

# **MacDonald's Corporation**

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**Analysis**

**FIN 284**

**ASSET MANAGEMENT**

**Summer 2005**

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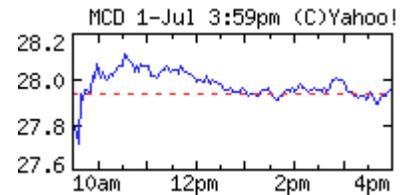
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MCDONALDS CP (NYSE:MCD) Delayed quote data

Last Trade:	<b>27.94</b>	Day's Range:	N/A - N/A
Trade Time:	Jul 1	52wk Range:	25.64 - 34.56
Change:	<b>0.00 (0.00%)</b>	Volume:	0
Prev Close:	27.94	Avg Vol (3m):	5,562,320
Open:	N/A	Market Cap:	35.41B
Bid:	N/A	P/E (ttm):	14.30
Ask:	N/A	EPS (ttm):	1.95
1y Target Est:	35.58	Div Yield (ttm):	0.55 (1.97%)



[1d](#) [5d](#) [3m](#) [6m](#) [1y](#) [2y](#) [5y](#) [max](#)

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### I. Executive Summary

This paper will look at the development of the McDonalds Corporation and the obstacles that it has overcome. It will also look at the McDonalds Corporation in relation to its major competitors and analyze how the company has responded to its surrounding environment. In closing, we will look at the prospects for McDonald's future and it will be clear that McDonalds will be able to maintain its dominant market position. It will continue to be a model that serves as a benchmark for others in the industry. We will go on to analyze the financial statements to reveal the stability and performance of McDonald's Corporation. In fact in the last three years the company has managed to decrease expenses while at the same time improve its profit margins.

The low correlation McDonald's offers us, combined with the growing trends in our current society towards the fast food industry makes us strongly believe that McDonald's will be a very good stock to allow us further diversify our portfolio. Based on our analysis, we recommend buying 500 shares at below \$30.50 per share. We believe McDonald's will offer the diversification benefits to our portfolio at the same time realizing the stability and financial strength of the corporation.

## **II. Company Overview**

McDonalds Corp., headquartered in Oak Brook Illinois, is the world's number one fast food chain, serving about 49 million customers daily. The company operates and licenses more than 31,000 restaurants (30,000 McDonald's) in about 120 countries which generated a total \$19.06 million in revenues for the fiscal year of 2004.

## **III. Business Description**

McDonald's Corporation engages in the operation and franchising of McDonald's restaurants worldwide.

### *McDonald's Restaurants*

The McDonald's restaurants are operated by MacDonald's Corp, franchisees, or affiliates under joint venture agreements. At March 31, 2005 there were 18,306 franchised restaurants (generating 60% of 2004 system wide sales), 8,091 company operated restaurants (27%) and 4,111 affiliated restaurants (13%). In addition to the McDonald's restaurants operating under the same brand name, which is one of the 10 most popular brand names in the world, McDonald's Corp operates other restaurant

chains under its Partner Brands which include Boston Market and Chipotle Mexican Grill. The restaurants operating under these brands are approximately 1,000 and represent 3.22% of the stores operated or franchised by the company.

*Systemwide restaurants at year end<sup>(1)</sup>*

	2004	2003	2002
U.S.	<b>13,673</b>	13,609	13,491
Europe	<b>6,287</b>	6,186	6,070
APMEA	<b>7,567</b>	7,475	7,555
Latin America	<b>1,607</b>	1,578	1,605
Canada	<b>1,362</b>	1,339	1,304
Other	<b>1,065</b>	942	1,083
<b>Total</b>	<b>31,561</b>	31,129	31,108

Table From 2004 annual Report

The franchise agreement which usually last 20 years provides that the franchisee invest in the capital equipment, signs, seating and decoration of the restaurant. McDonald's in turn usually invests in the real estate and either buys or leases the land and building. The Franchisee generates revenue for the company by paying rent and service fees as percentage of sales. Both franchise and company operated restaurants buy food, packaging and equipment from independent suppliers which have been approved by the Company, in order to achieve a uniform product and service.

*McDonald's Brand*

McDonald's brand is one of the ten most popular brands worldwide. Continuous marketing, promotional and public relations activities promote McDonald's brand image in order to differentiate the Company from its many competitors.

*McDonald's Products*

McDonald's restaurants offer a menu that is uniform to all locations and emphasizes low value prices which includes its famous burgers, cheeseburgers like the Big Mac, Quarter Pounder with Cheese, several chicken sandwiches, Chicken McNuggets, french fries, salads, desserts, sundaes, soft drinks and other beverages. Its restaurants also provide breakfast menu that would include Egg McMuffin, bagel sandwiches, hotcakes, and muffins. Many new products were introduced in the last two years in accordance to the management's decision to establish a new menu with more choices that is expected to bring a significant growth in sales as it was already shown by the financial results of 2004 which the highest increase in US comparable sales for the last 30 years.

