McDonald's Corp MCD (NYSE) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Morningstar Credit Rating	Industry Group
91.04 USD	98.00 USD	68.60 USD	132.30 USD	Medium	Wide	Stable	Exemplary	AA-	Restaurants

Cyclical and competitive pressures continue to weigh on McDonald's brand and scale advantages.

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The primary analyst covering this company does not own its stock.

Research as of 10 Sep 2014
Estimates as of 10 Sep 2014
Pricing data through 17 Oct 2014
Rating updated as of 17 Oct 2014

Currency amounts expressed with "$" are in U.S. dollars (USD) unless otherwise denoted.

Contents

Investment Thesis 10 Sep 2014

After an impressive eight-year run from 2004 to 2011 highlighted by average annual global same-store sales growth of 5.6% and roughly 1,500 basis points of operating margin expansion to 31.6%, McDonald's fundamentals have weakened in recent years amid increased competition, self-inflicted product pipeline and marketing issues, and a tepid macro environment. Although management anticipates muted top-line growth and ongoing cost pressures in 2014, we believe it has put together a sensible long-term blueprint to better adapt to cyclical and competitive pressures while laying a foundation for more consistent growth. In particular, McDonald's plans to enhance its brand reach while maintaining profitability, emphasizing new product innovations and customization across all dayparts and pricing tiers, capacity/throughput expansion initiatives, store openings in underpenetrated emerging markets, improved marketing messaging and reach, and use of consumer-driven insights to improve the planning process with franchisees and suppliers.

It will take time to reposition McDonald's to better compete in the evolving $900 billion global quick-service restaurant industry, particularly in "priority markets" such as the United States, Germany, Australia, and Japan. We believe the company can gradually return to longer-term goals (3%-5% system sales growth, 6%-7% operating income growth, returns on incremental invested capital in the high teens). Our confidence stems from a wide economic moat rating, the result of a strong brand intangible asset, convenient restaurant locations, a cohesive franchisee system, and unrivaled bargaining and advertising scale. These qualities have put McDonald's among industry leaders with respect to average unit volume ($2.5 million per restaurant compared with the QSR industry average just north of $1 million) and operating margins (31.2% in 2013, compared with industry averages in the high teens). Nevertheless, the pace of improvements in the company's priority markets has become a concern and indicates that McDonald's brand equity may be under pressure amid industry promotional activity and fast-casual competition.

Vital Statistics

Market Cap (USD Mil)	89,395
52-Week High (USD)	103.78
52-Week Low (USD)	89.34
52-Week Total Return %	-1.3
YTD Total Return %	-3.7
Last Fiscal Year End	31 Dec 2013
5-Yr Forward Revenue CAGR %	3.7
5-Yr Forward EPS CAGR %	6.4
Price/Fair Value	0.93

Valuation Summary and Forecasts

Fiscal Year:	2012	2013	*2014(E)*	*2015(E)*
Price/Earnings	16.5	17.5	*17.1*	*15.8*
EV/EBITDA	9.9	10.4	*10.2*	*9.8*
EV/EBIT	11.6	12.3	*12.1*	*11.6*
Free Cash Flow Yield %	4.4	4.5	*4.4*	*4.8*
Dividend Yield %	3.3	3.2	*3.7*	*3.8*

Financial Summary and Forecasts (USD Mil)

Fiscal Year:	2012	2013	*2014(E)*	*2015(E)*
Revenue	27,567	28,106	*28,046*	*28,530*
Revenue YoY %	2.1	2.0	*-0.2*	*1.7*
EBIT	8,605	8,764	*8,381*	*8,687*
EBIT YoY %	0.9	1.9	*-4.4*	*3.7*
Net Income, Adjusted	5,465	5,586	*5,254*	*5,461*
Net Income YoY %	-0.7	2.2	*-6.0*	*3.9*
Diluted EPS	5.36	5.55	*5.31*	*5.77*
Diluted EPS YoY %	1.7	3.7	*-4.5*	*8.7*
Free Cash Flow	4,061	4,739	*4,459*	*4,837*
Free Cash Flow YoY %	-16.2	16.7	*-5.9*	*8.5*

Historical/forecast data sources are Morningstar Estimates and may reflect adjustments.

Profile

McDonald's generates revenue through company-owned restaurants, franchise royalties, and licensing pacts. Restaurants offer a uniform value-priced menu with some regional variations. As of June, there were 35,700 locations in more than 120 countries: 29,000 franchisee/affiliate units and 6,700 company units. McDonald's Plan to Win is a multifaceted approach to bolster sales and profitability, including menu variety and beverage choices, efficient operations, extended hours, everyday affordability, and restaurant reinvestment.

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Morningstar Analysis

Valuation, Growth and Profitability 10 Sep 2014

We are cutting our fair value estimate to $98 per share from $100 based on a modest reduction to near-term estimates stemming from recent food scare concerns across Asia, which will have negative implications for comparable sales and margins in McDonald's APMEA region. Our updated fair value implies 2015 price/earnings of 17 times, enterprise value/EBITDA of 10 times, and a free cash flow yield of 4.4%. At 16 times forward earnings and 9 times forward EBITDA, the shares trade at a discount to restaurant industry averages (19 and 11 times) and our fair value estimate. McDonald's has reiterated its long-range growth objectives of 3%-5% annual sales growth, 6%-7% average annual operating income growth, and return on invested capital in the high teens, which is roughly consistent with the later years of our discounted cash flow forecast period.

With persistent global macroeconomic headwinds, increased competitive pressures, and the food quality and safety concerns in Asia, we expect essentially flat revenue during 2014, as contribution from 1,500-1,600 new restaurant openings worldwide will be offset by a 1%-2% decline in comparable sales (compared with a three-year historical trend of 3% growth). Over a longer horizon, we expect low- to mid-single-digit revenue growth for the consolidated company, driven largely by international unit openings and a return to traffic and ticket growth through new menu innovations and inflationary price increases. Our model assumes 1%-2% top-line growth in 2015, but we believe comps may take several months to accelerate against aggressive industry promotional activity and limited price increase opportunities.

While McDonald's will fall short of its 6%-7% operating income growth target in 2014, we believe it is well positioned for longer-term margin preservation because of its bargaining clout with suppliers and strong franchisee system. We expect company-owned restaurant margins will contract about 130 basis points this year (from 17.5% in 2013) amid elevated payroll costs and expense deleverage stemming from soft APMEA region sales trends, but gradually improve toward 19% over our 10-year explicit forecast period. Over the next 10 years, our model assumes operating margins reach 33% (compared with expectations of 29.9% in 2014), driven by higher franchisee rent and royalty agreements, increased emerging-market franchises, and margin-friendly menu additions, but tempered by labor and occupancy costs.

Scenario Analysis

The key variables for our discounted cash flow model assumptions are McDonald's response to competitive pressures in the U.S. and how quickly the company can build economies of scale in international markets. Our base case assumes that the U.S., Europe, APMEA, and other international country segments deliver annual average revenue growth of 3%, 4%, 5%, and 7%, respectively, over our 10-year explicit forecast period. This implies almost 15,000 units in the U.S., more than 9,400 units in Europe, almost 15,000 units in APMEA (including roughly 4,000-5,000 units in China), and 5,300 in other countries by 2023. As the company builds scale and shifts to more of a franchised model in emerging markets, we anticipate company-operated restaurant margins to grow to around 19% and consolidated operating margins to expand to approximately 33%.

We believe the company possesses several levers to accelerate comparable sales growth and unit expansion across the globe. From a comparable sales standpoint, we're optimistic about capacity and throughput expansion plans such as additional drive-through lanes, order kiosks, and handheld order devices; investments in high-density preparation tables to allow for greater customization while maintaining speed of service; and greater breakfast daypart and beverage category penetration in the Europe and APMEA segments. We also believe that enhanced site-selection mapping tools and a more-flexible

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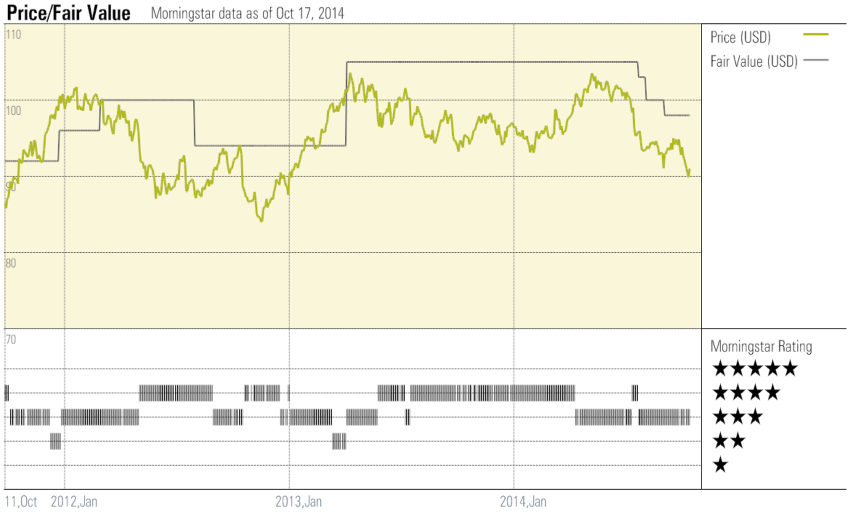
Price/Fair Value Morningstar data as of Oct 17, 2014



go-to-market restaurant buildout strategy should facilitate accelerated openings for both company-owned and franchise locations in the years to come. If new comparable-sales drivers and unit expansion efforts push U.S., Europe, APMEA, and other segment average annual top-line growth to 5%, 6%, 6%, and 12%, respectively, we believe it would be reasonable to assume a few additional points of operating margin expansion relative to our base assumptions. Assuming McDonald's increased consolidated operating margins to just over 36% over the next decade--driven by greater bargaining power over international market food suppliers, operating expense leverage at company-owned locations, and a greater proportion of franchised locations than our base model assumptions--our fair value estimate would be approximately $126 per share. Under this scenario, our model forecasts almost 15,500 units in the U.S., 9,900 units in Europe, 15,000 units in APMEA, and 5,800 in other countries by 2023.

