TresVista FINANCIAL SERVICES	**McDonald's Corp. (MCD)**	**CURRENT**	**$99.47**
	Company Snapshot	**FAIR VALUE**	**$95.68**
	TresVista Recommendation – HOLD ★★★☆☆	**DOWNSIDE**	**3.8%**

Company Overview

Business Description

McDonald's Corporation **franchises and operates** McDonald's restaurants in the global restaurant industry. These restaurants serve a varied, limited, value-priced menu in more than 100 countries around the world. A franchisor can enter into two different types of agreements with MCD, a conventional franchise agreement and a developmental license arrangement.

Under the **conventional franchise arrangement**, franchisees provide a portion of the capital required by initially investing in the equipment, signs, seating and décor of their restaurant, and by reinvesting in the business over time. MCD owns the land and building or secures long-term leases for both Company-operated and conventional franchised restaurant sites. This helps in maintaining long-term occupancy rights, control related costs and assists in alignment with franchisees. In certain circumstances, the Company participates in reinvestment for conventional franchised restaurants.

Under the **developmental license arrangement**, licensees provide capital for the entire business, including the real estate interest, and the Company has no capital invested. In addition, the Company has an equity investment in a limited number of affiliates that invest in real estate and operate and/or franchise restaurants within a market.

MCD primarily recognizes itself as a franchisor as it believes that franchising is important to deliver locally-relevant customer experiences and drive profitability. However, directly operating restaurants is vital to being a dependable franchisor and is essential to providing Company personnel with restaurant operations experience.

As of December 2011, there were a total of 27,075 franchised restaurants (81% of the mix) and 6,435 (19% of the mix) Company-operated restaurants. Company-operated restaurants as a % of system-wide restaurants, has been on a decline over the last five years (2006: 23%). However, MCD believes in the communal existence of both business models, despite the Company-operated restaurants demanding higher financial resources (i.e. higher CapEx) and yielding lower operating margins. As a result, the ~80-20 mix is expected to stabilize going forward.

Revenue Model

MCD's revenues consist of **sales by Company-operated restaurants** and **fees from restaurants operated by franchisees**. Revenues from conventional franchised restaurants include **initial fees, minimum rent payments and royalties based on a percent of sales**. Revenues from restaurants licensed to affiliates and developmental licensees include a **royalty based on a percent of sales, and generally include initial fees**. Fees vary by type of site, amount of Company investment, if any, and local business conditions. These fees, along with occupancy and operating rights, are stipulated in the franchise/license agreements that generally have 20-year terms.

As of December 2011, revenues from Company-operated restaurants contributed 68% to the total company revenues with the residual 32% coming from franchised restaurants. Again, as MCD executed its refranchising strategy, revenue contribution from Company-operated restaurants has been on a decline since 2006, when the Company-operated restaurants contributed 74% to the total company revenues. Similar to the stability in restaurant mix, the revenue mix is expected to stabilize at ~70-30.

Geographic Exposure

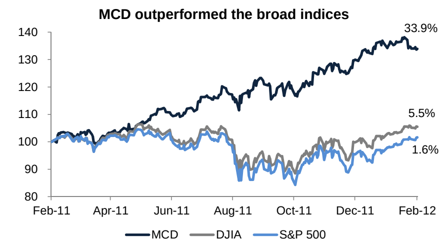
As of December 2011, **US, Europe and APMEA** (Asia-Pacific, Middle East and Africa) accounted for 32%, 40% and 22% of total revenues, respectively. UK, France and Germany, collectively, account for over 50% of Europe's revenues; and China, Australia and Japan, collectively, account for over 50% of APMEA's revenues. These six markets along with US and Canada are the major markets for the Company and they contribute ~70% to the total MCD revenues.