Despite the wide variety of food products offered, the company and its franchisees operate all restaurants in order to guarantee uniformity in both services and standards. When granting franchises and forming joint venture agreements, the company is selective and is not in the practice of franchising to, or partnering with, investor groups or passive investors.

Uniformity continues in McDonald's restaurants operating in the US and certain international markets that are open during breakfast hours, and offer a full or limited breakfast menu. In addition, McDonald's tests new products on an ongoing basis and sells a variety of other products during limited-time promotions.

Apart from its McDonald's restaurants, the corporation has new chains to address different sectors of the market. These include, in the US, Chipotle Mexican Grill, and a fresh-mex grill serving gourmet burritos and tacos. In the UK, Aroma Café is a small chain of coffee houses serving prepared sandwiches and pastries.

#### **IV. SWOT Analysis**

##### *Strengths*

MacDonald's has a strong global presence with its nearest domestic competitor being only half its size, McDonald's is the market leader in both the domestic and international markets. MacDonald's benefit from cost reduction through economies of scale because of its enormous size and its huge global presence allows it to diversify risk involved with the economic performance of specific countries. In international markets, MacDonald's is well placed to expand and take advantage of long-term economic growth.

MacDonald's also has a strong real estate portfolio. The company's outlets are located in areas that are highly known for visibility, traffic volume and ease of access. MacDonald's also has exceptional brand recognition. This strong brand recognition creates significant opportunities for the company. MacDonald's is able to generate more sales because of its brand recognition.

Through aggressive market planning, MacDonald's has been able to recapture its youth market once again.

##### *Weaknesses*

The food industry is really saturated. As a result of this, MacDonald's has to deal with the prospect of looming market saturation, which could make it difficult to add new outlets. The market is forecast to grow by around 2% per year.

There is also an increasing price competition driven by too many competitors, which reduces the company's ability to increase revenue. Nevertheless, the swift of the company's focus from a value menu to a more diverse one has recently limited the negative effect of the intense price competition that was traditionally taking place among the industry leaders.

Lack of product innovation is another weakness of McDonalds. The last breakthrough for McDonald's was the Chicken McNugget in 1983, but again the company's new strategy seems to have successfully dealt with the problem through the popularity of its new salads and other new products.

### *Opportunities*

MacDonald's sold its Donatos Pizzeria back to its founder in 2003 and discontinued Boston market operations outside of the US. The company will instead focus on Chipotle Grill which is the company's most successful non MacDonal'd's branded chain of restaurants. Also to increase profitability the company has slowed its expansion of McDonald's restaurants so as to refurbish and change the image of current restaurants and adding new features such as Internet access.

McDonald's still has plans for more international expansion. McDonald's still needs to penetrate in many countries especially in Europe, Asia and Latin America. Changing trends in eating habits toward more health eating, seen as a threat to McDonalds can also be seen as an opportunity. McDonalds introduced new premium salads and Fruit n'

Yogurt Parfaits in the US which lead to growth in 2004 and the same products will probably bring some more growth in foreign markets.

### *Threats*

McDonald's is exposed to changes in the global economy. The company's aggressive international expansion has left it extremely vulnerable to other countries economic slowdown. Foreign currency fluctuation is also another problem global companies like McDonalds.

The Fast food industry is becoming an increasingly competitive sector. MacDonald's keeps up with competitors through expensive promotional campaigns which leads to limited margins to gain market share. McDonald's is attempting to differentiate itself, with new formats and new menu items, but other fast food industry are doing the same too.

McDonald's, just like other fast food industry, often receives bad press because of its link obesity. Increased concern such as this has led the Food Standards Agency and the Department of Health in the UK to review the advertising of 'junk' foods such as McDonalds to children. Top Competitors for MacDonald's include: Yum! Brands, Inc, Wendy's International, Inc. Jack in the Box Inc, and Burger King Corporation.

### **V. Management**

Jim Skinner was elected McDonald's vice chairman and chief executive officer by the board of directors, effective November 22, 2004. Prior to becoming CEO, Skinner was vice chairman of McDonald's Corporation. As vice chairman, Skinner managed the McDonald's operation in Asia, the Middle East and Africa (AMEA), and Latin America. Skinner has held numerous leadership positions within the corporation. Before becoming

vice chairman, he served as president and chief operating officer of the McDonald's Restaurant Group. Prior to that, Skinner served as president and chief operating officer of McDonald's - Europe/Asia/Pacific and Middle East, which managed approximately 12,500 restaurants operating in those geographic sectors. From 1997 to 2001, Skinner was president of McDonald's Europe. Before that, he was executive vice president and international relationship partner for Central Europe, Middle East, Africa, and India from 1995 to 1997.

Andrew J. McKenna is the Chairman. Andrew J. McKenna was elected McDonald's Corporation's non-executive chairman of the board, effective April 19, 2004. Mr. McKenna has served as a director of the McDonald's board since 1991. Mr. McKenna is also the chairman of Schwarz Paper Company, a printer, converter, producer and distributor of packaging and promotional materials. McKenna is a graduate of the University of Notre Dame and DePaul University School of Law.

