



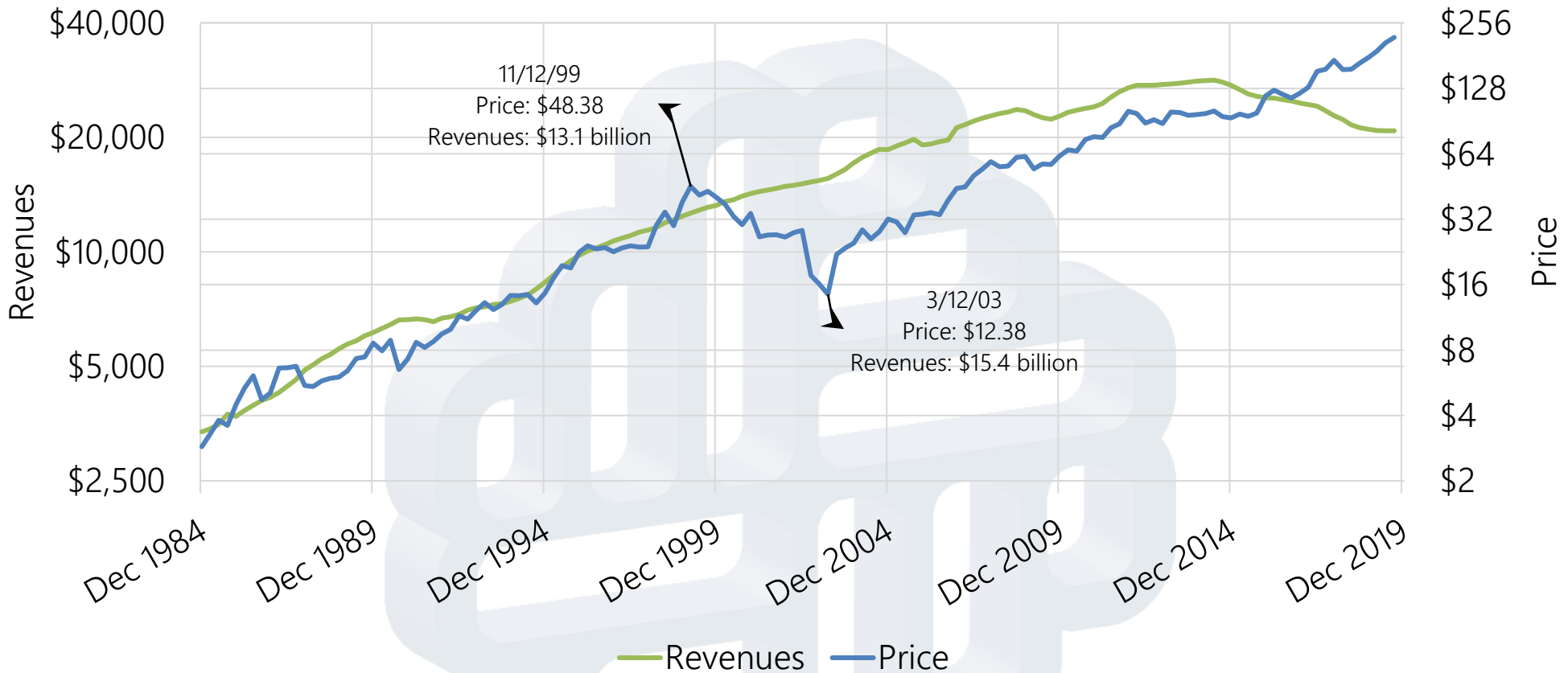
# EQUITY RISK SCIENCES

*A Quantum Leap in Investment Technology*

**McDonald's (MCD) Risk Analysis**

**September 6, 2019**

# McDONALD'S – REVENUE AND PRICE, 12/31/84 – 9/5/19



From 11/12/1999 to 3/12/2003, revenues grew 17.5%, liabilities grew 24.8% and tangible equity fell -8% (to \$8.7 bil.).  
**During this period, McDonald's stock price declined -74%. (McDonald's fell 75.5% more than the S&P 500 in this period.)**

From 6/30/2013 to 9/5/2019, revenues fell -25%, liabilities grew 175% and tangible equity fell -\$21.8 bil. (to -\$9.4 bil.).  
 During this period, McDonald's stock price rose 122%.

Two decades ago, McDonald's stock price fell -74% while revenues rose 18%.  
 In the last six years, revenues fell -25% and liabilities have soared, but the stock rose 122%.

# MCDONALD'S – REVENUE, 12/31/84 – 6/30/19



From 12/31/84 to 6/30/14, McDonald's revenues grew an average of 7.5% per year, declining in only 1 of 29 years. From 6/30/14 to 6/30/19, revenues have fallen **-26%** from \$28.3 billion to \$20.8 billion.

