growth (%)	44.3	7.7	11.6	5.4	42.6	8.5	(3.3)	(3.4)



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Equity was positive in 2015 but has been negative since due to share buybacks



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Costs	(20.9)	(19.9)	(17.6)	(15.3)	(15.3)	(14.5)	(15.7)	(17.0)
Net profit	4.5	4.7	5.2	5.9	6.0	4.7	7.5	6.2
Revenue growth (%)	(7.4)	(3.1)	(7.3)	(6.8)	0.5	(10.1)	20.9	(0.2)
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McDonalds (US\$bn)	2015	2016	2017	2018	2019	2020	2021	2022
Assets	37.9	31.0	33.8	32.8	47.5	52.6	53.9	50.4
Liabilities	30.9	33.2	37.1	39.1	55.7	60.5	58.5	56.4
Asset growth (%)	10.8	(18.2)	9.0	(2.9)	44.8	10.8	2.3	(6.3)
Liability growth (%)	44.3	7.7	11.6	5.4	42.6	8.5	(3.3)	(3.4)

McDonalds (US\$bn)	2015	2016	2017	2018	2019	2020	2021	2022
Paid up capital	6.6	6.8	7.1	7.4	7.7	7.9	8.2	8.6
Treasury stock	(41.2)	(52.1)	(56.5)	(61.5)	(66.3)	(67.1)	(67.8)	(71.6)
Total capital	(34.6)	(45.3)	(49.4)	(54.1)	(58.7)	(59.1)	(59.6)	(63.1)
Ret. earnings + Others	41.7	43.1	46.1	47.9	50.4	51.3	55.0	57.1
Equity	7.1	(2.2)	(3.3)	(6.3)	(8.2)	(7.8)	(4.6)	(6.0)

Negative equity makes ROE meaningless, hence ROA is a better measure, and it's about flat



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McDonalds (US\$bn)	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	25.4	24.6	22.8	21.3	21.4	19.2	23.2	23.2
Costs	(20.9)	(19.9)	(17.6)	(15.3)	(15.3)	(14.5)	(15.7)	(17.0)
Net profit	4.5	4.7	5.2	5.9	6.0	4.7	7.5	6.2
Revenue growth (%)	(7.4)	(3.1)	(7.3)	(6.8)	0.5	(10.1)	20.9	(0.2)
Net profit growth (%)	(4.8)	3.5	10.8	14.1	1.7	(21.5)	59.5	(18.1)
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Assets	37.9	31.0	33.8	32.8	47.5	52.6	53.9	50.4
Liabilities	30.9	33.2	37.1	39.1	55.7	60.5	58.5	56.4
Asset growth (%)	10.8	(18.2)	9.0	(2.9)	44.8	10.8	2.3	(6.3)
Liability growth (%)	44.3	7.7	11.6	5.4	42.6	8.5	(3.3)	(3.4)

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Paid up capital	6.6	6.8	7.1	7.4	7.7	7.9	8.2	8.6
Treasury stock	(41.2)	(52.1)	(56.5)	(61.5)	(66.3)	(67.1)	(67.8)	(71.6)
Total capital	(34.6)	(45.3)	(49.4)	(54.1)	(58.7)	(59.1)	(59.6)	(63.1)
Ret. earnings + Others	41.7	43.1	46.1	47.9	50.4	51.3	55.0	57.1
Equity	7.1	(2.2)	(3.3)	(6.3)	(8.2)	(7.8)	(4.6)	(6.0)

McDonalds (US\$bn)	2015	2016	2017	2018	2019	2020	2021	2022
Average equity	10.0	2.4	(2.7)	(4.8)	(7.2)	(8.0)	(6.2)	(5.3)
Return on avg. equity (%)	45.4	191.9	(189.8)	(124.4)	(83.3)	(59.0)	(121.4)	(116.5)
Average assets	36.1	34.5	32.4	33.3	40.2	50.1	53.2	52.1
Return on avg. assets (%)	12.6	13.6	16.0	17.8	15.0	9.4	14.2	11.8

COMPETITIVE ADVANTAGE



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**Is the company
financially world class?**



Here's the method I use as
an **investor** and **business**
owner to measure whether
a company has a
competitive advantage

The **World Class** **Benchmarking** score card we developed 10 years ago



Here's how I construct the scorecard for any company



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- ★ We gather the yearly and quarterly financial data of 26,000 companies worldwide
- ★ We then calculate each company's **Profitable Growth** score
 - Which is a composite measure of both profitability and growth

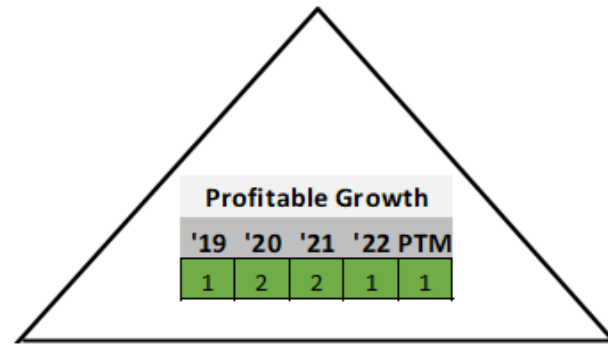
Here's how we construct the scorecard for any company

- ★ After that, we rank the subject company relative to sector peers of similar size
 - Decile ranking is from 1 (best) to 10 (worst)
 - A score of 1 or 2 is financially world class
- ★ We assess the company's performance over the prior four years and the past 12 months (PTM)



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**Is the company
financially
world class?**



Andrew Stotz, PhD, CFA



Benchmarked against 960 large Cons. Disc. companies worldwide.