Michael Roberts is McDonald's president and chief operating officer since November 22, 2004. Prior to being named president and COO, Roberts was chief executive officer of McDonald's U.S.A. Roberts previously served as president of McDonald's USA. Roberts began his career with McDonald's as a regional purchasing manager in 1977.

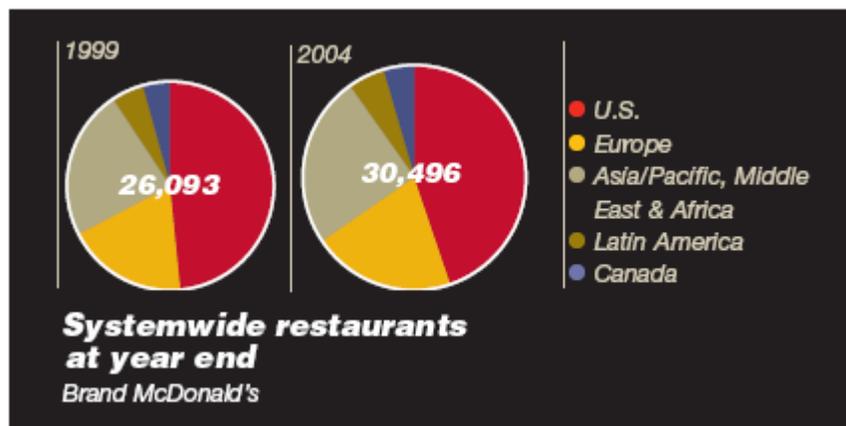
Matthew Paull is the Executive Vice President and CFO since 2001. He was promoted to his current position in 2001. Mr. Paull is responsible for all financial matters of the company and has direct reporting responsibilities for I/S, accounting, facilities and systems, tax, treasury and investor relations. Previously, Mr. Paull had been the senior vice president, finance since 1999.

Although McDonald's went through a management transition after the sudden death of its CEO, Jim Cantalupo, in April 2004, the company's management team has strong background and significant experience within the industry that can allow them to set a corporate strategy that will result in the company's growth and the investors expectations.

## VI. Operations Analysis

### Geographic Areas of Operation

McDonald's business is managed as distinct geographic segments: United States; Europe; Asia/Pacific, Middle East and Africa (APMEA); Latin America and Canada. For the fiscal year ended December 2005, the company generated revenues of \$51.2 billion, up 12% from \$45.9 billion in 2003. Net Income for the year totaled \$2.2 billion. The proportional share of systemwide sales by geographic region in 2004 was: U.S. 48% (same as 2003), Europe 28% (27% 2003), Asia/Pacific/ Middle East Africa 16% (16% 2003), Latin America 3% (3% 2003), Canada 4% (4% 2003) and Partner Brands 2% (3%).



Moreover certain countries within each region generate most of the revenues. For example, France, Germany and the United Kingdom account for about 65% of Europe's revenues; Australia, China and Japan (a 50%-owned affiliate accounted for under the equity method) account for over 45% of APMEA's revenues; and Brazil accounts for about 40% of Latin America's revenues.

*Revenues*

DOLLARS IN MILLIONS	Amount			Increase/(decrease)		Increase/(decrease) excluding currency translation	
	2004	2003	2002	2004	2003	2004	2003
<i>Company-operated sales:</i>							
U.S.	\$ 3,828	\$ 3,594	\$ 3,172	7%	13%	7%	13%
Europe	5,174	4,498	3,982	15	13	5	-
APMEA	2,390	2,158	2,115	11	2	7	(3)
Latin America	933	774	696	21	11	21	20
Canada	730	632	505	16	25	8	11
Other	1,169	1,139	1,030	3	11	3	10
Total	\$14,224	\$12,795	\$11,500	11%	11%	6%	6%
<i>Franchised and affiliated revenues:</i>							
U.S.	\$ 2,697	\$ 2,445	\$ 2,251	10%	9%	10%	9%
Europe	1,563	1,377	1,154	14	19	3	1
APMEA	331	289	253	14	14	4	-
Latin America	75	85	118	(12)	(28)	(10)	(20)
Canada	168	146	128	15	14	7	1
Other	7	3	2	nm	33	nm	33
Total	\$ 4,841	\$ 4,345	\$ 3,906	11%	11%	7%	5%
<i>Total revenues:</i>							
U.S.	\$ 6,525	\$ 6,039	\$ 5,423	8%	11%	8%	11%
Europe	6,737	5,875	5,136	15	14	4	-
APMEA	2,721	2,447	2,368	11	3	7	(3)
Latin America	1,008	859	814	17	6	18	14
Canada	898	778	633	15	23	8	9
Other	1,176	1,142	1,032	3	11	3	11
Total	\$19,065	\$17,140	\$15,406	11%	11%	7%	6%

Table from McDonald's 2004 annual Reports

*US Operations*

In US full year sales in this segment totaled \$6,525 million, an increase of 11% against the previous year's revenues that were \$6,039 million. In the US, ongoing menu, service and value initiatives drove the increase in revenues in 2003 as the US achieved its highest annual sales increase since 1987. Initiatives included the introduction of premium salads and McGriddles breakfast sandwiches, the Dollar Menu, extended hours, a

heightened focus on operations, more disciplined measurements and a new marketing direction. Results also reflected improvements in the US economy in 2003 and restaurant expansions.