# MCDONALD'S – LIABILITIES, 12/31/84 – 6/30/19



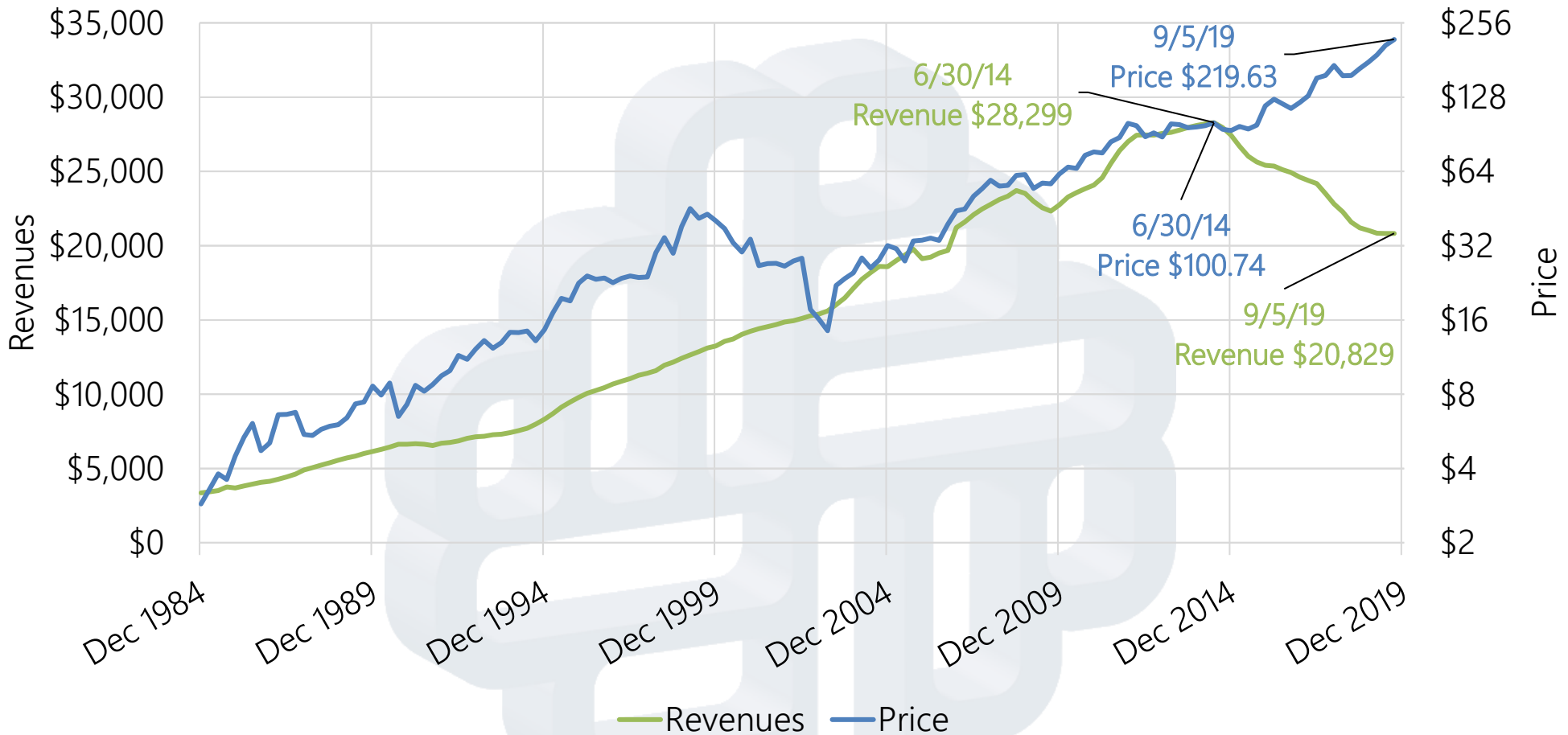
From 12/31/84 to 12/31/14, McDonald's liabilities grew an average of 7.7% per year. (Avg. revenue growth was 7.2%)  
From Dec 2014 to Jun 2019, liabilities grew 22.4% per year, from \$21.3 billion to \$53 billion.

# MCDONALD'S – NET TANGIBLE EQUITY, 12/31/84 – 6/30/19



From 12/31/84 to 12/31/06, McDonald's net tangible equity grew 9.5% per year, declining in only 3 of 22 years. From 12/31/06 to 6/30/14, net tangible equity declined by 1%, with no growth to speak of in those 7 years. From 6/30/14 to 6/30/19, net tangible equity declined from \$13.3 billion to **negative -\$9.4 billion**.