Sector – Restaurants
Ticker – MCD US

Company Data	
Equity Value	$102,921.6 mm
Enterprise Value	$113,062.4 mm
LTM Revenue	$27,006.0 mm
LTM Net Income	$5,503.1 mm

Per Share Data (February 2, 2012)	
Current Price	$99.47
52 Week High	$102.22
52 Week Low	$72.89
% of 52 Week High	97.3%
Number of Shares	1,034.7 mm

Multiples	
PE	
2011	19.0x
2012E	17.4x
2013E	15.7x
EV/EBITDA	
2011	11.5x
2012E	10.8x
2013E	10.2x



Source: Bloomberg

TresVista Financial Services: All prices are those current at the end of the previous trading session unless otherwise indicated. Prices are sourced from local exchanges via Bloomberg and other vendors. Investors should consider this report as only a single factor in making their investment decision. DISCLOSURES ARE LOCATED IN DISCLOSURE APPENDIX

Financial Summary

McDonald's Corp.
Income Statement
$ in mm

	Historical				
	2006	**2007**	**2008**	**2009**	**2010**
REVENUES					
Sales by Company-operated restaurants	$15,402.4	$16,611.0	$16,560.9	$15,458.5	$16,233.3
Revenues from franchised restaurants	5,492.8	6,175.6	6,961.5	7,286.2	7,841.3
Total revenues	**20,895.2**	**22,786.6**	**23,522.4**	**22,744.7**	**24,074.6**
OPERATING COSTS AND EXPENSES					
Company-operated restaurant expenses	12,905.1	13,741.7	13,652.9	12,651.2	13,059.5
Food paper	5,111.8	5,487.4	5,586.1	5,178.0	5,300.1
Payroll employee benefits	3,991.1	4,331.6	4,300.1	3,965.6	4,121.4
Occupancy other operating expenses	3,802.2	3,922.7	3,766.7	3,507.6	3,638.0
Franchised restaurants occupancy expenses	1,058.1	1,139.7	1,230.3	1,301.7	1,377.8
Selling, general administrative expenses	2,295.7	2,367.0	2,355.5	2,234.2	2,333.3
Impairment and other charges (credits), net	134.2	1,670.3	6.0	(61.1)	29.1
Other operating (income) expense, net	69.1	(11.1)	(165.2)	(222.3)	(198.2)
Total operating costs and expenses	16,462.2	18,907.6	17,079.5	15,903.7	16,601.5
Operating income	**4,433.0**	**3,879.0**	**6,442.9**	**6,841.0**	**7,473.1**
Interest expense net of capitalized interest	401.9	410.1	522.6	473.2	450.9
Nonoperating (income) expense, net	(123.3)	(103.2)	(77.6)	(24.3)	21.9
Gain on sale of investment		-	(160.1)	(94.9)	-
Income before provision for income taxes	4,154.4	3,572.1	6,158.0	6,487.0	7,000.3
Provision for income taxes	1,288.3	1,237.1	1,844.8	1,936.0	2,054.0
Income from continuing operations	2,866.1	2,335.0	4,313.2	4,551.0	4,946.3
Income from discontinued operations	678.1	60.1	-	-	-
Net income	**$3,544.2**	**$2,395.1**	**$4,313.2**	**$4,551.0**	**$4,946.3**
Diluted EPS - Continuing operations	$2.29	$1.93	$3.76	$4.11	$4.58
Weighted-average shares outstanding diluted	1,251.7	1,211.8	1,146.0	1,107.4	1,080.3
Dividends declared per common share	$1.00	$1.50	$1.63	$2.05	$2.26
Operating income	$4,433.0	$3,879.0	$6,442.9	$6,841.0	$7,473.1
Add: Impairment and other charges (credits), net	134.2	1,670.3	6.0	(61.1)	29.1
Add: Other operating (income) expense, net	69.1	(11.1)	(165.2)	(222.3)	(198.2)
Adjusted EBIT	**4,636.3**	**5,538.2**	**6,283.7**	**6,557.6**	**7,304.0**
Add: Depreciation and amortization	1,249.9	1,214.1	1,207.8	1,216.2	1,276.2
Adjusted EBITDA	**$5,886.2**	**$6,752.3**	**$7,491.5**	**$7,773.8**	**$8,580.2**
Normalized net income	$3,000.3	$4,005.3	$4,319.2	$4,489.9	$4,975.4
Adjusted EPS	**$2.40**	**$3.31**	**$3.77**	**$4.05**	**$4.61**
Operating Statistics					
Revenue growth		9.1%	3.2%	(3.3%)	5.8%
Adj. EBIT margin	22.2%	24.3%	26.7%	28.8%	30.3%
Adj. EBITDA margin	28.2%	29.6%	31.8%	34.2%	35.6%
Net income margin	17.0%	10.5%	18.3%	20.0%	20.5%
Normalized net income margin	14.4%	17.6%	18.4%	19.7%	20.7%
Days receivables	14	17	14	17	18
Days inventory	3	3	3	3	3
Days payables	17	15	15	17	24
Cash cycle	(0)	5	2	3	(3)
Total debt	$8,407.6	$9,301.1	$10,217.8	$10,578.4	$11,505.3
Net debt	$6,279.5	$7,319.8	$8,154.4	$8,782.4	$9,118.3
Total debt / EBITDA	1.4x	1.4x	1.4x	1.4x	1.3x
Net debt / EBITDA	1.1x	1.1x	1.1x	1.1x	1.1x
	$15,458.3	$15,279.8	$13,382.6	$14,033.9	$14,634.2
Effective tax rate	31.0%	34.6%	30.0%	29.8%	29.3%
ROE	**19.4%**	**26.2%**	**32.3%**	**32.0%**	**34.0%**
ROIC Calculation					
NOPLAT	$3,275.9	$3,913.2	$4,440.0	$4,633.5	$5,160.9
Current assets ex cash	$3,064.1	$1,600.6	$1,454.2	$1,620.3	$1,981.5
Less: Current liabilities ex ST debt	(2,933.9)	(2,507.4)	(2,506.1)	(2,970.6)	(2,916.4)
Net PP&E	19,438.1	20,984.7	20,254.5	21,531.5	22,060.6
Other assets ex Investments and advances	3,308.8	3,668.7	3,467.1	4,064.4	4,210.8
Invested capital	**$22,877.1**	**$23,746.6**	**$22,669.7**	**$24,245.6**	**$25,336.5**
ROIC	**14.3%**	**16.5%**	**19.6%**	**19.1%**	**20.4%**