The increase in US sales reflects the success of management's decision to swift from its "dollar menu" strategy which concentrated on an intense price competition with its competitors to its new "Plan to win" strategy which is aiming to current customers visits and increase the company's customer base through operations excellence that focuses on service, value, menu and restaurant ambiance. McDonald's menu (combined with the overall economic recovery) was the primary factor in the company's revenue growth last year. The company attempted to meet the growing consumer interest in the premium and wholesome food market by introducing in many countries new products including premium salads and Salads Plus menu, Chicken McNuggets made with white meat, Fish McDippers, Chicken Selects and new breakfast offerings like the McGriddles breakfast sandwiches. The company plans continue to attract and retain customers worldwide by complementing its core menu with new relevant sandwich, salad and beverage choices. Restaurant ambiance is also of great significance for the company. The company began the reimagining of many of its restaurants in several of its more established markets. As a result, 2005 capital expenditures are expected to be about \$1.7 billion, reflecting higher reinvestment in existing restaurants.

#### *European Sales*

In Europe, full year sales in this segment totaled \$6,737 million, an increase of 15% against the previous year's revenues that were \$5,875 million. Europe's revenues reflected strong performance in Russia driven by expansion and positive comparable

sales, along with expansion in France. These results were partially offset by weak results in the UK and Germany although Germany's performance improved in the second half of 2003.

#### *APMEA Sales*

In APMEA, full year sales in this segment totaled \$2,721 million, an increase of 1% against the previous year's revenues that were \$2,447 million. APMEA's revenues benefited from positive comparable sales in Australia and expansion in China. Revenues were negatively affected in 2003 by weak results in Hong Kong, South Korea and Taiwan compounded by consumer concerns about SARS in several markets in the first half of the year. In addition Japan had negative comparable sales for 2003 and 2002 although the markets performance improved in the fourth quarter of 2003.

#### *Latin American Sales*

Full year sales in this segment totaled \$1008 million, an increase of 17% against the previous year's revenues that were \$859 million. Revenues in 2004 increased due to a higher percentage of company-operated restaurants.

#### *Canadian Sales*

In Canada, full year sales in this segment totaled \$898million, an increase of 15% against the previous year's revenues that were \$778 million.

## **VII. Industry and Market Analysis**

Analyst estimate that by 2010 the fast food segment of the restaurant industry will account for half of all food service growth during the first decade of the 21<sup>st</sup> century. The industry is starved for growth as consumers increasingly demand what today's society craves for: fresh food served quickly in a distinctive, casual environment. In the past, the fast food industry has generally been an American institution. McDonald's has been able to capitalize on this trend and expand the business globally. The industry has indeed altered society and McDonald's might be the image that represents the fast food culture. The fast-food segment of the restaurant industry is approaching, if it is not already in, the mature stage of its life cycle. The restaurant industry, as a whole, is plagued by a declining availability of good expansion sites, market saturation, and rising labor costs. Intensified competition in the fast-food segment has resulted in a practice of heavy price discounting which reduces overall profitability. McDonald's thus far has been able to avoid this trend and has seen a general rise in profit margins. The act of transplanting a basically American phenomenon onto foreign soil has been a successful strategy for McDonald's. In its 1999 Annual Report McDonalds reported that 62 percent of its revenues now come from foreign (outside United States) operations.

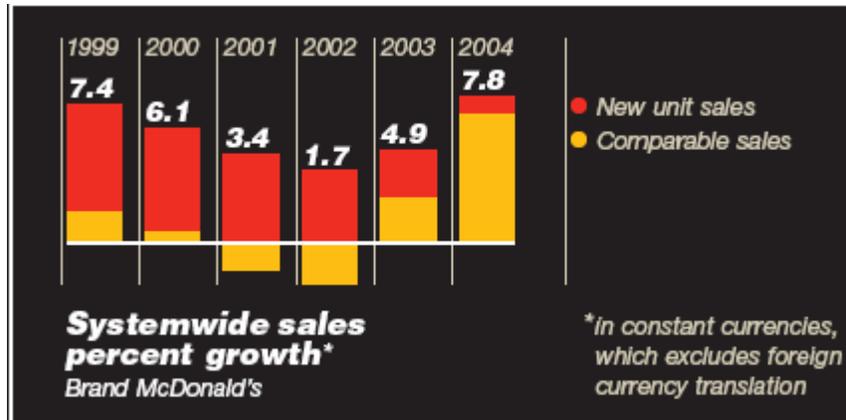
## **VIII. Overview of fiscal year 2004**

McDonald's strong performance in 2004 reflected the strength of the U.S. operations, which generated impressive sales and margin improvements for the second year in a row. Comparable sales for the European segment increased by 2.4%. This

