RealMoney Investment & Trading Ideas

Time to Take Some Profits on MCD

By Scott Rothbort
RealMoney Contributor
12/12/2007 9:34 AM EST

I have long been associated with being bullish on **McDonald's** (MCD) . This fact has been well-documented on this site and in various other media outlets.

It was nearly four years ago when I started accumulating some McDonald's shares after a Christmas Eve trading day mad-cow scare sent the stock down to such an attractive level that I put my money to work in a name that I was already prepared to buy. The price at that time was around $23.50, and McDonald's was an out-of-favor stock that had problems in the U.S. and throughout the world.

Chinese expansion had yet to hit investors' radar screens. The restaurant's menus were stale but in the process of being revamped. The company was set to earn about $1.40 and paid a 40-cent annual dividend in 2003. James Cantalupo was in the process of engineering a turnaround for the Golden Arches. I pounced on the opportunity, and the stock never looked back.

Despite the deaths of Cantalupo and his successor Charlie Bell, the company engineered one of the most remarkable turnarounds in corporate history over the next four years, and although this one will continue to grow, yesterday I decided to take some profits on a portion of my McDonald's holdings. I was being prudent.

Why did I take this action? Here are my reasons:

- At its current stock price, McDonald's has reached my 2008 price target based on a $3.15 EPS estimate for 2008 and a generous 20 times price multiple for the industry.

- The P/E expansion has likely run its course. At most, it has another 1 multiple point of expansion to go and a potential 2 points to 3 points of compression to the downside if the U.S. business should slow down.

- I sold about 25% to 30% of my holdings -- in essence, taking out nearly my entire cost position for McDonald's. This still leaves me with a fairly large long-term position in the stock, with nearly all of it representing profits.

- Earnings growth was derived from several sources, including menu changes, the sale of company-owned restaurants to franchisees, a weakening U.S. dollar, expanded business hours in the U.S., a fixing up of U.S. and European operations and expansion in China. The double-digit growth rates for McDonald's are going to slow down to high-single-digit rates as many of these growth factors, with the exception of Chinese expansion, begin to dwindle or dissipate. To put it simply, the low-hanging burgers have already been flipped at this joint, especially in the U.S.

- McDonald's quickly turned from a value opportunity to a growth story --

and now it's more of a momentum-fueled stock. When people started to buy the shares because they were breaking out on the charts and excessive call-buying began to kick in, fundamentals took a back seat to technicals, and at that juncture it was prudent to lighten up on my holdings.

- Sales and spinoffs of holdings -- such as **Chipotle Mexican Grill** (CMG) and **Boston Market** -- have already benefited McDonald's, and there are no other such corporate actions in the pipeline.
- Weaker (yet smaller) rival **Burger King** (BKC) has since gone public and is beginning to emulate several of Mickey D's successful strategies, and **Wendy's** (WEN) , which is an on-again/off-again private-equity deal, also has taken steps to mimic the Golden Arches' success and will continue to move in the same direction.

So what does the future hold for McDonald's? As I mentioned, I am holding on to a good portion of my position but have scaled back my growth expectations for the near future. I am expecting an 8% to 9% EPS growth rate coupled with a 3% annual dividend. This is sufficient to maintain a holding but also dictates a less aggressive posture than when the stock was growing at 15% to 17%. McDonald's remains in the Bar Mitzvah portfolio, and I did not sell any stock held in custodial accounts.

The worst that can happen is that McDonald's retraces some recent price gains, and I can add back to my positions. The best that can happen is that I was too conservative on my 2008 estimates, and/or P/E multiples continue to expand, and the stock still forges higher. To me it's a win-win situation.

So, if you have played McDonald's alongside me for the past few years, it may be time to take a little off the table. If you are new to the stock, then welcome aboard but realize that I might have been selling some of that stock to you.

RELATED STORIES
Can TPX Investors Rest Easy?
What Could Save SDXOF
KR Delivers Very Fine Results

At the time of publication, Rothbort was long McDonald's and Burger King, although positions can change at any time.

Scott Rothbort has over 20 years of experience in the financial services industry. In 2002, Rothbort founded LakeView Asset Management, LLC, a registered investment advisor based in Millburn, N.J., which offers customized individually managed separate accounts, including proprietary long/short strategies to its high net worth clientele.

Immediately prior to that, Rothbort worked at Merrill Lynch for 10 years, where he was instrumental in building the global equity derivative business and managed the global equity swap business from its inception. Rothbort previously held international assignments in Tokyo, Hong Kong and London while working for Morgan Stanley and County NatWest Securities.

Rothbort holds an MBA in finance and international business from the Stern School of Business of New York University and a BS in economics and accounting from the Wharton School of Business of the University of Pennsylvania. He is a Professor of Finance and the Chief Market Strategist for the Stillman School of Business of Seton Hall University.

For more information about Scott Rothbort and LakeView Asset Management, LLC, visit the company's Web site at www.lakeviewasset.com. Scott appreciates your feedback; click here to send him an email.

Terms of Use | Privacy Policy