Growth

- MCD has been reporting strong results over the last few years
- Even in 2009, the 3.3% decline in total revenues was primarily due to negative impact of unfavorable currency rates
  - Total Comparable Sales in 2009 essentially increased by 3.8%

Profitability

- On a non-GAAP basis, the Company, in the last five years, has never experienced any decline in margins at any level in the statement of income
- The non-GAAP EBIT and EBITDA margins, over the last five years, have increased by 815 bps and 747 bps respectively
- The consistent expansion in ROE and ROIC over the last five years is evidence of good application of capital by the Company's management team.
  - Even the marginal decline in 2009 was primarily due to an array of adverse macroeconomic events that followed the collapse of Lehman Brothers

Capital Structure

- The Company has been extremely cognizant of its debt levels and has consistently maintained a healthy Balance Sheet
  - Total Debt / EBITDA ratio of 1.4x and a Net Debt / EBITDA ratio of 1.1x has been consistently maintained
- However, MCD has been leveraging up its Balance Sheet over the past years
  - Debt, which formed 35% of the total capital of the Company in 2006, now forms 44% of the total capital of the Company
- MCD was concurrently able to lever up its capital structure and maintain a healthy Balance Sheet as a result of consistent topline growth and margin expansion

In summary, over the past five years, the Company's topline growth was fixated around mid-single digits while the margins expanded significantly on the back of its refranchising strategy which diluted the company's topline growth but was accretive to the consolidated operating margins of the Company.

SWOT Analysis

Strengths:

- Thriving business model with a good mix of Company-operated and franchised restaurants
- Solid financial performance over the past five years despite the occurrence of the global financial meltdown in 2008-09
- The refranchising strategy over the past few years has yielded positive results
- High diversity in exposure to geographies with operations across the globe makes MCD a categorically global brand
    - Flexibility and high level of adaptability in the food menu across geographies to tailor to local taste and provide a local experience
- ~80% of MCD's system-wide restaurants are run by franchisees which churn out higher margins for the Company compared to Company-operated restaurants
- Addictive food and drinks served at MCD's restaurants have ensured implied brand loyalty among MCD's customers
- Long-term licenses with franchises (20 year terms) are tight control mechanisms for MCD over the life of its franchised restaurants
- Economies of scale allows the Company to operate at high profitability levels

Weaknesses:

- Despite some stabs, MCD has been unable to successfully launch brands with exposure to different food genres, such as pizzas and organic foods
- Operations across different geographies exposes MCD to high currency risk
    - For example, the company recorded a decline in total revenues in 2009 purely due to negative impact of currency fluctuations
- Obesity and other ill effects of the food served at MCD's restaurants can lead to a tainted brand reputation
- Competition from local fast food joints who enjoy greater freedom with regards to pricing of their products
- Most of their major markets (that contribute ~70% to total revenues) are mature markets with limited or minimal scope of expansion in the product range