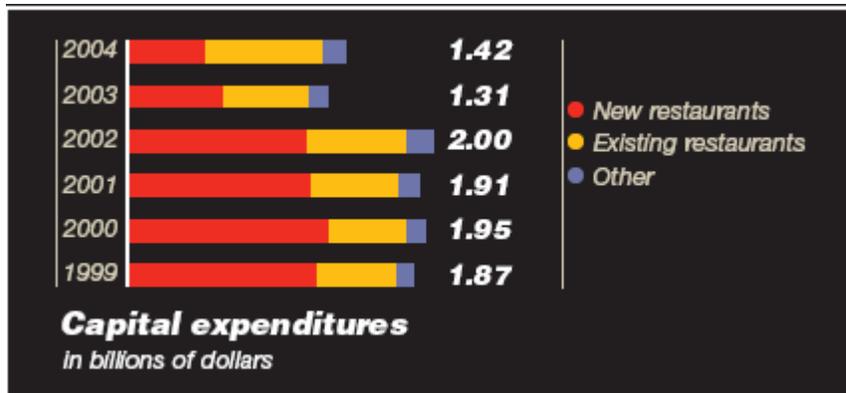
indicates that the company is making progress toward revitalizing this important business segment, despite challenges in certain markets.

*Highlights from the year included:*

- Comparable sales increased 6.9% on top of a 2.4% increase in 2003. US comparable sales were up 9.6% the highest in 30 years. This figure is very important since it proves the success of the management's new strategy in the US market. It also shows that significantly revenue growth can be achieved through an increase in customer visits and not necessarily through the opening of more locations. In 2002, the Company's results reflected a focus on growth through adding new restaurants, with associated high levels of capital expenditures and debt financing. This strategy, combined with challenging economic conditions and increased competition in certain key markets, adversely affected results and returns on investment. In 2003, the Company introduced a comprehensive revitalization plan to increase McDonald's relevance to today's consumers as well as improve the company's financial discipline. The company redefined its strategy to emphasize growth through adding more customers to existing restaurants.
  
- Systemwide sales increased 12%. Excluding the positive impact of currency translation, Systemwide sales increased 8%. The following graph clearly shows that although growth was traditionally due to an increase in new unit sales, during 2004 most of the growth was the result of an increase in comparable sales.



- Net income per common share totaled \$1.79, compared with \$1.15 in 2003.
- Cash from operations increased more than \$600 million to \$3.9 billion, primarily due to increased margins driven by higher sales at existing restaurants as well as stronger foreign currencies.
- Capital expenditures increased to \$1.4 billion, with a higher percentage related to reinvestment in existing restaurants as compared with 2003. The current level of capital expenditures is lower than the historic average, even though it is expected to grow to \$1.5 billion in 2005. The capital expenditure numbers for the last year also reflects the management's decision to focus on existing locations and most of the capital is currently spend in order to improve these locations and not to open up new restaurants as was the traditional strategy up to now.



- Debt pay-down totaled more than \$800 million. Over the past two years, the company has exercised increased financial discipline; by paying down debt, reducing capital expenditures and selling, general & administrative expenses as a percent of revenues. In addition, the company returned a significant amount of excess cash to shareholders in the form of dividends and share repurchases. The payment of \$800 million of long-term debt is the primary reason for the relatively low current ratio.
- The annual dividend was increased 38%, to about \$700 million. The Company has paid dividends on its common stock for 29 consecutive years and has increased the dividend amount every year. In 2004, the Company declared a 38% increase in the annual dividend to \$0.55 per share or \$695 million, reflecting the Company's confidence in the ongoing strength and reliability of its cash flow and positive results from its revitalization efforts.
- McDonald's served an additional 1.6 million customers a day – compared with 2003. For each quarter of 2004, McDonald's increased customer visits, improved margins and delivered double-digit growth in operating income and earnings per share. In addition, comparable sales were positive across all geographic segments during each and every quarter.

## **IX. Management Outlook for 2005**

Consistent with McDonald's long-term revitalization plan the company is targeting long term average annual Systemwide sales and revenue growth of 3% to 5%, average annual operating income growth of 6% to 7%, and annual returns on incremental invested capital in the high teens.

The company will continue to evolve its menu to remain relevant. In the U.S., Fruit N' Walnut Salads, as well as new, premium chicken sandwiches will be added to the menu, along with a new coffee blend. In Europe, McDonald's will introduce a range of new products. In Canada, Toasted Deli Sandwiches were introduced during the fourth quarter of 2004 and a similar product line is being launched in Australia in 2005. New products and branded everyday value remain a focus.

In light of Chipotle Mexican Grill's strong performance and growing popularity, the company is exploring strategic alternatives to fuel growth of this emerging fast-casual brand, which currently operates more than 400 restaurants.

While the Company does not provide specific guidance on earnings per share, the following information is provided in the Company's 10-K to assist in analyzing the Company's results.