Conversely, if the company struggles with the speed to market or pacing of new menu innovations, value menu offerings fail to resonate with consumers, site selection tools are neutralized by increased industry competition for new locations, or cyclical or competitive pressures limit menu price increase opportunities, McDonald's may fall short of our base assumptions. Assuming average annual revenue growth in the U.S., Europe, APMEA, and the other segment were to slow to 2%, 3%, 3%, and 2%, respectively, we believe it would be more difficult to the company to leverage expenses. Under this scenario, we would expect consolidated operating margins to contract to approximately 30% over the course of the next 10 years, putting our fair value estimate at about $77 per share. In this scenario, we would expect almost 14,500 units in the U.S., 8,900 units in Europe, 11,200 units in APMEA, and 4,800 in other countries by 2023.

Economic Moat

Nonexistent switching costs, intense industry competition, and low barriers to entry make it difficult for restaurant operators to establish an economic moat. Nevertheless, we believe McDonald's possesses a wide moat, stemming from a mix of structural and intangible competitive advantages including strong brand equity, cohesive franchisee system, and tremendous scale. These qualities have helped McDonald's to build the largest restaurant system in the world and leading market share in the majority of countries in which it operates (with the exception of China). McDonald's generated $89 billion in sales at its company-owned and franchised restaurants during 2013, representing 4% of the $2.3 trillion global restaurant industry (using Euromonitor estimates). This more than doubles Yum Brands' systemwide sales of $40 billion and dwarfs Subway's $12 billion.

With a widely recognized brand, consistent customer experience, convenient restaurant locations, and a largely uniform value-priced menu (with geographic variations), McDonald's is among the few restaurant concepts to be successfully replicated across the globe. McDonald's average trailing 12-month sales of around $2.5 million per

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restaurant easily trumps the quick-service restaurant industry average of just over $1 million per location. Additionally, exterior and interior restaurant decor upgrades, more-efficient kitchen and drive-through configurations, and an Innovation Center (a 38,000-square-foot facility where the company can simulate new restaurant prototypes across a wide range of configurations, technologies, dayparts, and guest count volume) should keep McDonald's productivity metrics ahead of restaurant competition.

Menu innovation has also historically played a central role in enhancing McDonald's intangible asset moat source with introduction of several margin-accretive products like McWraps and the McCafe beverage platform. Management has acknowledged executional issues with its product pipeline during 2012 and 2013, but menu innovation plans appear more robust over the next several years with launches planned across multiple dayparts, menu categories, and pricing tiers. We're also intrigued by the rollout of high-density kitchen prep tables in the U.S. during the back half of 2014, which are designed for greater customization and menu choices while maintaining speed of service, as well as enhanced value platforms across all regions and individualized customer-engagement tactics.

Management has emphasized new sales layers across protein categories (primarily beef and chicken) and reiterated the tremendous opportunities that still exists for the breakfast daypart across the entire system; breakfast represents approximately 25% of system sales in the U.S., but only 13% in Asia Pacific, Middle East, and Africa and roughly 5% in Europe. Each of these core categories (beef, chicken, breakfast) represent an incremental sales opportunity of more than $2 billion in the years to come, which should be accretive to comparable-restaurant sales trends and average unit volumes.

We also share management's enthusiasm for the potential in the beverage category, which could represent $3 billion in incremental sales and could help to expand the McDonald's brand beyond its restaurant locations. Coffee is the most significant opportunity in the beverage category, and management has laid out a game plan to build market share in the $65 billion global informal eating out coffee category through new beverage product innovations, further rollout of blended iced coffee beverages, a grocery packaged coffee partnership with Kraft (to build greater awareness of the McCafe brand), and additional McCafe restaurant locations and kiosks. Management estimates that it currently accounts for 13% of the IEO coffee market (suggesting $8.3 billion in coffee sales or roughly 9% of McDonald's $89 billion in systemwide sales during 2013), and we believe there is an opportunity to increase this number to exceed 15% over time. More important, coffee not only represents an opportunity to drive incremental traffic and drive restaurant margins, but also it can be employed as a loss leader to help developing the breakfast daypart (and by extension, the brand intangible asset) in the Europe and Asia Pacific, Middle East, and Africa segments.

We believe McDonald's brand intangible asset is enhanced by its cohesive franchisee and affiliate system, which collectively operates more than 80% of the chain. This structure allows the company to expand its brand reach with minimal corresponding capital needs while also providing an annuitylike stream of rent and royalties, even during challenging economic times. As a result, McDonald's generates excellent free cash flow and returns on invested capital in the mid- to high teens. These results are even more impressive when considering that the firm owns 45% of the land for its restaurants (more than $5.8 billion in land assets), meaning that the returns are generated on a higher invested capital base than most franchised restaurant chains. We believe considerable land assets provide an additional competitive buffer that most other restaurant

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Morningstar Analysis

firms cannot match.

As the world's largest restaurant chain in terms of systemwide sales, McDonald's wields tremendous economies of scale relative to its QSR peers. The firm can exert a significant amount of bargaining power over its suppliers, many of whom owe their existence to McDonald's, thus ensuring access to food and other raw materials at predictable, competitive prices. The McDonald's brand is also one of strongest in the world, aided by an unrivaled advertising budget of more than $800 million in 2013.

Moat Trend

Despite facing stagnant informal eating out market trends, new sources of competition, aggressive (and often irrational) industry promotional activity, limited price increase opportunities, and uneven global macroeconomic and geopolitical trends, we believe McDonald's intangible asset and cost advantage moat sources remain intact and we assign the company a stable moat trend rating. Yum Brands, Subway, a combined Burger King/Tim Hortons entity, Wendy's, and a host of new specialty fast-casual restaurant chains all vie for market share in the intensely competitive restaurant industry, and while these rivals could make it more challenging for McDonald's brand intangible asset to stand out, they do not threaten the firm's franchise system or scale advantages, in our view.

McDonald's remains the dominant player in the global QSR industry (accounting for about 12% of U.S. QSR sales, 8% of the global informal eating out marketplace, and about 4% of global restaurant sales), and productivity metrics have remained relatively healthy as the company has expanded across a wide variety of geographies. Over the next several years, we anticipate that new product innovations and customization across all dayparts and pricing tiers, capacity/throughput expansion initiatives, store openings in underpenetrated emerging markets, improved marketing messaging and reach, and use of consumer-driven insights to improve the planning process with franchisees and suppliers will help to protect the company's intangible asset moat source. We also believe these initiatives will help drive traffic across the globe and ultimately encourage trade-up and add-on purchases as the global macroeconomic picture improves, boosting the average transaction size in the process. However, if traffic trends continue to lag over an extended period, this indicates that McDonald's brand equity may be waning amid industry promotional activity and heightened industry competition, potentially putting our stable moat trend rating at risk.

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Bulls Say/Bears Say

Bulls Say

- By 2015, management believes franchisees can account for 20%-25% of China restaurants compared with 15% in 2013. We believe this will help bring APMEA margins closer to other divisions and supports our longer-term margin forecasts.
- Despite an influx of new entrants, we believe McDonald's can remain the dominant player in the QSR breakfast category, which accounts for 25% of its U.S. sales but 35%-40% of operating profits.
- With a dividend yield around 3%, McDonald's is suitable for income investors looking for more defensive exposure to an expanding global middle class, in our view.

Bears Say

- The global QSR industry is fiercely competitive, marked by a history of price wars. The explosive growth of the fast-casual category could make it more difficult for McDonald's to stand out among a more affluent millennial audience.
- Food commodity and labor cost volatility and foreign currency movements could disrupt McDonald's quarter-to-quarter results.
- Bankruptcies among quick-service franchisees increase during recessions. High food, energy, and labor costs are a concern, and tighter credit markets could constrain growth among smaller franchisees.

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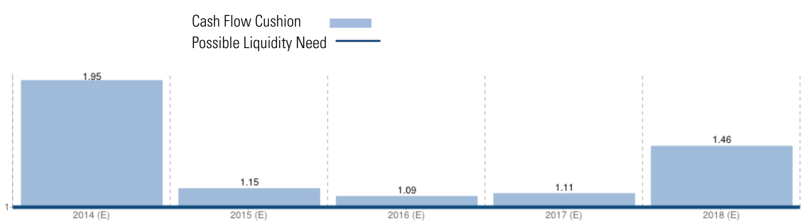
Credit Analysis

Five Year Adjusted Cash Flow Forecast (USD Mil)

	2014(E)	2015(E)	2016(E)	2017(E)	2018(E)
Cash and Equivalents (beginning of period)	2,237	1,386	1,632	332	1,333
Adjusted Available Cash Flow	2,524	2,829	3,515	3,914	4,425
Total Cash Available before Debt Service	4,760	4,215	5,148	4,246	5,758
Principal Payments	—	-1,199	-2,095	-1,054	-1,004
Interest Payments	-551	-560	-596	-627	-663
Other Cash Obligations and Commitments	-1,889	-1,921	-2,043	-2,152	-2,274
Total Cash Obligations and Commitments	-2,439	-3,680	-4,734	-3,833	-3,941

Cumulative Annual Cash Flow Cushion



Adjusted Cash Flow Summary

	USD Millions	% of Commitments
Beginning Cash Balance	2,237	12.0
Sum of 5-Year Adjusted Free Cash Flow	17,206	92.4
Sum of Cash and 5-Year Cash Generation	19,443	104.4
Revolver Availability	1,500	8.1
Asset Adjusted Borrowings (Repayment)	—	—
Sum of Cash, 5-Year Cash Generation, Revolver and Adjustments	20,943	112.4
Sum of 5-Year Cash Commitments	-18,628	—

Credit Rating Pillars–Peer Group Comparison

	MCD	Sector	Universe
Business Risk	2	5.3	5.1
Cash Flow Cushion	7	6.0	6.0
Solvency Score	4	5.3	4.7
Distance to Default	2	3.9	3.8
Credit Rating	AA-	BBB	BBB+

Source: Morningstar Estimates

Note: Scoring is on a scale 1-10, 1 being Best, 10 being Worst

Financial Health & Capital Structure

McDonald's is in sound financial health. Its debt/capital ratio is around 47%, EBITDA covers interest by approximately 20 times, and cash on the balance sheet and future cash flow easily cover debt and other debtlike commitments over the next five years. With free cash flow expected to average just under 17% of revenue the next five years (including $4.3 billion in 2014), we believe McDonald's can easily support its $14.1 billion debt burden. In addition, the balance sheet has $25.7 billion in net property, plant, and equipment (including more than $5.8 billion in land), which provides an asset base to secure debt if necessary. Morningstar assigns McDonald's an issuer credit rating of AA-, implying very low default risk.