# McDONALD'S – REVENUE AND PRICE, 12/31/84 – 9/5/19



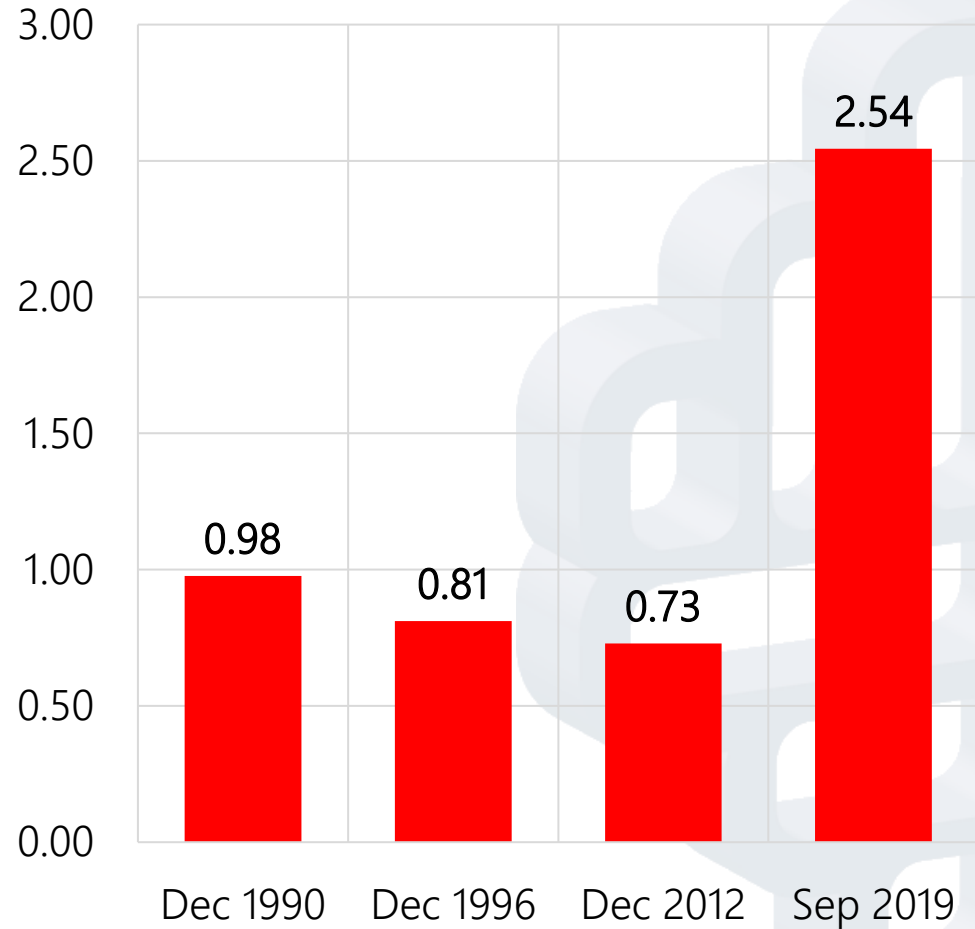
From 12/31/84 to 6/30/14, McDonald's revenues grew an average of 7.5% per year, declining in only 1 of 29 years. During this period their stock price rose from \$2.87 to \$100.74.

From 6/30/14 to 9/5/19, revenues fell **-26%** from \$28.3 billion to \$20.8 billion. However, during this period their stock price rose **118%** from \$100.74 to \$219.63.

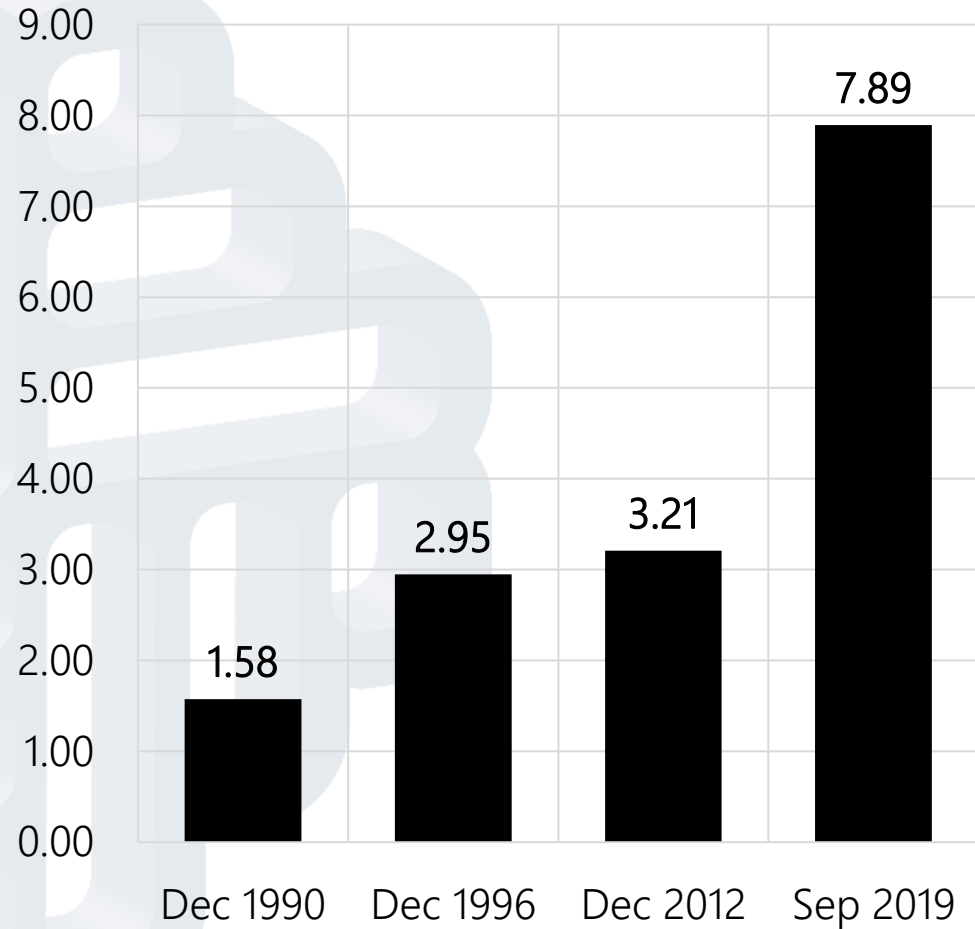
Why did their stock price rise while revenues fell, liabilities soared and equity was eliminated?