- Changes in Systemwide sales are driven by changes in comparable sales and restaurant unit expansion. The Company expects net restaurant additions to add slightly more than 1 percentage point to sales growth in 2005 (in constant currencies). Most of this anticipated growth will result from restaurants opened in 2004.

- The Company does not provide specific guidance on changes in comparable sales. However, as a perspective, assuming no change in cost structure, a 1-percentage point increase in U.S. comparable sales would increase annual earnings per share by about 2 cents. Similarly, an increase of 1 percentage point in Europe's comparable sales would increase annual earnings per share by about 1.5 cents.
- The Company expects full-year 2005 selling, general & administrative expenses to be relatively flat or to increase slightly in constant currencies and to decline as a percent of revenues and Systemwide sales, compared with 2004.
- A significant part of the Company's operating income is from outside the U.S., and about 70% of its total debt is denominated in foreign currencies. Accordingly, earnings are affected by changes in foreign currency exchange rates, particularly the Euro and the British Pound. If the Euro and the British Pound both move 10% in the same direction (compared with 2004 average rates), the Company's annual earnings per share would change about 6 cents to 7 cents. In 2004, foreign currency translation benefited earnings per share by 6 cents due primarily to the Euro and the British Pound.
- For 2005, the Company expects its net debt principal repayments to be approximately \$600 million to \$800 million. The company plans to maintain a debt-to-capital ratio of 35% to 40% in the near term. The Company expects interest expense to be relatively flat in 2005 compared with 2004, based on current interest and foreign currency exchange rates and after considering net repayments.

- The Company expects capital expenditures for 2005 to be approximately \$1.7 billion, reflecting higher investment in existing restaurants and stronger foreign currencies.
- The Company expects to return at least \$1.3 billion to shareholders through dividends and share repurchases in 2005.
- McDonald's expects the effective income tax rate for the full year 2005 to be approximately 29% to 30%, although this does not take into account any actions that might be taken under the American Jobs Creation Act of 2004.
- In 2005, the Company expects to open about 550 traditional McDonald's restaurants and 150 satellite restaurants and close about 225 traditional restaurants and 125 satellite restaurants.

**X. Financial Results Q1 2005** (see appendix A)

*Operating Highlights for the Quarter Included:*

- Consolidated revenues increased 9% compared to Q1 2004 (6% in constant currencies).
- Comparable sales increased 4.6%.
- Company-operated restaurant margins increased \$30 million (\$19 million in constant currencies).
- Franchised restaurant margins increased \$76 million (\$58 million in constant currencies).
- Operating income increased 6% (4% in constant currencies).
- Operating expenses rose by 10% due to higher commodity and labor costs.

- Net income per common share was \$0.56, up 40% versus \$0.40 in 2004, including a \$0.13 per share benefit from a lower effective tax rate as well as a \$0.03 per share expense related to share-based compensation.
- Cash provided by operations totaled \$793 million.
- It is important to note that the current ratio for Q1 2005 is over 1.0, since current assets for that quarter exceeded current liabilities.

## **XI. Trend Analysis**

### *Common Size Statement of Income (see appendix B)*

- The common size financial statements reveal the stability of the financial performance of McDonald's Corp. It is evident that very limited fluctuation exists in the company's operating expenses. In fact in the last three years the company has managed to decrease these expenses and improve its margins.
- In fact the greatest fluctuation in the company's income statements exists in the operating income and net income which have increased over the last three years and express the company's improved profitability.

### *Common Size Balance Sheet (see appendix C)*

- McDonald's Common Size Balance Sheet shows that current assets have significantly increased in the last years in relation to current liabilities, which is reflected in the improvement of the current ratio.
- The increase in current assets was mainly due to the increase in cash & equivalents which was the result of an increase in cash from operations (as shown in the statement of cash flows) due to higher sales and improved margins.
- Current maturities of long term debt are the primary reason for the increase in current liabilities. The company paid off \$800 million of debt in 2004 which in turn is reflected in the continuous drop of long term liabilities over the last few years.

*Common Size Statement of Cash Flows (see appendix D)*

- Cash flows from McDonald's have improved over the last two years as reflected by the significant increase in cash and cash equivalents.
- Net income has increased significantly
- At the same time cash from operations has also increased because of increasing revenues and improved margins.
- Cash from investing activities has changed mainly due to less investing in purchases of new restaurants, reflecting the swift of the company's strategy towards improving existing locations.
- At the same time financing payments have increased due to management's strategy to pay off debt and improve liquidity.

- The company has increased common stock dividends and treasury stock purchases as part of its \$5 billion dollar buy back that started in 2000.

## **XII. Correlation with Current Portfolio**

<b>Stock</b>	<b>CORRELATION COEFFICIENT (R)</b>
MCD	
C	0.298
COH	0.143
DELL	0.215
EBAY	0.145
ERTS	0.181
FRX	0.155
GD	0.203
GE	0.373
HDI	0.256
KSS	0.223
PEP	0.226
WMT	0.309
XOM	0.265

The correlation coefficient was calculated by obtaining the stock price returns of MacDonald's and the other stocks in the portfolio from June 14, 2002-June 14, 2005, a three-year period. Based on the above table, the security with the highest correlation to MacDonald's is General Electric with a value of just 0.373.