Opportunities:

- International expansion to untapped markets in the APMEA region can fuel the company's topline growth going forward
- New products and services could accelerate growth for MCD in its existing markets, such as the US, where sales have shown a flattish trajectory
- Product innovation to meet the changing consumers' demands over time will enable MCD to preserve the competitive advantage it currently enjoys
- Keeping stores fresh and modern via reimages will help to improve the brand image and customer experiences which will, in eventuality, boost the guest count
- Beaten down real estate markets in the US and abroad offer worthy opportunities to MCD to expand and grow the total system-wide restaurants
- Expanding its reach across different geographies and in emerging markets, via its refranchising strategy, means that they will be able to grow while attracting lower risks

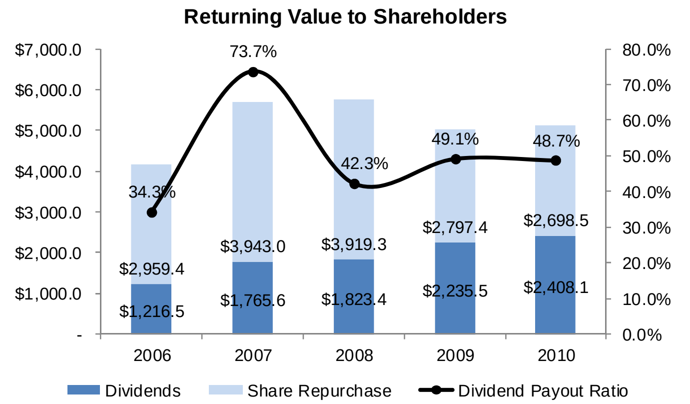
Threats:

- Competition from local fast food joints, who are in a much better position to adapt to changing trends in domestic markets due to their size
- There is a slim chance that the FDA will regulate the fast food industry since awareness regarding the calorie counts is becoming the norm in many parts of US. Further regulations may target unhealthy eating habits
- Changing eating habits of people in the US is causing many industries to change their food production and sales to encourage healthier choices and organic products
- The economic instability and the instable jobs market in the US pose threats to the performance of the Company
- Inflation has been a systemic concern in emerging economies and a commodity boom can lead to an adverse impact on MCD's operating margins
    - Such a commodity cycle will also lead to declines in the disposable incomes of the people living in emerging economies in the APMEA region

Investment Rationale

Returning Value to Shareholders

MCD has consistently been announcing dividends maintaining a payout ratio of ~50% in the past. Also, a total of $16.3bn has been spent by the Company in buyback programs over the past five years. The Company, in sum, has spent $25.8bn over the past five years to return cash to its shareholders.



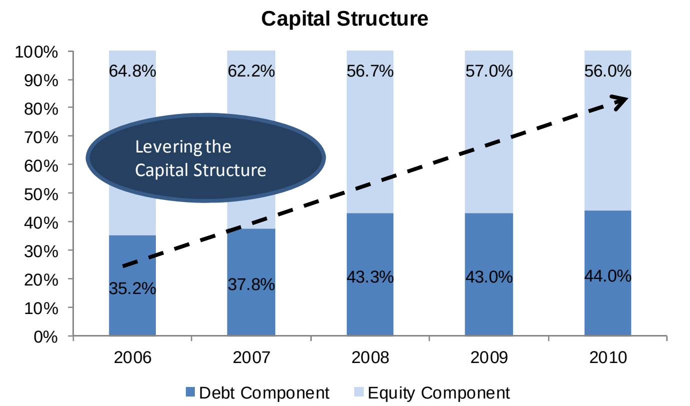
Stable Cash Flows

The franchisee business offers stability in terms of cash flows, but again, they are concurrent to the system-wide revenues and the overall performance of system-wide restaurants. Moreover, the stock was moderately in good health even during the financial crisis in 2008 and 2009, and has outperformed the DJIA and the S&P 500 convincingly in last 12 months.

