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Dow 30

25,335.74  
+440.53 (+1.77%)



Nasdaq

7,560.81  
+132.86 (+1.79%)



Russell 2000

1,597.14  
+25.18 (+1.60%)



# Intrinsic Value Introduction

## McDonald's

Stig Brodersen October 16, 2017

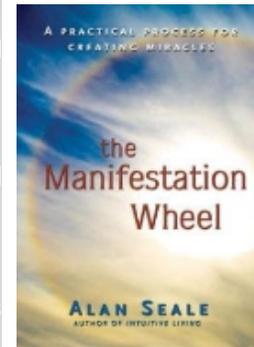
McDonald's is an employer of 350,000 people and serves 68 million people daily across 119 countries. These restaurants are either owned by McDonald's or are franchised restaurants; this can be both positive and negative to the Golden Arches brand as we explore later. Franchising is responsible for operating over 80% of the branches and is, therefore, creating a strong flow of capital for the corporation. As McDonald's owns all of the lands on which the restaurants are established it has a large real estate empire and this married with co-investment from franchisees has led to one of the most successful franchises in the world economy. In 2014 of the total \$1.2 trillion in sales generated by all the world's 'Informal Eating Out' (IEO) Segment, McDonald's which accounts for 0.5% of all IEO's globally, generated 7.2% of sales. When this sector is expanded to include all restaurants McDonald's market presence is 0.2%, and yet it accounts for 3.6% of sales in the market of \$2.4 trillion sales. As we can see from the above performance, McDonald's is a major fixture in the global eatery marketplace.

### Intrinsic Value

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McDonald's has a consistent free cash flow which allows high ranking members of the corporation to reinvest the money into the company through expansion into other marketplaces. As we can see the FCF has grown 70% of the time over the last decade, this indicates that the company has been run with controlled spending and positive income flows generated from its franchise income. We like to see this level of continued FCF growth as it shows a competent management is in place and can control both the inflows and outflows of the corporation.

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Above we can see the 10 years projected free cash flow for McDonald's with 3 projected future FCF bands containing an Upper (5% growth), Middle (2% growth) and Lower (-2% growth). I selected the upper band by judging the size of the company and how much potential for growth there actually is, with the company being so globalized there is little room for expansion. Therefore the level of growth achieved is unlikely to grow at any large rates or even more significant than it has over the past decade which has been 4.5%.

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The middle band was selected on a similar principle to the upper band about such past levels of growth being extremely unlikely to replicate. The lower band uses negative growth also at such a low level in spite of the company's lack of room to expand as it receives such a healthy stipend through franchise revenue. The IRR which will be generated based on my calculations will be 1.3% this level of return is in line with the yield on US T-Bills which once factored for inflation generates just below 1%. The level of dividends payments over

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the last decade have been between \$2 and \$4 a share. T

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his payout ratio for these dividends has been quite high over the last few years between 60-70%. This level of payout is large and is something which the company can keep providing as they are more than likely not going to expand over the foreseeable future. Also, any repercussions in reducing the dividend will greatly out way any minimal growth achieved by expansion. This level of payment may be due to the low levels of return otherwise generated by the stock and is the company's way of rewarding stockholders.

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### Competitive Advantage

A major moat that McDonald's possesses is its name; the name is synonymous with tasty fast food and good times. This idea is most noted in the "Happy Meal" a child's meal that comes with a toy and is the highlight of many children's outings and adult's childhood memories. McDonald's keeps this nostalgic and family element of the franchise throughout the majority of marketing campaigns and food offerings, while always projecting that image and association with the McDonalds name. This one option on the McDonalds menu accounts for just under 15% of all orders in the restaurant and is responsible for generating \$10,000,000 daily for the corporation worldwide.

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