The low correlations combined with the fact that there is no company representing the food industry within the portfolio, makes us strongly believe that McDonald's will be a very good candidate to allow us further diversify our portfolio. The diversification effect that McDonald's has in our portfolio is a very important factor in making our final recommendation. In making our final determination as to whether McDonald's should be included in the portfolio we have to consider that although McDonald's is a mature company that will probably will not lead to excessive returns, it is a stable company that can prove a very good diversifier for our portfolio which is characterized by growth stocks.

### XIII. Financial Statement Analysis

Analysis of Short-Term Liquidity Ratios								
Measure	2004	2003	2002	2001	2000	Wendy's	Yum Yum	Industry
1. Current Ratio	0.8117597	0.685974	0.7081699	0.809189	0.7041383	0.67	0.54	0.61
2. Acid Test	0.6036927	0.446534	0.4894935	0.578215	0.5159897	0.2	0.18	0.43
3. Accounts Receivable Turnover	25.573038	23.33628	18.012043	16.86132	17.881984	30.67	52.7	63.63
4. Inventory Turnover	35.050199	35.79262	36.071823	37.12988	45.226955	34.91	95.57	54.68
5. Day's Sales in Receivable	18.868376	20.66524	26.77554	28.75579	27.394669	23.82	10.12	
6. Days Sales in Inventory	3.7331796	3.640683	3.4968173	3.439999	3.4153052	10.55	4	
7. Working Capital	-662.7	-863.1	-706.9	-429	-698.5	-229.00	-629.00	

\*Industry represents the average ratios of the following companies: JBX, CKR, SNS, YUM, WEN, CKE, SONS, PZZA.

\*\* In order to provide a better comparison we revised Wendy's income statement to conform it to the historical performance of the company. We removed a \$190 million goodwill impairment that Wendy's reported in the fourth quarter of 2004 in order to write down assets from the Baja Fresh Acquisition of 2002. We also used a 40% tax rate slightly above the company's average tax rate for the last 10 years but much lower than the unusual 71% rate actually incurred in 2004.

#### Analysis of Short-Term Liquidity:

As we can see from McDonald's current ratio and quick ratio the financial health of the company is steadily improving over the years. We can see that

compared to its competitors as well as the industry McDonald's seems to be much more comfortable with its ability to pay short term debt. McDonald's is progressing to the point where they will not have to rely on sales of inventory in order to pay the bills. We feel they are effectively using their funds and have an above satisfactory rating compared to the industry. Since the acid test ratio excludes inventory and we feel that this in an industry where inventory should be quickly convertible into cash we will not place much emphasis on this ratio although we can see that McDonald's is also showing a strong quick ratio compared to its industry.

By comparing McDonald's accounts receivable turnover ratio's to its competitors as well as the industry it seems as though the company does not show a tight enough credit policy. Although they have shown improvement there may be some indication of collection problems, which may be due to bad debts.

McDonald's inventory turnover compared to its competitors and the industry is also not looking too strong. A low turnover is usually a bad sign because products usually tend to deteriorate as they sit in the warehouse. Companies having high perishable products (such as the food industry) have a higher turnover as we can see from McDonald's competitor and the industry. You want a company to turn its inventories as often as possible during the year in order to free up that working capital to do other things.

The efficiency with which McDonald's turns its receivables into cash is drastically improving and is working its way towards its top competitor. We regard this as a strong sign as the company is continually trying to improve its short-term liquidity. The average number of days McDonald's needs to sell its inventory has also been consistent and well below its competitors.

The negative working capital for McDonald's indicated that they may lack the funds necessary for growth. We know that McDonald's is undergoing renovations to their domestic facilities and well as expansions on a global level and they are using some of their liquid assets for this undertaking. They are very comparable to its top competitor and we do not foresee a problem.

Overall, by looking at McDonald's short-term liquidity analysis we believe that they have a strong footing in the industry. We are also still mindful about the globalization trends and the impact this may have as it goes into new markets and strengthen existing markets and how this may positively impact future short-term liquidity figures once they are stabilized.

Analysis of Capital Structure and Solvency Ratios								
Measure	2004	2003	2002	2001	2000	Wendy's	Yum Yum	Industry
1. Total Debt to Equity	0.6572545	0.838123	0.9983173	0.968003	0.9053713	1.31	2.57	1.42
2. Total Debt Ratio	0.3353031	0.388664	0.4281763	0.407588	0.3843199	0.77	0.72	
5. Financial Leverage Ratio	2.049982	2.237297	2.3523848	2.365483	2.1738399	3.01	4.17	
6. Financial Leverage Index	3.15	3.44	3.62	3.64	3.34	na	na	

Analysis of Capital Structure and Solvency:

We can see that McDonald's has drastically reduced its debt to equity ratio. The company is currently using 65% of its debt to finance its operations. We feel McDonald's will continue to lower this figure and are in far better shape compared to industry norms. When we compare this ratio to the dividend payout ratio, which has been significantly increasing we realize that they are not using their debt to payout dividends, which we see as a good sign. *McDonald's is keeping a conservative approach with its debt to equity and are mindful about avoiding any undue financial distress risk.*

By looking at our debt ratio's we can easily see that McDonald's competitors have almost as much debt as they do assets. We can see from McDonald's figure that they have significantly more assets than they do debt.