# MCDONALD'S HAS CHANGED

Debt to Revenue



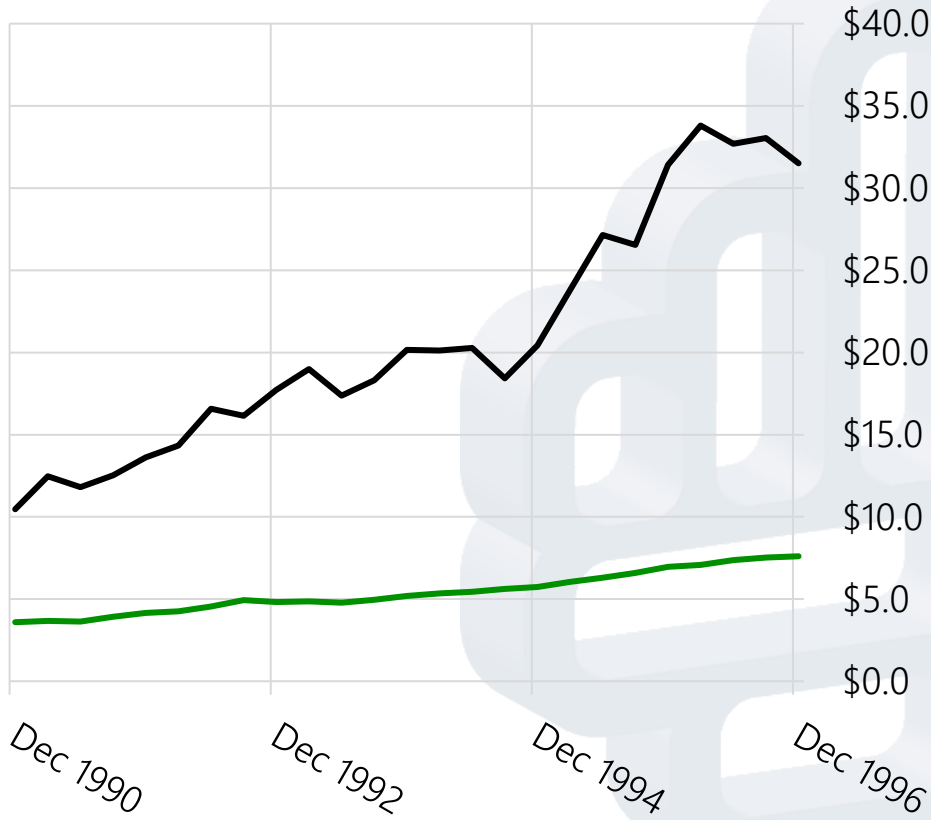
Price to Sales



# MCDONALD'S HAS CHANGED

## The McDonald's of 1990-96

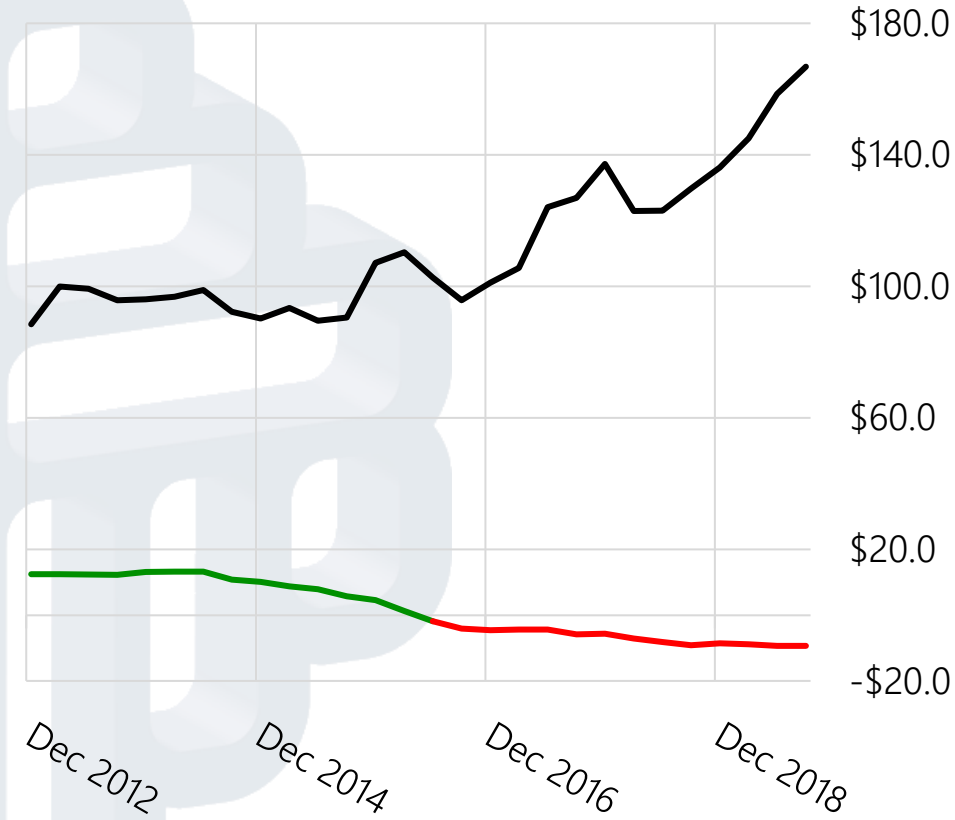
(\$ in billions)