We believe the company's current capital structure is reasonable. Debt maturities aren't a concern, as they are well spread and manageable in each of the next five years and could be fully serviced by free cash flow. In fact, minimum rent under contractual franchise arrangements more than covers maturities in each of the next five years. There is little reason to believe that McDonald's will be forced to access capital markets on unfavorable terms over the foreseeable future. In fact, given the leverageable assets on its balance sheet and a strong free cash flow profile, we believe additional leverage could be supported to help the company reach its 2014-16 cash return targets of $18 billion-$20 billion in dividends and share repurchases (which is consistent with our model assumptions calling for $8.3 billion in share repurchases and $10.3 billion in dividends over the next three years).

However, CFO Pete Bensen has been adamant in maintaining McDonald's current credit rating. Given that we believe a cohesive franchisee system is one of the key attributes of McDonald's intangible asset moat source, we believe management recognizes the importance of balancing near-term leverage and share-repurchase activity with opportunities to co-invest with franchisees to modernize locations, which reinforces our Exemplary Stewardship Rating.

Enterprise Risk

Even the best-operated restaurant chains are susceptible to cyclical headwinds, including high unemployment rates and volatile commodity, labor, and occupancy costs. We expect restaurants to increasingly compete on price and product differentiation in the years to come, including Burger King/Tim Hortons, Subway, and Yum Brands, fast-casual competitors like Panera and Chipotle, and specialty burger chains like Five Guys, In-N-Out Burger, and Smashburger. If heightened competition were to cause a material decline in restaurant productivity metrics, it could impair McDonald's brand intangible asset and its intrinsic value. With 57% of total operating profits coming from its Europe and APMEA segments, McDonald's is exposed to economic fluctuations in these regions, including currency movements, increased labor costs, and negative publicity tied to food quality concerns. Additionally, we believe the company will face increasing competition from other quick-service and fast-casual restaurant rivals as they expand globally.While its size affords McDonald's scale advantages, questions about the agility of its supply chain have surfaced recently. Although we agree with management that it possesses an "infrastructure positioned for growth," there have been instances when rivals brought new products to market more rapidly than McDonald's because of raw material procurement constraints. We believe McDonald's can improve speed to market through better communication with its key vendors and franchisees, though supply chain changes can take time.Considering its risk profile, we assign McDonald's a medium uncertainty rating. We believe the company's brand and scale advantages make it better positioned to weather global macro pressures and increased competition than most QSR peers, but the sluggish pace of strategic initiatives in its priority markets makes near-term free cash generation less visible.

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Management & Ownership

Management Activity

Name	Position	Shares Held	Report Date*	InsiderActivity
JOHN W. ROGERS,JR	Director	87,500	30 Sep 2014	—
GLORIA SANTONA	Executive VP/Secretary/General Counsel	60,719	25 Apr 2014	—
RICHARD FLOERSCH	Executive VP/Other Executive Officer	20,666	24 Apr 2014	—
PETER J. BENSEN	CFO/Senior Executive VP	13,218	12 Feb 2014	—
MR. DONALD THOMPSON	CEO/Director/President,Director	12,248	23 Apr 2014	—
JOSE ARMARIO	Executive VP, Divisional	7,932	16 Sep 2014	15,120
KEVIN OZAN	Chief Accounting Officer/ Controller/Senior VP	7,117	12 Feb 2014	—
DR. WALTER E MASSEY	Director	5,750	31 Dec 2013	—

*Represents the date on which the owner's name, position, and common shares held were reported by the holder or issuer.

Fund Ownership

Top Owners	% of Shares Held	% of Fund Assets	Change (k)	Portfolio Date
Vanguard Total Stock Mkt Idx	1.64	0.43	68	30 Sep 2014
Vanguard Five Hundred Index Fund	1.04	0.53	-43	30 Sep 2014
Vanguard Institutional Index Fund	1.01	0.53	-173	30 Sep 2014
SPDR® S&P 500 ETF	0.96	0.53	-116	16 Oct 2014
Vanguard Dividend Growth Fund	0.48	2.21	-1,640	30 Jun 2014
Concentrated Holders				
JNL/Mellon Cptl The Dow 10 Fund	0.06	9.76	-17	30 Jun 2014
Fongrum/Valor FI	—	8.36	2	31 Aug 2014
CPH Capital Forbrugsaktier	0.01	8.06	-105	31 Jul 2014
SHBNPP Tops Global SRI Equity 1	—	7.89	—	30 Jun 2014
1A Global Balanced	—	6.41	—	30 Sep 2014

Institutional Transactions

Top 5 Buyers	% of Shares Held	% of Fund Assets	Shares Bought/ Sold (k)	Portfolio Date
Arnhold & S. Bleichroeder Advisers, LLC	0.37	0.88	3,618	30 Jun 2014
Invesco Advisers, Inc	0.25	0.16	2,191	30 Jun 2014
Mason Capital Management LLC	0.20	2.33	1,946	30 Jun 2014
New Jersey Division of Pensions and Benefits	0.13	0.14	1,340	30 Jun 2010
Merrill Lynch & Co Inc	1.47	0.76	1,333	30 Jun 2014
Top 5 Sellers				
Fisher Asset Management, LLC	0.02	0.03	-4,971	30 Jun 2014
Wellington Management Company, LLP	1.31	0.35	-2,048	30 Jun 2014
Deutsche Bank AG	0.22	0.34	-1,406	30 Jun 2014
Franklin Advisers, Inc.	0.45	0.34	-1,337	30 Jun 2014
Fidelity Management and Research Company	1.55	0.21	-1,332	30 Jun 2014

Management 10 Sep 2014

McDonald's boasts exemplary corporate stewardship and a management team with a deep bench of seasoned executives. In June 2012, Don Thompson took the CEO reins from Jim Skinner, who had been CEO since November 2004 and had held various leadership responsibilities at the firm for more than 38 years. Although management acknowledged executional missteps in 2012 and 2013 with respect to product pipeline and value menu marketing, we remain optimistic about Thompson's ability to manage the company over a longer horizon. In addition to being a strong advocate of McDonald's and Skinner's Plan to Win strategy, Thompson has been a critical influence on the development of McDonald's McCafe beverage program, and we're intrigued by new ways to enhance restaurant productivity levels under his purview.

Despite laying the groundwork for global expansion, reinvesting a meaningful amount of capital to restaurant renovations across the globe, and delivering meaningful improvements in operating margins and return on invested capital during the past several years, management has remained committed to returning cash to shareholders. This includes returning $4.9 billion to shareholders in 2013. We also believe that management's plans to discuss capital structure optimization efforts (increased leverage to fund $18 billion-$20 billion in dividends and share repurchases between 2014 and 2016 while preserving its credit ratings), refranchising activities outside the U.S., and selling, general, and administrative cost controls could bolster longer-term shareholder returns. We're also encouraged that Thompson and other top executives are expected to hold a multiple of their individual base salary in company stock, which provides them with ample incentive to increase shareholder value. With 12 nonexecutive board members out of 13, we view the board as sufficiently independent. Overall, executives and directors have been excellent stewards of shareholder capital, but we would prefer a declassified board.

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Analyst Notes

McDonald's August Sales Update Reinforces That Top-Line Struggles Are Unlikely to Reverse Overnight 09 Sep 2014

McDonald's August sales update provided additional color on the magnitude of recent food supplier issues in China, its impact across the APMEA region, and its ongoing struggles in the U.S. The August comp decline of 14.5% in APMEA supports our outlook for double-digit segment comp declines over the balance of the year, and management's guidance that the supplier issue will dilute third-quarter earnings by $0.15-$0.20 per share confirms that segment restaurant margins are likely to fall to the high-single-digit or low-double-digit range the next few quarters (compared with 14% in the first half of the year). That said, we continue to assume some improvement in segment comps in 2015, as the company puts a greater emphasis on value offerings to stimulate traffic and likely engages in food-quality marketing campaigns. Longer-term, we continue to view mid-single-digit revenue growth as a reasonable assumption for APMEA.

More troubling are the continued comp pressures in the U. S., which fell 2.8% despite facing easier comparisons than July's 2.5% decline. Admittedly, McDonald's efforts to drive more consistent traffic through menu innovation/ customization, reduced operating complexity, and enhanced value platforms are only in early stages, but we plan to trim our near-term comp outlook for this region based on current trends as well as transition to new leadership. We still view our wide moat rating as valid based on a strong franchise system and scale advantages and believe current menu initiatives can be accretive longer-term, but concede that the brand intangible asset component of our stable moat trend may be at risk if traffic declines persist.

We're planning to shave a dollar or two from our fair value based on updated 2014 and 2015 assumptions. Although shares look inexpensive using traditional valuation metrics (and still offer a dividend yield north of 3%), we believe investors must have some patience with this name given the aforementioned struggles.

July Sales Update Gives First Look at McDonald's Results Post-China Food Scare, and It's Not Pretty 08 Aug 2014

McDonald's July sales update provided the first quantifiable measures of the recent food scare issues in China, and the takeaways are less than encouraging. APMEA segment comps fell 7.3% for the month, and given that the food scare only impacted the final weeks of the period, we believe this will now put McDonald's on track for double-digit comp declines in the region for the back half of the year. Given that China is also a heavily company-operated region for McDonald's, the comp declines will also drive expense deleverage, with APMEA restaurant margins potentially falling to the low-double-digit range (compared to 14% in the first half of the year) and consolidated restaurant margins coming in at or below 17%. That said, we believe investors must put the food scare situation in perspective, as the affected regions represent 10% of system sales and that global restaurant chains have historically bounced back from issues like these through a greater emphasis on value offerings and food quality marketing campaigns. Assuming no additional supplier issues surface, we would expect a rebound in APMEA comps and margins in the back half of 2015.

Nevertheless, U.S. comps, which fell 3.2% and lapped the Monopoly promotion a year ago, were not much more comforting. We still find merit in plans to drive more consistent traffic through menu innovation/customization, reduced operating complexity, and enhanced value platforms, but the lack of tangible results from these efforts is a concern. We still believe our wide moat rating is valid based on a strong franchise system and scale advantages,

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Analyst Notes

but our stable moat trend may be at risk if traffic continues to struggle.