Valuations Appear Stretched

As a result of the stock's run up in the last twelve months, the valuations appear stretched. The stock is currently trading at 18.9x LTM earnings and 17.4x 2012 earnings. Historically, the stock has been trading in a spectrum of 14.0x – 16.0x LTM earnings. The stock's outperformance has come on the back of three key drives:

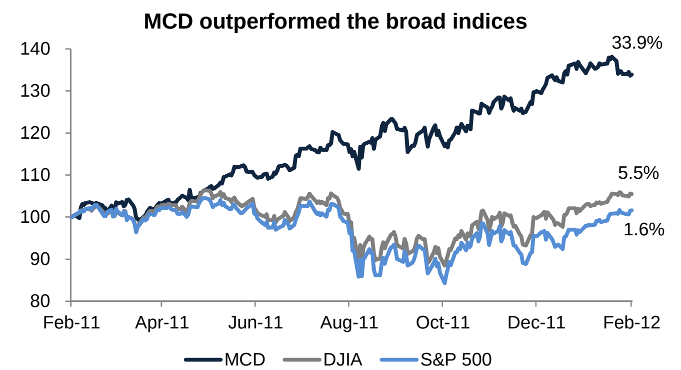
1. Earnings growth by successful deployment of debt capital
2. Increasing focus on franchising resulting in stable cash flows
3. Returning value to shareholders



Overambitious Plans?

MCD over the past five years increased their system-wide restaurant count by 1,691 restaurants. Management is now guiding 1,300 restaurant openings in 2012, which is 77% of their total restaurant openings over the past five years. Also, it plans to reimage 2,400 restaurants in 2012. It plans to spend $2.9bn in CapEx to achieve this expansion, the highest in the past five years.

The capital for the expansion is expected to come in the form of more debt and the management team, on the fourth quarter earnings call, hinted at increasing the debt levels on the balance sheet. This can potentially bring the debt component in MCD's capital structure to nearly 50% from 35% in 2006, flagging the risk profile of the company, which may, in eventuality, result in contraction of valuations.



Stock at a Tipping Point

The ambitious expansion plans and high valuations put the stock at a tipping point, given the bleak macroeconomic environment. Any bad news from Europe (40% of total revenues) can potentially punish the valuations the stock is trading at. Therefore, it would be safe to assume, that the stock is currently exposed to high execution, and thereby earnings risk.

So what's the Fair Value

Assuming a low WACC of 7% (which may climb as the company's risk profile intensifies) and a perpetuity growth rate of 1%, by our DCF valuation, we arrive at fair value of $91.20 per share. Our DDM valuation yields a fair value of $100.16 per share. Assigning a 50-50 weightage to both the methods, our target price for the stock is $95.68 per share. This represents 3.8% downside to the current market price of $99.47 per share.

	DCF				
	Terminal Perpetuity Growth				
	0.5%	0.8%	1.0%	1.3%	1.5%
6.0%	$102.97	$107.04	$111.52	$116.47	$121.98
6.5%	$93.49	$96.81	$100.43	$104.40	$108.77
7.0%	$85.47	$88.22	$91.20	$94.44	$97.97
7.5%	$78.60	$80.90	$83.39	$86.07	$88.97
8.0%	$72.65	$74.60	$76.70	$78.95	$81.37

	DDM				
	Terminal EPS Multiple				
	15.0x	16.0x	17.0x	18.0x	19.0x
6.0%	$94.43	$99.74	$105.05	$110.36	$115.67
6.5%	$92.22	$97.39	$102.57	$107.74	$112.92
7.0%	$90.06	$95.11	$100.16	$105.20	$110.25
7.5%	$87.97	$92.89	$97.81	$102.73	$107.65
8.0%	$85.95	$90.74	$95.54	$100.34	$105.13

Disclosure Appendix

Stock Rating Key:

★★★★★	**5-STARS (Strong Buy)**: Total shareholder return, is expected to outperform the broad market benchmark by a wide margin and we highly recommend that investors buy the stock.
★★★★☆	**4-STARS (Buy)**: Total shareholder return, is expected to outperform the broad market benchmark and we recommend that investors buy the stock.
★★★☆☆	**3-STARS (Hold)**: Total return is expected to be in line with the overall expected market return in the short and long term and we do not recommend a Buy or Sell.
★★☆☆☆	**2-STARS (Sell)**: Total shareholder return is expected to underperform the broad market benchmark and the stock is not anticipated to show a gain.
★☆☆☆☆	**1-STAR (Strong Sell)**: Total shareholder return is expected to underperform the broad market benchmark by a wide margin and the stock is anticipated to fall in price on an absolute basis.

Other important disclosures:

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