— Market Cap — Tangible Equity

## The "New" McDonalds

(\$ in billions)



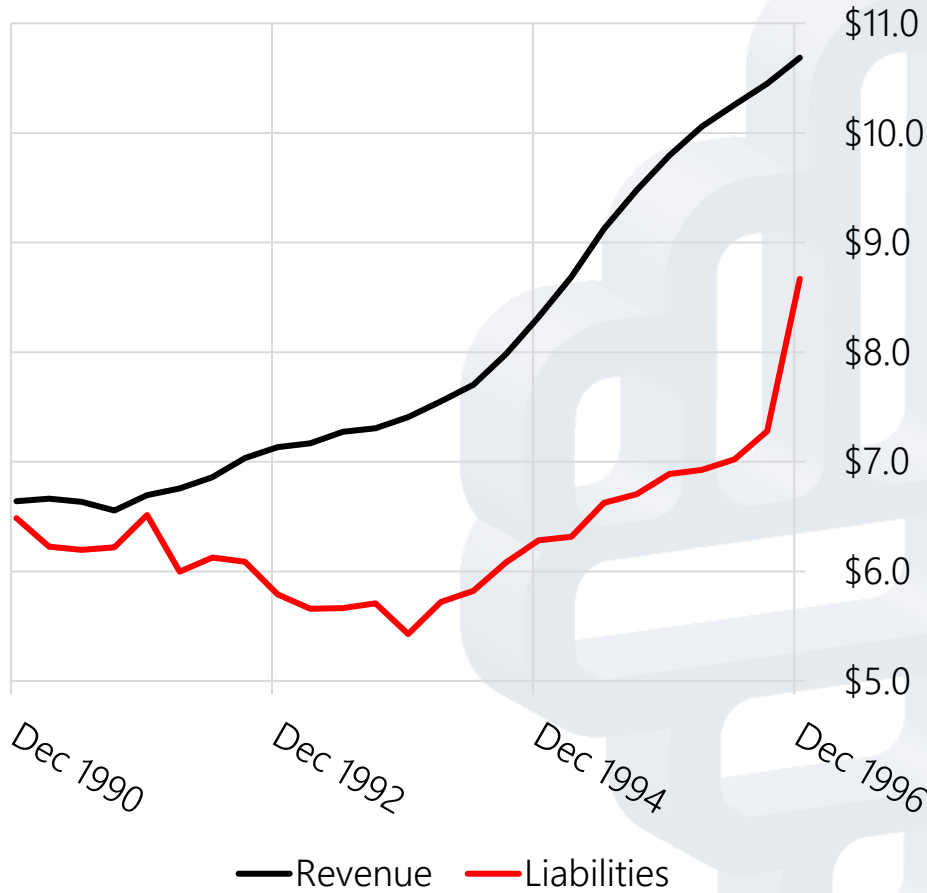
— Market Cap — Tangible Equity



# MCDONALD'S HAS CHANGED

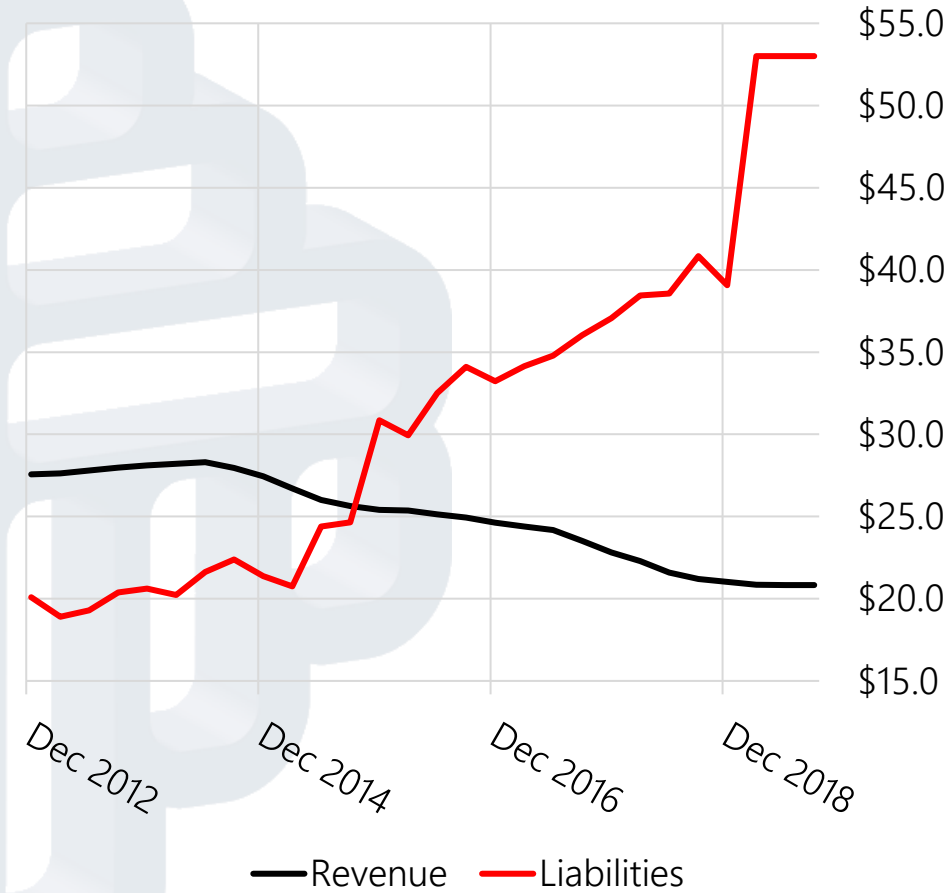
## The McDonald's of 1990-96

(\$ in billions)