We're planning a modest reduction in our fair value based on our updated near-term outlook. Although shares look inexpensive relative to traditional valuation metrics (and still offer a healthy dividend yield north of 3%), we believe investors must have some patience with this name given the aforementioned issues.

Yum's Comments on Food Scare in China Validate Our Concerns, but May Create Buying Opportunities 31 Jul 2014

Yum Brands and McDonald's shares have come under pressure after Yum disclosed in a July 30 8-K filing that media reports over improper food handling by Shanghai Husi, a key supplier to Yum, McDonald's, and other food-service firms across Asia, has resulted in "a significant, negative impact to same-store sales at both KFC and Pizza Hut in China over the past 10 days" and that "if the significant sales impact is sustained, it will have a material impact on full-year EPS."

Yum immediately terminated its relationship with OSI globally and we do not view this development as indicative of structural supply chain concerns at any of the restaurant chains affected, but this announcement corroborates our fears that negative publicity could adversely affect top-line and operating margin results for Yum's China and McDonald's APMEA divisions over the foreseeable future.

We've already cut our second-half same-store sales outlook for Yum China to low- to mid single-digit growth (versus guidance calling for high-single-digit growth) and expect a low-single-digit decline in McDonald's APMEA segment comps, but acknowledge there could still be downside risk based on current consumer sentiment toward Western QSR brands. We also concede that it may take longer for traffic to rebound compared to previous food quality scares in the region given that this comes on the heels of last year's poultry supplier controversy. Nevertheless, we believe both Yum and McDonald's brand intangible assets--factors behind our moat ratings for each firm--are strong enough to weather this development through new menu innovations and food quality marketing campaigns. Both firms face heightened near-term volatility, but we believe the pullback creates potential buying opportunities for longer-term investors. Yum and McDonald's are both trading at discounts to our $82 and $103 fair value estimates, respectively, with Yum currently looking like the more compelling risk/reward proposition at a 16% discount.

Latest China Food Safety Scare Poses Risk to Yum, McDonald's, and Other Western Restaurant Companies 23 Jul 2014

Several restaurant and food-service firms have cut ties with meat supplier OSI this week amid a China Food and Drug Administration investigation into OSI subsidiary Shanghai Husi Food for allegedly supplying expired beef and chicken to Yum Brands, McDonald's, and other food-service firms across China and other Asian markets. OSI believes the Husi incident was an isolated event, and we do not view this development as indicative of structural supply chain issues at any of the restaurant chains affected. Nevertheless, the negative publicity could adversely affect top-line and operating margin results for Yum's China and McDonald's APMEA divisions in the back half of the year.

We plan to trim our same-store sales outlook for Yum China to mid-single-digit growth for the back half of the year (KFC China is lapping negative comps in the third and fourth quarters amid last year's poultry supplier issues), falling short of guidance calling for high-single-digit growth. We still believe 18% restaurant margins are achievable for Yum

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China based on first-half trends and continued margin benefits from the recent menu revamp and store portfolio mix changes. These changes will not be enough to affect our $82 fair value estimate, however, and we still expect 20% EPS growth for the year.

For McDonald's, we now expect APMEA segment comps to decline slightly during the back half of the year and consolidated operating margins of 30%-31%. We plan to trim our $105 fair value estimate by a dollar or two to account for these changes.

Historically, restaurant companies have been able to bounce back from food quality issues (in China and other markets) through new menu innovations and food quality marketing campaigns. But given that this situation comes on the heels of other food quality scares in the region, we will continue to monitor consumer response for more severe brand impairment issues, which could have implications for our valuation assumptions and economic moat ratings.

McDonald's Plans for Customer Engagement Appropriate, but Execution Speed Is Increasing Concern 22 Jul 2014
We believe McDonald's is taking appropriate steps to drive more consistent traffic through menu innovation/customization, improved marketing messaging and reach, enhanced value platforms, and use of consumer-driven insights, but the company's execution speed is becoming a concern. Our model had assumed a modest comp decline in the U.S. and nominal growth in Europe and APMEA during the back half of the year. However, June comp declines across each region and management's outlook for a continuation of first-half trends into the second half (including negative global comps in July) raise questions about whether industry and macro headwinds have longer-lasting implications than we've assumed. McDonald's profitability remains healthy despite sluggish top-line trends--operating margins were down just 50 basis points to 30.5%--and suggests that the franchise system and scale advantages behind our wide moat rating are still valid. However, if traffic trends continue to lag, it could indicate McDonald's brand equity may be waning amid industry promotional activity and fast-casual competition, potentially putting our stable moat trend rating at risk.

There is no change to our $105 fair value estimate, as modest reductions to our near-term estimates will be offset by cash generated since our last update. For 2014, we now expect 2% top-line growth versus prior expectations of 3%. Our model also assumes 40 basis points of operating margin contraction (versus 31.2% last year) due to customer-engagement efforts and expense deleverage. Looking beyond 2014, we expect a return to low- to mid-single-digit top-line growth and operating margins in the 31%-32% range, which balances refranchising efforts with industry competition and labor cost increases. We find shares modestly undervalued and view buybacks/dividend, refranchising, and cost control plans as positives. Nevertheless, without more tangible comp improvement starting in 2015, our longer-term estimates could prove aggressive.

We continue to view management's customer-engagement and planning efforts as most critical in the U.S., where comps declined 1.5% during the quarter (including a 3.5% decrease in June) and guest traffic declines more than offset 3% contribution from menu price increases. Management reiterated its optimism for a number of current initiatives, including a "reset" of employee staffing and scheduling to maximize capacity during peak hours while eliminating inefficiencies elsewhere. We also remain encouraged about the potential for the McDonald's high-density preparation tables, which have been rolled out across much of the U.S. system. These tables are designed to incorporate new ingredients and facilitate greater customization while

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maintaining speed of service. This could create new menu innovation opportunities while also helping to enhance McDonald's brand intangible asset. Management's updated second-half outlook confirmed our thoughts that investors shouldn't expect much of a comparable sales lift from this investment in 2014, but we still believe this helps to drive a steady improvement in traffic beginning in 2015. However, we also recognize that the continued gravitation toward fast-casual restaurant chains among McDonald's more affluent customers could neutralize some of the benefits from these initiatives. We believe we have captured the give and take of these factors with our longer-term U.S. comp outlook in the low single digits, but will continue to monitor's management's efforts for reengaging with customers for changes to our longer-term assumptions.

McDonald's Dividend/Buyback, Refranchising, and G&A Plans Augment Total Shareholder Returns 28 May 2014

On May 28, McDonald's provided additional color regarding plans to return cash to shareholders, refranchising activities, and SG&A allocation, including targets of returning $18 billion-$20 billion in dividends and share repurchases between 2014-16, and refranchising 1,500 restaurants primarily in its APMEA and Europe regions by 2016.

The cash return targets (which will be partly supported by an undisclosed amount of incremental leverage) are consistent with our model, which had assumed $8.5 billion in share repurchases and $10.3 billion in dividends over the next three years. This represents a 10%-20% increase compared with the three-year period ended in 2013 and augments the broader McDonald's investment story.

The refranchising targets were directionally consistent with management comments from its Europe and APMEA investor meeting earlier this month, and we view this decision as a critical step in bringing APMEA division operating margins (23.1% in 2013) closer to McDonald's other divisions (42.8% in the U.S. and 29.6% in Europe) and supports our 10-year consolidated operating margin outlook of about 33%. Management also elaborated on its future G&A plans, committing to a reallocation of resources to the firm's global digital capabilities (which likely include online ordering, payment, and loyalty program efforts, each of which should drive improved customer engagement levels).

There is no change to our $105 fair value estimate based on today's announcements, though we believe these initiatives will bolster total shareholder returns for a wide-moat name that is well leveraged to capitalize on the expansion of middle-class consumers across many developing economies. Shares are only trading at a modest discount to our fair value, but we would not require a wide margin of safety before taking a position given the company's competitive advantages, aforementioned cash return and refranchising initiatives, and upcoming menu innovation and customization plans.

McDonald's Europe/APMEA Investor Day Reveals Strategies for Solidifying Moat Across the Globe 19 May 2014

On May 16, we attended McDonald's Europe and APMEA investor meeting, where Europe President Doug Goare and APMEA President Dave Hoffman provided a brief overview of their respective regions and answered investor questions. With these two regions representing increasingly important free cash flow contributors over the next 10 years--Europe represents 38% of consolidated operating income which we expect to grow at a mid-single-digit pace over the next several years, while Asia Pacific, Middle East, and Africa represents 17% of total operating income that we expect to increase at a high-single-digit clip--we were particularly interested in management's plans in these regions as quick-service restaurant consumer expectations continue to

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evolve. Also, each region features a key underperforming market--Germany in Europe and Japan in APMEA--and better understanding management's turnaround techniques for these regions likely shed some light on upcoming U.S. initiatives.

We walked away from the event with greater conviction that a number of the company's long-term margin expansion drivers are fully in place, including refranchising and other restaurant ownership changes, daypart expansion (including an increased emphasis on breakfast and beverages), unit-level productivity enhancements, and customer engagement efforts. Although some endeavors will take more time than others, we believe management's plans in Europe and APMEA will ultimately strengthen the company's brand equity and relationship with franchisees, two factors underpinning the intangible asset behind our wide moat rating.

There is no change to our $105 fair value estimate based on our takeaways from the event, though accelerating refranchising activity in Europe and APMEA could ultimately drive upside to our base assumptions. We view shares as fairly valued, though believe management's upcoming plans to discuss capital allocation plans, refranchising efforts, and cost cuts could provide a positive catalyst.

Restaurant ownership outside the U.S. remains one of the three key topics that management plans to address in the coming months (in addition to capital structure optimization--namely increased leverage to fund buybacks/ dividends--and selling, general, and administrative cost controls), so it was not surprising that management devoted a good deal of commentary on franchising opportunities across both regions. In APMEA, Hoffman noted that the region was ahead of plans to have franchisees account for 20%-25% of its restaurants in the region by 2015 (compared with 15% at year's end). We continue to think this will be one of the first steps in bringing APMEA consolidated operating margins (23.1% in 2013) closer to McDonald's other divisions (42.8% in the U.S. and 29.6% in Europe), and supports our 10-year consolidated operating margin outlook around 33%. We were also intrigued by new European developmental license agreements in Slovenia and Belarus (where licensees provide capital for the entire business, including the real estate), which demonstrates that international franchising opportunities will likely be facilitated through a combination of conventional licensing and developmental licensing arrangements. Additionally, management reiterated confidence that site selection mapping tools, more flexible go-to-market restaurant strategies, and providing franchisees with better access to lenders and real estate developers in each region should facilitate accelerated franchise unit openings.