Source: A. Stotz Investment Research. Notes: 1 = top ranking and 10 = worst. Most recent year's data is based on the past 12 months (PTM) of published data.

**Is your company financially
world class?**

**Just message me, and I'll
score your company**



VALUATION



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Free cash flow

(YE Dec, US\$ m)	2020A	2021A	2022A	2023E	2024E	2025E	2026E	2027E
EBIT	7,207	9,873	10,345	11,573	11,920	12,278	12,646	13,025
Est tax rate (%)	23	18	21	22	22	22	22	22
NOPAT	5,519	8,127	8,134	9,027	9,298	9,577	9,864	10,160
Add: Depre & amort	1,751	1,868	1,871	1,831	1,923	2,019	2,099	2,162
Cash NOPAT	7,271	9,995	10,005	10,858	11,221	11,596	11,963	12,322
Chg in A/R	114	238	(243)	106	(60)	(62)	(64)	(66)
Chg in inventory	(1)	(5)	4	1	(2)	(2)	(2)	(2)
Chg in oth curr asst	(262)	121	(162)	(26)	(21)	(22)	(22)	(23)
Chg in A/P	(155)	484	(118)	(88)	72	74	76	78
Chg in oth curr liabs	530	(402)	(100)	117	43	45	46	47
Less: Chg in work cap	227	437	(619)	110	32	33	34	35
Less: CAPEX	(1,613)	(1,934)	(1,860)	(2,796)	(2,935)	(3,065)	(1,975)	(2,035)
Less: Chg in invest cap								
Free cash flow to firm	5,884	8,499	7,526	8,172	8,318	8,564	10,022	10,322
FCF per share (US\$)	7.8	11.3	10.2	11.2	11.7	12.2	14.5	15.1
NOPAT growth (%)	(18.3)	47.3	0.1	11.0	3.0	3.0	3.0	3.0
FCF growth (%)	(17.0)	44.4	(11.5)	8.6	1.8	3.0	17.0	3.0

Discounted cash flow analysis

Calculation of cost of equity (COE, %) Estimate

Market: United States of America

Market risk-free rate 3.5

Market equity risk premium 7.5

Market return 11.0

Company beta (x) 0.8

COE 9.1

Calculation of WACC Average

Cost of debt 3.8

Average tax rate 24.0

After tax cost of debt 2.9

Cost of preferred stock -

Debt as a % of total capital 23.2

Preferred stock as a % of total capital -

Equity market value as a % of total capital 76.8

Weighted average cost of capital 7.7

MCD: Valuation (US\$ m) DDM % FCFF % FCFE %

PV of cash flow in years 2023-27 20,498 18 36,031 24 38,274 22

PV of fade period 33,366 29 49,824 33 46,431 27

PV of terminal value 60,371 53 98,708 65 85,069 49

Present value of future cash flows 114,235 100 184,562 121 169,774 98

Add: Cash & ST investments na* - 2,584 2 2,584 1

Add: Long-term investments na - 1,065 1 1,065 1

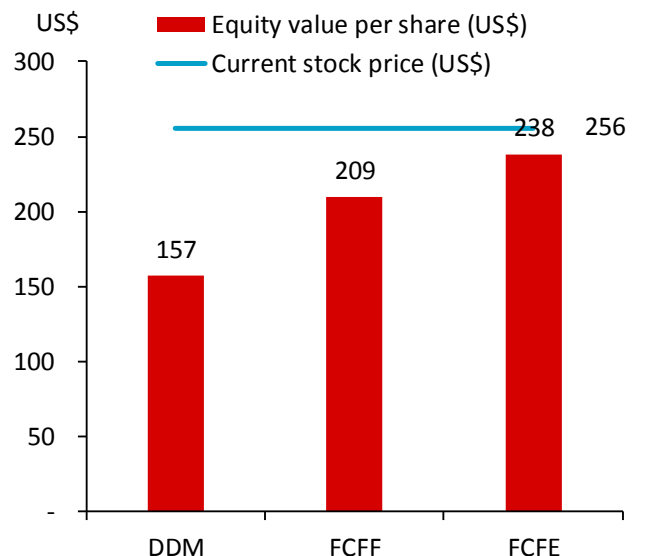
Corporate value 114,235 100 188,211 124 173,423 100

Less: Total debt, preferred stock & minorities na - (35,904) (24) na -

Shareholder value 114,235 100 152,307 100 173,423 100

Number of shares (m) 728 728 728

Equity value per share (US\$) 157 209 238



Multiple valuation



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PE ratio (x)	2021A	2022A	2023E	2024E
MCD	24.8	26.9	23.0	22.0
USA	28.0	38.9	28.2	24.1
Asia ex Japan	30.9	24.2	15.1	12.6
World	21.9	25.8	19.6	17.3

EPS growth (%)	2021A	2022A	2023E	2024E
MCD	60.8	1.1	14.0	4.6
USA	0.5	16.4	na	16.3
Asia ex Japan	(13.2)	17.6	60.3	20.0
World	55.5	(0.1)	31.7	13.1

PB ratio (x)	2021A	2022A	2023E	2024E
MCD	(38.8)	(32.0)	(25.9)	(22.8)
USA	7.1	9.4	8.0	6.8
Asia ex Japan	2.3	2.1	1.9	1.7
World	3.1	3.5	3.3	2.9

ROE (%)	2021A	2022A	2023E	2024E
MCD	na	na	na	na
USA	25.4	24.2	28.6	28.2
Asia ex Japan	7.5	8.8	12.9	13.8
World	14.3	13.5	16.6	16.9

What is your company worth?

**Message me, and let's discuss
the value of your company**