## The "New" McDonald's

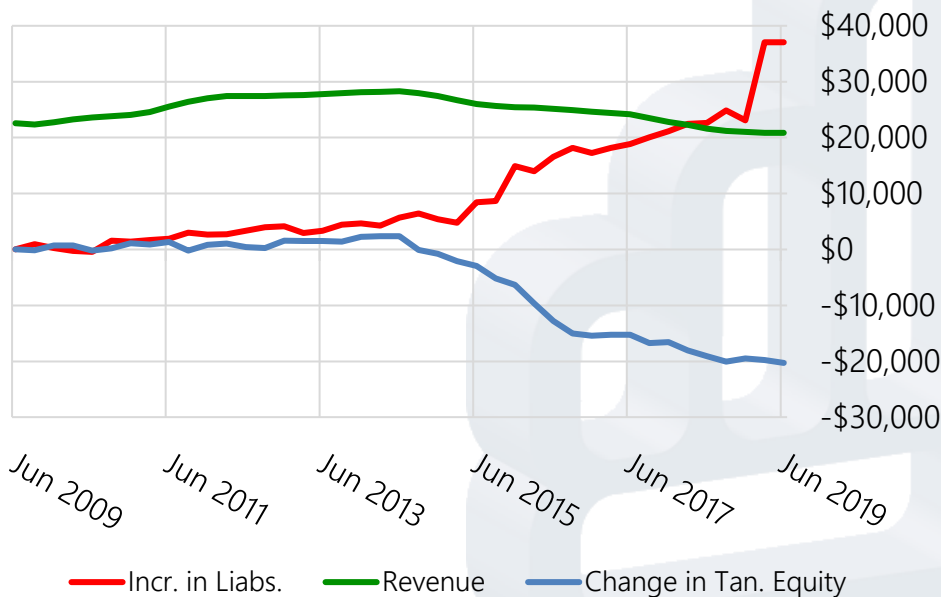
(\$ in billions)



# HOW MUCH IS MCDONALD'S WORTH?

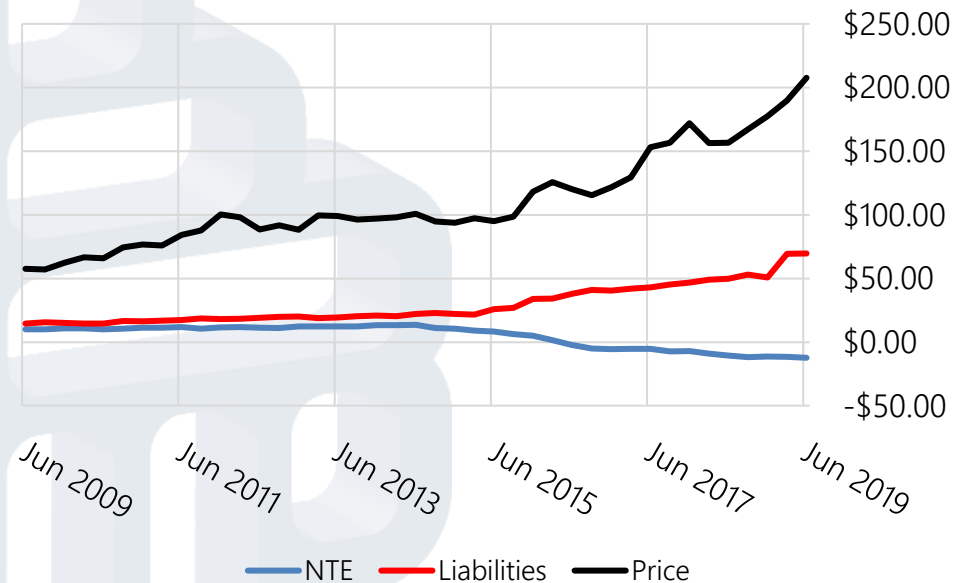
**Graph A:**

Changes in Revenues, Liabilities and Tangible Equity (\$ in millions)



**Graph B:**

Changes per share: Price, Liabilities and Tangible Equity



**Graph A** shows the relationship between McDonald's revenues and the growth of its liabilities. The company has decreased its revenues from \$22.6 to \$20.8 billion over the last 10 years, but has increased its total debts by \$37 billion over the same period. What does that say about their future ability to pay their debts?

**Graph B** shows the relationship between McDonald's debts, its equity and its share price. Over the last 10 years, the company's debts have risen from \$15 a share to nearly \$70 a share, while its tangible equity fell from \$10 a share to -\$12 a share. Given these trends, how justified has the \$150 rise in the company's stock price been? Is there any reason to expect it to continue to grow?