On the daypart expansion front, Goare and Hoffman reiterated the tremendous opportunity that still exists for the breakfast daypart across the entire system (breakfast represents approximately 25% of system sales in the U.S., but only 13% in APMEA and roughly 5% in Europe). Some countries are further along than others in terms of consumer breakfast adoption--France, Poland, and Sweden are all poised to expand this daypart, while Japan, Germany, Italy, and Spain are at earlier stages of development or adoption-- but we believe this daypart could represent 20% of total revenue in APMEA and 10%-15% of total revenue in Europe over the next five years. We also continue to believe coffee and other beverages can also be deployed as loss leaders to further develop the breakfast daypart in the Europe and APMEA regions.

APMEA remains critical to our longer-term valuation assumptions, where 70% of the world's population resides. Although Hoffman characterized the external environment across APMEA as tough, we're still optimistic about the longer-term opportunity in this region due to favorable

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wealth creation and disposable income trends, a flight to urban centers, and young and digitally savvy populations. In fact, management estimates $9 trillion in wealth will be created in China over the next 10 years, another $9 trillion coming from India, Southeast Asia, and the Middle East, and Africa potentially developing into a key contributor. Although McDonald's will bear the brunt of some of this wealth creation through higher wages, management believes a more efficient site selection and store opening process, daypart expansion, and restaurant format extensions (increased drive-thrus locations, delivery, and coffee/dessert kiosks) will help offset these pressures.

McDonald's Japan remains in a state of transition, though we're optimistic about the new local management team's current priorities, including a reset local value menu, accelerated reimaging plans, and emphasized new menu innovation across all dayparts. Japan also remains a leader across the system for online ordering and loyalty program efforts, both of which we believe can improve customer engagement levels. We don't expect an immediate turnaround in McDonald's Japan amid a challenging macroeconomic backdrop and structural differences in the market (namely competition with convenience stores) but do think there are longer-term opportunities to enhance the company's competitive position in the market.

The informal eating out market in Europe remains in a state of contraction, with consumers choosing to eat at home more often and intensified competition with local players in certain markets. Still, McDonald's remains larger than the next nine quick-service restaurant competitors combined, and we believe the company is maintaining or growing share in most markets, lending additional credence to our wide moat rating. Despite the near-term headwinds, we still view Europe as a longer-term opportunity, and expect that several of the product innovations (McCafe in particular), capacity/throughput enhancements, customization efforts (management has already adopted its "made-for-you" assembly line enhancements at 500 locations and hopes to have 1,200 units by year-end), and site selection processes outlined for other divisions can be applied to this region. We also continue to believe McDonald's could be a key beneficiary as the macro environment in the region stabilizes, with the company generating 40% of consolidated revenue and 38% of consolidated operating income from the region.

There were also a number of questions about the German market, where the company is still struggling to regain consumer trust amid strategic missteps with respect to its value menu platform and increased competition from local bakeries. With a new management team in place and better coordination among franchisees, we believe new value offerings across menu, more effective promotions, and adopting in-store process best practices from other regions will ultimately lead to the path of recovery for this market. Adding conviction to this view is the fact that the new management team in Germany is utilizing a blueprint similar to the U.K. market over the past decade, which helped to turn that market from an under-performer to one of the stronger markets in the European system.

Top-Line Pressures Linger, but McDonald's Customer Engagement and Shareholder Initiatives Promising 22 Apr 2014

With McDonald's first-quarter results representing a continuation of muted top-line trends and lingering cost pressures, our focus has shifted to management's plans to re-engage with consumers through menu innovation and customization efforts, improved marketing messaging and reach, enhanced value platforms, and use of consumer-driven insights to improve the planning process with franchisees and suppliers. Although we anticipate it will take time for these efforts to play out--our model still assumes modest comparable sales declines in the U.S. and low-single-digit growth in Europe and APMEA the next two

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quarters--we believe these are the appropriate building blocks for driving more consistent traffic longer-term, particularly among "priority markets" such as the U.S., Germany, Australia, and Japan. Even with its recent top-line challenges, McDonald's continues to deliver resilient profitability metrics--company-operated operating margins were down just 10 basis points to 16.1%, while consolidated operating margins were down 60 basis points to 28.9%--lending support to our wide moat rating.

First-quarter results were in line with our expectations and won't affect our $105 fair value. For 2014, we continue to expect 3% top-line growth (driven largely 1,500-1,600 new restaurant openings) and 40-50 basis points of operating margin contraction (versus 31.2% last year) as a result of customer-engagement efforts and other cost headwinds. However, our model assumes a return to mid-single-digit top-line growth in 2015 and operating margins of 31%-32% over the next several years, which balances refranchising efforts with industry competition and labor cost increases. We view shares as modestly undervalued and believe management's plans to discuss capital structure optimization efforts (increased leverage to fund buybacks/dividend while preserving its credit ratings), refranchising activities outside the U.S., and SG&A cost controls could provide a positive catalyst.

Not surprisingly, we view management's customer-engagement and planning efforts as most critical in the U. S., where comparable sales declined 1.7% during the quarter and guest traffic declines (some of which was the result of unfavorable weather) more than offset 3% contribution from menu price increases. Among the initiatives discussed for the U.S. on today's conference call, we're particularly optimistic about plans for a "reset" of employee staffing and scheduling to maximize capacity during peak hours while eliminating inefficiencies elsewhere. We also remain encouraged about the potential for the McDonald's high-density preparation tables, which are expected to be rolled out across the U.S. by the middle of the year. These tables are designed to incorporate new ingredients and facilitate for greater customization while maintaining speed of service, which we expect to contribute to low-single-digit traffic gains in later years while also enhancing McDonald's brand intangible asset. We don't expect much of a comparable sales lift from this investment in 2014, but we believe this help to drive more improved comparable traffic results beginning in 2015. Breakfast also a key strategic priority in the U.S., and management noted that it had not seen much impact from Taco Bell's recent nationwide breakfast launch. We expect additional developments for this daypart (such as expanded hours and new menu items) in the months to come, which should be accretive to segment profitability.

With same-store sales growth of 1.4% and 30 basis points of company-owned operating margin expansion to 17%, Europe remains a bright spot for McDonald's relative to many rival restaurant operators in the region. We continue to believe the company is maintaining or growing share in most markets, with the exception of Germany, where management continues to work with a new local management team to reinvigorate its value menu platform. We still view Europe as a meaningful longer-term opportunity, and expect that several of the product innovations, capacity/throughput enhancements, marketing enhancements, and staffing initiatives outlined for the U.S. can be applied to this region.

The APMEA division also remains a key component of our longer-term valuation assumptions, and we believe management comments about reviewing its restaurant ownership structure and refranchising efforts are most applicable in this region. By 2015, management still believes that franchisees can account for 20%-25% of its restaurants in the region, compared to 15% at the end of 2013, supported

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Analyst Notes

by a more structured conventional franchising structure in China and refranchising efforts in other markets. We think this will be one of the first steps in bringing APMEA division consolidated operating margins (22.8% year to date) closer to McDonald's other divisions (42.7% in the U.S., 40.5% in Latin America and Canada, and 29.8% in Europe), and supports our longer-term consolidated margin goals of around 33%. Japan remains an area of concern, though many of the same corrective measures management has identified for its other priority markets should help to improve results in the region.

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Morningstar Analyst Forecasts

Financial Summary and Forecasts

Fiscal Year Ends in December

Growth (% YoY)	3-Year Hist. CAGR	2011	2012	2013	*2014* (Forecast)	*2015* (Forecast)	*5-Year Proj. CAGR*
Revenue	*5.3*	12.2	2.1	2.0	*-0.2*	*1.7*	*3.7*
EBIT	*5.5*	14.1	0.9	1.9	*-4.4*	*3.7*	*4.1*
EBITDA	*5.8*	13.7	1.5	2.5	*-4.3*	*4.1*	*4.5*
Net Income	*4.1*	11.2	-0.7	2.2	*-6.0*	*3.9*	*4.0*
Diluted EPS	*6.7*	15.0	1.7	3.7	*-4.5*	*8.7*	*6.4*
Earnings Before Interest, after Tax	*3.4*	9.5	-1.7	2.7	*-6.6*	*4.6*	*4.2*
Free Cash Flow	*1.5*	6.8	-16.2	16.7	*-5.9*	*8.5*	*7.4*

Profitability	3-Year Hist. Avg	2011	2012	2013	*2014*	*2015*	*5-Year Proj. Avg*
Operating Margin %	*31.3*	31.6	31.2	31.2	*29.9*	*30.5*	*30.9*
EBITDA Margin %	*36.8*	36.8	36.6	36.8	*35.3*	*36.1*	*36.9*
Net Margin %	*20.0*	20.4	19.8	19.9	*18.7*	*19.1*	*19.5*
Free Cash Flow Margin %	*16.5*	18.0	14.7	16.9	*15.9*	*17.0*	*18.1*
ROIC %	*21.8*	23.4	21.3	20.8	*19.2*	*19.3*	*20.7*
Adjusted ROIC %	*18.4*	19.5	18.0	17.7	*16.1*	*16.1*	*16.8*
Return on Assets %	*16.2*	16.9	16.0	15.5	*14.3*	*14.5*	*15.4*
Return on Equity %	*36.8*	37.9	36.8	35.7	*32.3*	*32.7*	*38.4*

Leverage	3-Year Hist. Avg	2011	2012	2013	*2014*	*2015*	*5-Year Proj. Avg*
Debt/Capital	*0.47*	0.46	0.47	0.47	*0.46*	*0.47*	*0.52*
Total Debt/EBITDA	*1.32*	1.26	1.35	1.37	*1.41*	*1.44*	*1.48*
EBITDA/Interest Expense	*19.85*	20.18	19.54	19.83	*17.99*	*18.40*	*18.78*

Valuation Summary and Forecasts

	2012	2013	*2014(E)*	*2015(E)*
Price/Fair Value	0.94	0.92	—	—
Price/Earnings	16.5	17.5	*17.1*	*15.8*
EV/EBITDA	9.9	10.4	*10.2*	*9.8*
EV/EBIT	11.6	12.3	*12.1*	*11.6*
Free Cash Flow Yield %	4.4	4.5	*4.4*	*4.8*
Dividend Yield %	3.3	3.2	*3.7*	*3.8*

Key Valuation Drivers

Cost of Equity %	10.0
Pre-Tax Cost of Debt %	5.0
Weighted Average Cost of Capital %	8.3
Long-Run Tax Rate %	32.7
Stage II EBI Growth Rate %	3.0
Stage II Investment Rate %	15.0
Perpetuity Year	20

Additional estimates and scenarios available for download at http://select.morningstar.com.