# HOW MUCH IS McDONALD'S "WORTH"?

## HOW SAFE IS THEIR STOCK?

| MCD's Growth    | 1990-1996 | 2013-2019 |
|-----------------|-----------|-----------|
| Revenue         | 62%       | -25%      |
| Liabilities     | 34%       | 175%      |
| Tangible Equity | 111%      | -100%     |
| Price           | 206%      | 65%       |

|           | Cost of Div's & Buybacks | Liabilities | Tangible Equity | Net Income |
|-----------|--------------------------|-------------|-----------------|------------|
| 6/30/2013 |                          | \$19,283    | \$12,392        |            |
| 6/30/2014 | \$5,322                  | \$21,626    | \$13,253        | \$5,511    |
| 6/30/2015 | \$7,459                  | \$24,387    | \$7,933         | \$4,180    |
| 6/30/2016 | \$14,773                 | \$32,507    | -\$1,859        | \$4,733    |
| 6/30/2017 | \$8,385                  | \$34,786    | -\$4,346        | \$5,079    |
| 6/30/2018 | \$9,211                  | \$38,559    | -\$8,198        | \$5,454    |
| 6/30/2019 | \$7,473                  | \$53,009    | -\$9,389        | \$5,898    |
| Sum       | \$52,622                 |             |                 | \$30,855   |
| Change    |                          | +\$33,726   | -\$21,781       |            |

| MCD's Ratios        | 12/31/1990 | 12/31/1996 | 6/30/2013 | 6/30/2019 |
|---------------------|------------|------------|-----------|-----------|
| Debt/Rev            | 98%        | 81%        | 69%       | 254%      |
| Debt to Tan. Equity | 181%       | 114%       | 156%      | -565%     |
| Price/Sales         | 156%       | 294%       | 357%      | 788%      |

- From June 2013 to June 2019, McDonald's spent \$33.4 billion to buy back its own shares;
- During this period, McDonald's spent \$19.2 billion on dividends;
- They reported \$30.8 billion of net income;
- Their liabilities grew by \$33.7 billion, and their tangible equity declined by -\$21.8 billion;

MCD, by every metric we can quantify, is a poorer, much riskier and far more expensive company than at any time in its past.

The following two pages provide greater detail. The question remains: "how safe is McDonald's?"

# HOW MUCH IS McDONALD'S "WORTH"?

## HOW SAFE IS THEIR STOCK?

The past will not tell you the future, but if the past has been dreadful, one should have clear and compelling reasons to believe that the future will be much better. Tigers do not change their stripes.

- 6 years ago, MCD had \$19.3 billion in total liabilities and \$27.8 billion in revenues.
- 6 years ago, MCD had \$12.4 billion of net tangible equity; now *negative* equity is **-\$9.4 billion**.
  - *(Negative equity occurs when your properties are mortgaged by more than 100% of their value.)*
- Since June 2013, it has bought back \$33.4 billion of its own stock, 64% with borrowed money
- If sales and profits don't grow very significantly, its debt level may be unsustainable (*Kraft Heinz*).
- Falling sales, growing debt and zero equity - these are common causes of insolvency.
- While consumer preferences change, competition is rapidly growing and becoming more fierce.

### Why do investment advisors own McDonald's stock?

- Maybe because investment advisors have and understand information which we do not.
- Maybe because all large-cap stocks are very overpriced and risky.
- Maybe because ETFs and some investment advisors, who remain fully invested in stocks at all times, must buy many stocks which are very risky to fill up their portfolios.

Maybe all three explain why highly speculative stocks are still being purchased by investment professionals. Are these the same professionals who bought Kraft Heinz at \$100 a share?

How much can MCD's stock price rise from its current level?  
More importantly, how much can it fall?

# WHAT DOES WALL STREET SAY ABOUT MCDONALD'S?

**Morningstar** has a lengthy, detailed and entirely speculative and conceptual article that explains how McDonalds WILL become very successful and IS worth holding in expectation of a turn-around. I wonder how many unsuccessful turn-arounds the author has identified?

Jul 30, 2019 – Morningstar – by R.J. Hottovy

"We like that McDonald's capital-allocation plans continue to balance global expansion efforts, reinvesting in new restaurant openings and renovations, and returning cash to shareholders. This includes capital structure optimization efforts, refranchising activities outside the U.S., and selling, general, and administrative cost reductions, which could lift longer-term shareholder returns."

Today (8/26/19) on the Morningstar site, MCD's price is considered "fairly valued" at \$215.00. They do not quantify the risks of owning the stock; they only quantify the implied, almost "promised" profits. They do not mention how much this stock could fall if XYZ conditions occur. There's no mention of the RISKS of loss if sales continue to fall, if competition continues to take their customers, if customers choose better food or if the company's finances do not improve as well as expected. Over the past 6 years, MCD's management has added tremendous leverage to the company and have destroyed \$21.8 billion of tangible equity.

**Morningstar** approves of these menacing practices; ignoring all increased risks.

Is this the most thorough, prudent and independent analysis and advice that investment professionals can provide clients? We think not.

Call **Equity Risk Sciences** for reliable and accurate risk analysis of your stock holdings.

-Raymond Mullaney, president

# INSTITUTIONAL HOLDERS OF MCD

| Owner Name                    | Date       | Value (in \$1,000s) |
|-------------------------------|------------|---------------------|
| VANGUARD                      | 6/30/2019  | \$14,689,642        |
| BLACKROCK                     | 6/30/2019  | \$11,151,371        |
| STATE STREET                  | 6/30/2019  | \$8,678,517         |
| FMR                           | 6/30/2019  | \$4,662,931         |
| PRICE T ROWE                  | 6/30/2019  | \$3,635,241         |
| WELLINGTON MGT                | 6/30/2019  | \$3,469,100         |
| BANK OF AMERICA               | 6/30/2019  | \$2,652,915         |
| NORTHERN TRUST                | 6/30/2019  | \$2,563,157         |
| GEODE CAPITAL                 | 6/30/2019  | \$2,562,377         |
| CAPITAL RESEARCH              | 6/30/2019  | \$2,550,650         |
| WELLS FARGO                   | 6/30/2019  | \$1,934,233         |
| NORGES BANK                   | 12/31/2018 | \$1,640,018         |
| BANK OF NEW YORK MELLON       | 6/30/2019  | \$1,623,395         |
| JPMORGAN                      | 6/30/2019  | \$1,507,555         |
| UBS GROUP AG                  | 6/30/2019  | \$1,470,872         |
| MORGAN STANLEY                | 6/30/2019  | \$1,344,979         |
| NUVEEN ASSET MGT              | 6/30/2019  | \$1,252,740         |
| JANUS HENDERSON               | 6/30/2019  | \$1,218,138         |
| LEGAL & GENERAL               | 6/30/2019  | \$1,047,736         |
| GOLDMAN SACHS                 | 6/30/2019  | \$963,574           |
| CA PUBLIC EMPLOYEES RETIREMT. | 6/30/2019  | \$872,969           |
| ROYAL BANK OF CANADA          | 6/30/2019  | \$823,258           |
| PNC FINANCIAL SERVICES        | 6/30/2019  | \$806,975           |
| TIAA CREF INVESTMENT MGT      | 3/31/2019  | \$753,928           |
| CHARLES SCHWAB                | 6/30/2019  | \$735,689           |
| MAGELLAN ASSET MGT            | 6/30/2019  | \$734,989           |
| DEUTSCHE BANK                 | 6/30/2019  | \$734,887           |
| AMERIPRISE FINANCIAL          | 6/30/2019  | \$708,114           |
| SUMITOMO MITSUI TRUST         | 6/30/2019  | \$705,004           |
| SWISS NATIONAL BANK           | 6/30/2019  | \$693,511           |
| <b>Total</b>                  |            | <b>\$78,188,465</b> |



# RECENT INSIDER SALES

| Trade Date | Insider Title                 | Sell Price | Shares Sold | Owned  | % of Holdings Sold | Value        |
|------------|-------------------------------|------------|-------------|--------|--------------------|--------------|
| 10/24/2018 | Pres, CEO                     | \$175.63   | -201,123    | 41,022 | <b>-83%</b>        | \$35,323,232 |
| 11/21/2017 | Pres, CEO                     | \$168.32   | -171,577    | 2,799  | <b>-98%</b>        | \$28,879,841 |
| 2/5/2019   | EVP, Chief People Officer     | \$178.25   | -76,411     | 3,148  | <b>-96%</b>        | \$13,620,261 |
| 5/1/2019   | EVP, CFO                      | \$195.90   | -40,930     | 15,991 | <b>-72%</b>        | \$8,018,078  |
| 5/3/2019   | Pres, McDonald's USA          | \$195.21   | -38,729     | 0      | <b>-100%</b>       | \$7,560,288  |
| 1/31/2018  | Pres, Int. Lead Markets, CRO  | \$173.53   | -34,575     | 25,576 | <b>-57%</b>        | \$5,999,800  |
| 8/1/2019   | EVP, CMO                      | \$212.58   | -26,649     | 21,359 | <b>-56%</b>        | \$5,665,044  |
| 1/31/2019  | Chairman Emeritus             | \$180.27   | -30,000     | 43,154 | <b>-41%</b>        | \$5,408,100  |
| 5/2/2019   | Pres - Intl Oper Mkts         | \$193.37   | -21,683     | 5,020  | <b>-81%</b>        | \$4,192,842  |
| 5/1/2019   | EVP, GC, Secretary            | \$196.40   | -20,641     | 2,797  | <b>-88%</b>        | \$4,053,974  |
| 1/31/2019  | Corp EVP - Corp Relations     | \$180.95   | -22,036     | 3,942  | <b>-85%</b>        | \$3,987,414  |
| 5/1/2018   | Exec Vice Pres, CFO           | \$165.69   | -18,636     | 14,721 | <b>-56%</b>        | \$3,087,799  |
| 10/24/2018 | EVP-Worldwide Supp Chain, Sus | \$176.17   | -15,136     | 10,391 | <b>-59%</b>        | \$2,666,509  |
| 5/1/2018   | Pres, Int. Lead Markets, CRO  | \$165.40   | -13,255     | 20,501 | <b>-39%</b>        | \$2,192,377  |
| 10/25/2017 | Corp EVP - Ops, Tech Sys      | \$165.00   | -8,046      | 7,693  | <b>-51%</b>        | \$1,327,590  |

# ERS'S PROFIT BAR ON MCDONALD'S

McDonald's Corp (MCD): Dec 31, 1998 to Sep 6, 2019 (5,213 Days)

Grouped by Metric into 10%, 10%, 20%, 20% and 40% Groups Based on PRI

Current PRI: 100.0