Discounted Cash Flow Valuation

	USD Mil	Firm Value (%)	Per Share Value
Present Value Stage I	44,503	41.9	45.19
Present Value Stage II	28,743	27.1	29.18
Present Value Stage III	32,910	31.0	33.42
Total Firm Value	**106,155**	**100.0**	**107.79**
Cash and Equivalents	2,799	—	2.84
Debt	-14,130	—	-14.35
Preferred Stock	—	—	—
Other Adjustments	-2,367	—	-2.40
Equity Value	**92,457**	**—**	**93.88**
Projected Diluted Shares	985		
Fair Value per Share (USD)	—		

The data in the table above represent base-case forecasts in the company's reporting currency as of the beginning of the current year. Our fair value estimate may differ from the equity value per share shown above due to our time value of money adjustment and in cases where probability-weighted scenario analysis is performed.

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Morningstar Analyst Forecasts

Income Statement (USD Mil)
Fiscal Year Ends in December

				Forecast	
	2011	2012	2013	*2014*	*2015*
Revenue	**27,006**	**27,567**	**28,106**	***28,046***	***28,530***
Cost of Goods Sold	16,319	16,751	17,203	*17,345*	*17,613*
Gross Profit	**10,686**	**10,816**	**10,903**	***10,700***	***10,918***
Selling, General & Administrative Expenses	2,394	2,455	2,386	*2,529*	*2,444*
Other Operating Expense (Income)	-233	-252	-247	*-209*	*-213*
Other Operating Expense (Income)	-4	8	—	—	—
Depreciation & Amortization (if reported separately)	—	—	—	—	—
Operating Income (ex charges)	**8,529**	**8,605**	**8,764**	***8,381***	***8,687***
Restructuring & Other Cash Charges	—	—	—	—	—
Impairment Charges (if reported separately)	—	—	—	—	—
Other Non-Cash (Income)/Charges	—	—	—	—	—
Operating Income (incl charges)	**8,529**	**8,605**	**8,764**	***8,381***	***8,687***
Interest Expense	493	517	522	*551*	*560*
Interest Income	-25	-9	-38	*-2*	*-2*
Pre-Tax Income	**8,012**	**8,079**	**8,205**	***7,829***	***8,125***
Income Tax Expense	2,509	2,614	2,619	*2,575*	*2,664*
Other After-Tax Cash Gains (Losses)	—	—	—	—	—
Other After-Tax Non-Cash Gains (Losses)	—	—	—	—	—
(Minority Interest)	—	—	—	—	—
(Preferred Dividends)	—	—	—	—	—
Net Income	**5,502**	**5,465**	**5,586**	***5,254***	***5,461***
Weighted Average Diluted Shares Outstanding	1,045	1,020	1,006	*990*	*947*
Diluted Earnings Per Share	**5.27**	**5.36**	**5.55**	***5.31***	***5.77***
Adjusted Net Income	5,502	5,465	5,586	*5,254*	*5,461*
Diluted Earnings Per Share (Adjusted)	**5.27**	**5.36**	**5.55**	***5.31***	***5.77***
Dividends Per Common Share	2.50	2.84	3.10	*3.33*	*3.58*
EBITDA	**9,944**	**10,093**	**10,349**	***9,906***	***10,309***
Adjusted EBITDA	**9,944**	**10,093**	**10,349**	***9,906***	***10,309***

McDonald's Corp MCD (NYSE) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Morningstar Credit Rating	Industry Group
91.04 USD	98.00 USD	68.60 USD	132.30 USD	Medium	Wide	Stable	Exemplary	AA-	Restaurants

Morningstar Analyst Forecasts

Balance Sheet (USD Mil)

Fiscal Year Ends in December	2011	2012	2013	*Forecast* 2014	*Forecast* 2015
Cash and Equivalents	1,796	1,785	2,237	*1,386*	*1,632*
Investments	540	551	562	*561*	*571*
Accounts Receivable	1,335	1,375	1,320	*1,321*	*1,347*
Inventory	117	122	124	*127*	*131*
Deferred Tax Assets (Current)	—	—	—	—	—
Other Short Term Assets	616	1,089	808	*806*	*820*
Current Assets	**4,403**	**4,922**	**5,050**	***4,201***	***4,502***
Net Property Plant, and Equipment	22,835	24,677	25,747	*27,173*	*28,470*
Goodwill	2,653	2,804	2,873	*2,614*	*2,355*
Other Intangibles	—	—	—	—	—
Deferred Tax Assets (Long-Term)	—	—	—	—	—
Other Long-Term Operating Assets	1,672	1,603	1,747	*1,743*	*1,773*
Long-Term Non-Operating Assets	1,427	1,381	1,209	*1,209*	*1,209*
Total Assets	**32,990**	**35,387**	**36,626**	***36,940***	***38,309***
Accounts Payable	961	1,142	1,086	*1,097*	*1,117*
Short-Term Debt	367	—	—	—	—
Deferred Tax Liabilities (Current)	600	669	599	*597*	*608*
Other Short-Term Liabilities	1,581	1,592	1,485	*1,482*	*1,508*
Current Liabilities	**3,509**	**3,403**	**3,170**	***3,177***	***3,232***
Long-Term Debt	12,134	13,633	14,130	*13,931*	*14,836*
Deferred Tax Liabilities (Long-Term)	1,344	1,531	1,648	*1,644*	*1,673*
Other Long-Term Operating Liabilities	1,613	1,526	1,669	*1,666*	*1,694*
Long-Term Non-Operating Liabilities	—	—	—	—	—
Total Liabilities	**18,600**	**20,093**	**20,617**	***20,417***	***21,435***
Preferred Stock	—	—	—	—	—
Common Stock	17	17	17	*17*	*17*
Additional Paid-in Capital	5,487	5,779	5,994	*5,994*	*5,994*
Retained Earnings (Deficit)	36,708	39,278	41,751	*43,709*	*45,780*
(Treasury Stock)	-28,271	-30,576	-32,180	*-33,625*	*-35,344*
Other Equity	450	796	428	*428*	*428*
Shareholder's Equity	**14,390**	**15,294**	**16,010**	***16,522***	***16,874***
Minority Interest	—	—	—	—	—
Total Equity	**14,390**	**15,294**	**16,010**	***16,522***	***16,874***

McDonald's Corp MCD (NYSE) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Morningstar Credit Rating	Industry Group
91.04 USD	98.00 USD	68.60 USD	132.30 USD	Medium	Wide	Stable	Exemplary	AA-	Restaurants

Morningstar Analyst Forecasts

Cash Flow (USD Mil)

Fiscal Year Ends in December				Forecast	
	2011	2012	2013	*2014*	*2015*
Net Income	5,503	5,465	5,586	*5,254*	*5,461*
Depreciation	1,415	1,489	1,585	*1,525*	*1,622*
Amortization	—	—	—	—	—
Stock-Based Compensation	86	93	89	*94*	*91*
Impairment of Goodwill	—	—	—	—	—
Impairment of Other Intangibles	-4	8	—	—	—
Deferred Taxes	188	135	25	*-5*	*39*
Other Non-Cash Adjustments	-79	-100	27	—	—
(Increase) Decrease in Accounts Receivable	-161	-29	56	*-1*	*-27*
(Increase) Decrease in Inventory	-52	-27	-44	*-3*	*-4*
Change in Other Short-Term Assets	—	—	—	*2*	*-14*
Increase (Decrease) in Accounts Payable	36	124	-61	*11*	*19*
Change in Other Short-Term Liabilities	217	-191	-143	*-3*	*26*
Cash From Operations	**7,150**	**6,966**	**7,121**	***6,874***	***7,213***
(Capital Expenditures)	-2,730	-3,049	-2,825	*-2,950*	*-2,920*
Net (Acquisitions), Asset Sales, and Disposals	325	236	259	*259*	*259*
Net Sales (Purchases) of Investments	—	—	—	*1*	*-10*
Other Investing Cash Flows	-166	-354	-108	*0*	*-1*
Cash From Investing	**-2,571**	**-3,167**	**-2,674**	***-2,690***	***-2,672***
Common Stock Issuance (or Repurchase)	-3,029	-2,287	-1,545	*-1,445*	*-1,719*
Common Stock (Dividends)	-2,610	-2,897	-3,115	*-3,296*	*-3,390*
Short-Term Debt Issuance (or Retirement)	261	-118	-187	—	—
Long-Term Debt Issuance (or Retirement)	743	1,322	722	*-199*	*905*
Other Financing Cash Flows	102	129	81	*-94*	*-91*
Cash From Financing	**-4,533**	**-3,850**	**-4,043**	***-5,035***	***-4,295***
Exchange Rates, Discontinued Ops, etc. (net)	-98	51	59	—	—
Net Change in Cash	**-52**	**1**	**463**	***-851***	***246***

McDonald's Corp MCD (NYSE) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Morningstar Credit Rating	Industry Group
91.04 USD	98.00 USD	68.60 USD	132.30 USD	Medium	Wide	Stable	Exemplary	AA-	Restaurants

Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

Valuation Analysis

		Price/Earnings			EV/EBITDA			Price/Free Cash Flow			Price/Book			Price/Sales		
Company/Ticker	Price/Fair Value	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)
Yum Brands Inc YUM USA	0.85	25.0	21.3	18.8	14.3	11.4	10.4	30.7	25.7	20.9	15.5	11.7	9.0	2.6	2.2	2.1
Average		25.0	21.3	18.8	14.3	11.4	10.4	30.7	25.7	20.9	15.5	11.7	9.0	2.6	2.2	2.1
McDonald's Corp MCD US	**0.93**	**17.5**	**17.1**	**15.8**	**10.4**	**10.2**	**9.8**	**22.4**	**22.8**	**20.8**	**6.0**	**5.4**	**5.3**	**3.4**	**3.2**	**3.1**

Returns Analysis

		ROIC %			Adjusted ROIC %			Return on Equity %			Return on Assets %			Dividend Yield %		
Company/Ticker	Last Historical Year Total Assets (Mil)	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)
Yum Brands Inc YUM USA	8,695 USD	32.6	29.3	29.2	18.4	17.0	18.1	50.5	62.3	56.7	12.3	16.5	17.3	1.8	1.9	2.1
Average		32.6	29.3	29.2	18.4	17.0	18.1	50.5	62.3	56.7	12.3	16.5	17.3	1.8	1.9	2.1
McDonald's Corp MCD US	**36,626** USD	**20.8**	**19.2**	**19.3**	**17.7**	**16.1**	**16.1**	**35.7**	**32.3**	**32.7**	**15.5**	**14.3**	**14.5**	**3.2**	**3.7**	**3.8**

Growth Analysis

		Revenue Growth %			EBIT Growth %			EPS Growth %			Free Cash Flow Growth %			Dividend/Share Growth %		
Company/Ticker	Last Historical Year Revenue (Mil)	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)
Yum Brands Inc YUM USA	13,084 USD	-4.0	3.0	6.8	-21.6	17.3	13.3	-7.3	6.4	13.1	3.9	-9.7	18.2	16.0	-5.8	12.7
Average		-4.0	3.0	6.8	-21.6	17.3	13.3	-7.3	6.4	13.1	3.9	-9.7	18.2	16.0	-5.8	12.7
McDonald's Corp MCD US	**28,106** USD	**2.0**	**-0.2**	**1.7**	**1.9**	**-4.4**	**3.7**	**3.7**	**-4.5**	**8.7**	**16.7**	**-5.9**	**8.5**	**9.1**	**7.5**	**7.5**

McDonald's Corp MCD (NYSE) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Morningstar Credit Rating	Industry Group
91.04 USD	98.00 USD	68.60 USD	132.30 USD	Medium	Wide	Stable	Exemplary	AA-	Restaurants

Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

Profitability Analysis

Company/Ticker	Last Historical Year Net Income (Mil)	Gross Margin % 2013	2014(E)	2015(E)	EBITDA Margin % 2013	2014(E)	2015(E)	Operating Margin % 2013	2014(E)	2015(E)	Net Margin % 2013	2014(E)	2015(E)	Free Cash Flow Margin % 2013	2014(E)	2015(E)
Yum Brands Inc YUM USA	1,390 USD	27.4	27.8	27.7	19.3	21.0	21.6	13.7	15.7	16.6	10.6	10.8	11.4	8.3	8.6	9.9
Average		27.4	27.8	27.7	19.3	21.0	21.6	13.7	15.7	16.6	10.6	10.8	11.4	8.3	8.6	9.9
McDonald's Corp MCD US	**5,586** USD	**38.8**	**38.2**	**38.3**	**36.8**	**35.3**	**36.1**	**31.2**	**29.9**	**30.5**	**19.9**	**18.7**	**19.1**	**15.3**	**14.0**	**15.1**

Leverage Analysis

Company/Ticker	Last Historical Year Total Debt (Mil)	Debt/Equity % 2013	2014(E)	2015(E)	Debt/Total Cap % 2013	2014(E)	2015(E)	EBITDA/Interest Exp. 2013	2014(E)	2015(E)	Total Debt/EBITDA 2013	2014(E)	2015(E)	Assets/Equity 2013	2014(E)	2015(E)
Yum Brands Inc YUM USA	2,989 USD	138.0	115.0	89.2	58.0	53.5	47.2	10.2	21.0	21.5	1.2	1.0	1.0	4.0	3.6	3.0
Average		138.0	115.0	89.2	58.0	53.5	47.2	10.2	21.0	21.5	1.2	1.0	1.0	4.0	3.6	3.0
McDonald's Corp MCD US	**14,130** USD	**88.3**	**84.3**	**87.9**	**46.9**	**45.8**	**46.8**	**19.8**	**18.0**	**18.4**	**1.4**	**1.4**	**1.4**	**2.3**	**2.2**	**2.3**

Liquidity Analysis

Company/Ticker	Market Cap (Mil)	Cash per Share 2013	2014(E)	2015(E)	Current Ratio 2013	2014(E)	2015(E)	Quick Ratio 2013	2014(E)	2015(E)	Cash/Short-Term Debt 2013	2014(E)	2015(E)	Payout Ratio % 2013	2014(E)	2015(E)
Yum Brands Inc YUM USA	29,911 USD	1.24	1.31	2.55	0.75	0.75	0.96	0.62	0.62	0.83	8.07	8.34	16.22	56.4	38.8	38.2
Average		1.24	1.31	2.55	0.75	0.75	0.96	0.62	0.62	0.83	8.07	8.34	16.22	56.4	38.8	38.2
McDonald's Corp MCD US	**89,395** USD	**2.22**	**1.40**	**1.72**	**1.59**	**1.32**	**1.39**	**1.55**	**1.28**	**1.35**	—	—	—	**55.8**	**62.7**	**62.1**

Research Methodology for Valuing Companies

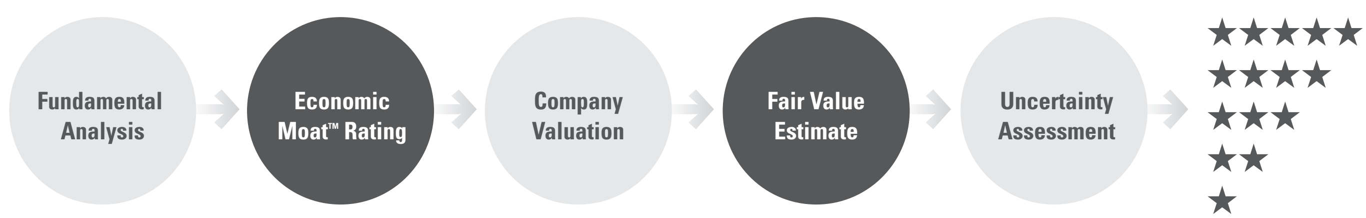
Components of Our Methodology
- Economic Moat™ Rating
- Moat Trend™ Rating
- Moat Valuation
- Three-Stage Discounted Cash Flow
- Weighted Average Cost of Capital
- Fair Value Estimate
- Scenario Analysis
- Uncertainty Ratings
- Margin of Safety
- Consider Buying/Selling
- Stewardship Rating

The Morningstar Rating for stocks identifies companies trading at a discount or premium to our analysts' assessment of their fair value. A number of components drive this rating: (1) our assessment of the firm's economic moat, (2) our estimate of the stock's intrinsic value based on a discounted cash-flow model, (3) the margin of safety bands we apply to our Fair Value Estimate, and (4) the current stock price relative to our fair value estimate.

The concept of the Morningstar Economic Moat™ Rating plays a vital role not only in our qualitative assessment of a firm's investment potential, but also in our valuation process. We assign three moat ratings—none, narrow, or wide—as well as the Morningstar Moat Trend™ Rating—positive, stable, or negative—to each company we cover. There are two major requirements for firms to earn either a narrow or wide moat rating: (1) the prospect of earning above-average returns on capital; and (2) some competitive edge that prevents these returns from quickly eroding. The assumptions we make about a firm's moat determine the length of "economic outperformance" that we assume in the latter stages of our valuation model. We also quantify the value of each firm's moat, which represents the difference between a firm's enterprise value and the value of the firm if no future net investment were to occur. Said differently, moat value identifies the value generated by the firm as a result of any future net new investment. Our Moat Trend Rating reflects our assessment of whether each firm's competitive advantage is either getting stronger or weaker, since we think of moats as dynamic, rather than static.

At the heart of our valuation system is a detailed projection of a company's future cash flows. The first stage of our three-stage discounted cash flow model can last from 5 to 10 years and contains numerous detailed assumptions about various financial and operating items. The second stage of our model—where a firm's return on new invested capital (RONIC) and earnings growth rate implicitly fade until the perpetuity year—can last anywhere from 0 years (for no-moat firms) to 20 years (for wide-moat companies). In our third stage, we assume the firm's RONIC equals its weighted average cost of capital, and we calculate a continuing value using a standard

Morningstar Research Methodology for Valuing Companies



Fundamental Analysis	Economic Moat™ Rating	Company Valuation	Fair Value Estimate	Uncertainty Assessment	★
Analyst conducts company and industry research: ► Financial statement analysis ► Channel checks ► Trade-show visits ► Industry and company reports and journals ► Conference calls ► Management and site visits	Strength of competitive advantage is rated: None, Narrow, or Wide Advantages that confer an economic moat: **High Switching Costs** (Microsoft) **Cost advantage** (Wal-Mart) **Intangible assets** (Johnson & Johnson) **Network Effect** (Mastercard) **Efficient Scale** (Lockheed Martin)	Analyst considers past financial results and focuses on competitive position and future prospects to forecast future cash flows. Assumptions are entered into Morningstar's proprietary discounted cash-flow model.	Analyst uses a discounted cash-flow model to develop a Fair Value Estimate, which serves as the foundation for the Morningstar Rating for stocks.	The analyst then evaluates the range of potential intrinsic values for the company and assigns an Uncertainty Rating: Low, Medium, High, Very High, or Extreme. The Uncertainty Rating determines the margin of safety required before we would recommend the stock. The higher the uncertainty, the wider the margin of safety.	The current stock price relative to Morningstar's Fair Value Estimate, adjusted for uncertainty, determines the Morningstar Rating for stocks. The Morningstar Rating for stocks is updated each evening after the market closes.

Research Methodology for Valuing Companies

Detailed Methodology Documents and Materials*

- Comprehensive Equity Research Methodology
- Uncertainty Methodology
- Cost of Equity Methodology
- Morningstar DCF Valuation Model
- Stewardship Rating Methodology

* Please contact a sales representative for more information.

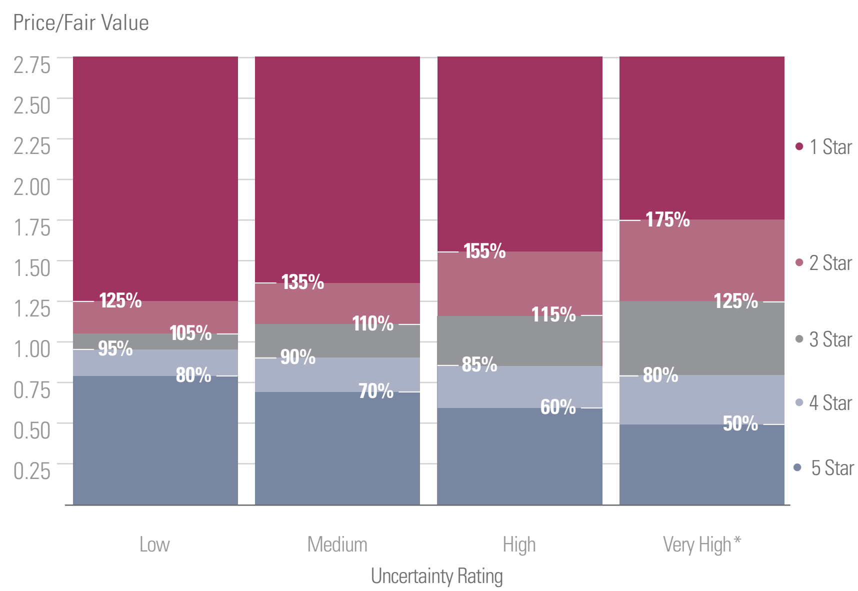
perpetuity formula. In deciding on the rate at which to discount future cash flows, we ignore stock-price volatility. Instead, we rely on a system that measures the estimated volatility of a firm's underlying future free cash flows, taking into account fundamental factors such as the diversity of revenue sources and the firm's fixed cost structure.

We also employ a number of other tools to augment our valuation process, including scenario analysis, where we assess the likelihood and performance of a business under different economic and firm-specific conditions. Our analysts typically model three to five scenarios for each company we cover, stress-testing the model and examining the distribution of resulting fair values.

The Morningstar Uncertainty Rating captures the range of these potential fair values, based on an assessment of a company's future sales range, the firm's operating and financial leverage, and any other contingent events that may impact the business. Our analysts use this range to assign an appropriate margin of safety—or the discount/premium to a fair value we apply in setting our consider buying/consider selling prices. Firms trading below our consider-buying prices receive our highest rating of five stars, whereas firms trading above our consider-selling prices receive our lowest rating of one star.

Our corporate Stewardship Rating represents our assessment of management's stewardship of shareholder capital, with particular emphasis on capital allocation decisions. Analysts consider companies' investment strategy and valuation, financial leverage, dividend and share buyback policies, execution, compensation, related party transactions, and accounting practices. Corporate governance practices are only considered if they've had a demonstrated impact on shareholder value. Analysts assign one of three ratings: "Exemplary," "Standard," and "Poor." Analysts judge stewardship from an equity holder's perspective. Ratings are determined on an absolute basis. Most companies will receive a Standard rating, and this is the default rating in the absence of evidence that managers have made exceptionally strong or poor capital allocation decisions.

Morningstar Margin of Safety and Star Rating Bands



* Occasionally a stock's uncertainty will be too high for us to estimate, in which case we label it Extreme.

Morningstar's Approach to Rating Corporate Credit

- Offers a proprietary measure of the credit quality of companies on our coverage list.
- Encapsulates our in-depth modeling and quantitative work in one letter grade.
- Allows investors to rank companies by each of the four underlying components of our credit ratings, including both analyst-driven and quantitative measures.
- Provides access to all the underlying forecasts that go into the rating, available through our institutional service.

Purpose

The Morningstar Corporate Credit Rating measures the ability of a firm to satisfy its debt and debt-like obligations. The higher the rating, the less likely we think the company is to default on these obligations.

The Morningstar Corporate Credit Rating builds on the modeling expertise of our securities research team. For each company, we publish:

- Five years of detailed pro-forma financial statements
- Annual estimates of free cash flow
- Annual forecasts of return on invested capital
- Scenario analyses, including upside and downside cases
- Forecasts of leverage, coverage, and liquidity ratios for five years
- Estimates of off balance sheet liabilities

These forecasts are key inputs into the Morningstar Corporate Credit Rating and are available to subscribers at select.morningstar.com.

Methodology

We feel it's important to perform credit analysis through different lenses—qualitative and quantitative, as well as fundamental and market-driven. We therefore evaluate each company in four broad categories.

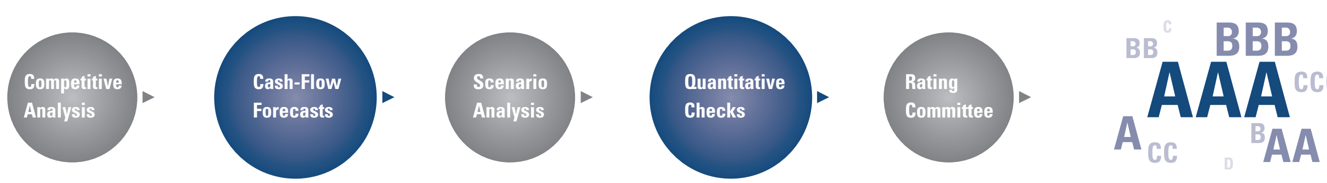
Business Risk

Business Risk captures the fundamental uncertainty around a firm's business operations and the cash flow generated by those operations. Key components of the Business Risk rating include the Morningstar Economic Moat™ Rating and the Morningstar Uncertainty Rating.

Cash Flow Cushion™

Morningstar's proprietary Cash Flow Cushion™ ratio is a fundamental indicator of a firm's future financial health The measure reveals how many times a company's internal cash generation plus total excess liquid cash will cover its debt-like contractual commitments over the next five years. The Cash Flow Cushion acts as a predictor of financial distress, bringing to light potential refinancing, operational, and liquidity risks inherent to the firm.

Morningstar Research Methodology for Determining Corporate Credit Ratings



Competitive Analysis: Analyst conducts company and industry research:

- Management interviews
- Conference calls
- Trade show visits
- Competitor, supplier, distributor, and customer interviews
- Assign Economic Moat™ Rating

Cash-Flow Forecasts: Analyst considers company financial statements and competitive dynamics to forecast future free cash flows to the firm.

Analyst derives estimate of Cash-Flow Cushion™.

Scenario Analysis: Analysts run bull and bear cases through the model to derive alternate estimates of enterprise value.

Based on competitive analysis, cash-flow forecasts, and scenario analysis, the analyst assigns Business Risk.

Quantitative Checks: We gauge a firm's health using quantitative tools supported by our own backtesting and academic research.

- Morningstar Solvency Score™
- Distance to Default

Rating Committee: Senior personnel review each company to determine the appropriate final credit rating.

- Review modeling assumptions
- Approve company-specific adjustments

AAA	Extremely Low Default Risk
AA	Very Low Default Risk
A	Low Default Risk
BBB	Moderate Default Risk
BB	Above Average Default Risk
B	High Default Risk
CCC	Currently Very High Default Risk
CC	Currently Extreme Default Risk
C	Imminent Payment Default
D	Payment Default
UR	Under Review
UR+	Positive Credit Implication
UR-	Negative Credit Implication

Morningstar's Approach to Rating Corporate Credit

The advantage of the Cash Flow Cushion ratio relative to other fundamental indicators of credit health is that the measure focuses on the future cash-generating performance of the firm derived from Morningstar's proprietary discounted cash flow model. By making standardized adjustments for certain expenses to reflect their debt-like characteristics, we can compare future projected free cash flows with debt-like cash commitments coming due in any particular year. The forward-looking nature of this metric allows us to anticipate changes in a firm's financial health and pinpoint periods where cash shortfalls are likely to occur.

Morningstar Solvency Score™

The Morningstar Solvency Score™ is a quantitative score derived from both historical and forecasted financial ratios. It includes ratios that focus on liquidity (a company's ability to meet short term cash outflows), profitability (a company's ability to generate profit per unit of input), capital structure (how does the company finance its operations), and interest coverage (how much of profit is used up by interest payments).

Distance to Default

Morningstar's quantitative Distance to Default measure ranks companies on the likelihood that they will tumble into financial distress. The measure is a linear model of the percentile of a firm's leverage (ratio of Enterprise Value to Market Value), the percentile of a firm's equity volatility relative to the rest of the universe and the interaction of these two percentiles. This is a proxy methodology for the common definition of Distance to Default which relies on option-based pricing models. The proxy has the benefit of increased breadth of coverage, greater simplicity of calculation, and more predictive power.

For each of these four categories, we assign a score, which we then translate into a descriptive rating along the scale of Very Good / Good / Fair / Poor / Very Poor.

Overall Credit Rating

The four component ratings roll up into a single preliminary credit rating. To determine the final credit rating, a credit committee of at least five senior research personnel reviews each preliminary rating.

We review credit ratings on a regular basis and as events warrant. Any change in rating must be approved by the Credit Rating Committee.

Investor Access

Morningstar Corporate Credit Ratings are available on Morningstar.com. Our credit research, including detailed cash-flow models that contain all of the components of the Morningstar Corporate Credit Rating, is available to subscribers at select.morningstar.com.

McDonald's Corp MCD (NYSE) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Morningstar Credit Rating	Industry Group
91.04 USD	98.00 USD	68.60 USD	132.30 USD	Medium	Wide	Stable	Exemplary	AA-	Restaurants

The Morningstar Rating for stocks identifies stocks trading at a discount or premium to their intrinsic value. Five-star stocks sell for the biggest risk-adjusted discount whereas one-star stocks trade at premiums to their intrinsic value. Based on a fundamentally focused methodology and a robust, standardized set of procedures and core valuation tools used by Morningstar's Equity Analysts, four key components drive the Morningstar Rating: 1. Assessment of the firm's economic moat, 2. Estimate of the stock's fair value, 3. Uncertainty around that fair value estimate and 4. Current market price. Further information on Morningstar's methodology is available from http://global.morningstar.com/equitydisclosures.

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