McDonald's financial index greater than 1 tells us that McDonald's is using is debt in a positive way. This clearly shows us that, as borrowing for the company has increased the debt the company took on was beneficial

Although it is difficult to determine a firm's optimal capital structure, through this analysis we have determined that McDonald's has had consistently if not a safe capital structure. We have seen consistency and stability with McDonald's capital structure and have also been able to confirm that the company does not have any unpaid taxes with the IRS, or unpaid wages to its employees.

McDonald's is also in good standing with its general creditors and has secured bondholders. All of this leads us to the conclusion that McDonald's is not in any danger of bankruptcy.

Analysis of Asset Utilization Ratios								
Measure	2004	2003	2002	2001	2000	Wendy's	Yum Yum	Industry
1. Cash Turnover Sales	20.361743	41.64359	41.164195	35.41319	37.65499	20.89	70.95	
2. Account Receivable Turnover	25.763108	21.56309	17.736242	17.71926	23.540203	30.67	52.7	63.63
3. Sales to Inventory	137.70098	142.1858	141.85727	145.2148	181.09345	66.09	125.15	
4. Working Capital Turnover	-6.247444	-5.45876	-6.781275	-6.59423	-4.631569	-24.72	-14.04	
5. Fixed Asset Turnover	0.9385052	0.890228	0.8589046	0.866119	0.9540204	1.61	2.68	
6. Total Assets Turnover	0.7103688	0.688256	0.6625395	0.672577	0.767856	1.16	1.58	1.77

Analysis of Asset Utilization:

By looking at McDonald's accounts receivable turnover ratio (*the # of times a company completely clears out all of its outstanding credits*) we notice that it is extremely lower than the industry standards as well as its top two competitors. This low ratio solidifies our previous findings that the company should re-assess its credit policies in order to ensure the timely collection of imparted credit not earning interest for the firm. We can clearly see that its competitors are doing a better job of either operating on a cash basis or its extension of credit and collections of account receivable is more efficient.

McDonald's fixed asset turnover and total asset turnover has shown a steady but slow improvement over the years. Compared to the industry and its competitors we can see here that McDonald's has not been able to effectively manage the company's investments in plant, property and equipment. The company is not

achieving as much productivity from its fixed assets as its competitors. This measures the company's effectiveness in generating sales revenue from investments back into the company. We can conclude that this is due to McDonald's continuous commitment to major improvements in its stores.

McDonald's high sales to inventory turnover implies high sales although we can also look at this high level as unhealthy because it represents an investment with a rate of return of zero. This may also open the company up to trouble in the case of falling prices although we have not seen this situation with McDonalds. We can come to the conclusion to support our previous statement that this is due to ineffective buying. *If two companies are the same in every way but one is turning over its inventories more often, the one with better inventory management is the one that is going to be able to grow faster. Inventory management actually is a bottleneck for growth if it is not efficient enough, tying up a lot of working capital that could be better used elsewhere.*

We believe that McDonald's has to show improvement on managing their inventory through effective use of their assets. Overall they have not shown any competitiveness in this area, or that they are prepared to make any changes in managing their inventory in the future. Our thoughts are that McDonald's should and can bring some focus into this area, which may in-turn improve their competitiveness as they introduce new products.

The company is currently achieving low productivity from its inventory and fixed assets. It is also not collecting from its customers as quickly as the industry. It needs to improve its sales and/or reduce inventories and fixed assets to better match its competitors. It has shown constancy in its working capital turnover which does imply that they are conscience and need working capital to effectively operate. We can also conclude from this that they have predicted high sales for their stores that they opted to buy enough inventory to account for this so they do not run short in which case justifies their asset utilization figures.

Analysis of Profit Margin Ratios								
Measure	2004	2003	2002	2001	2000	Wendy's	Yum Yum	Industry
1. Gross Profit Margin	36.53%	35.79%	35.70%	36.42%	38.57%	47.00%	24%	32.48
2. Operating Profit Margin	16.80%	13.69%	10.79%	15.67%	20.24%	11.47%	12.82%	8.65
3. Net Profit Margin	11.95%	8.58%	5.80%	11.01%	13.88%	3.40%	8.21%	4.63

Analysis of Profit Margins:

We notice that McDonald's gross profit margins have been consistent over the years. Considering the economic impact the company had in 2001 we feel this is a strong sign for McDonald's. Compared to the rest of the industry we feel that McDonald's is financially healthy with its current pricing strategy. Since they have been stable, we consider this an enormous value to the company.

We solidify this theory by looking at the companies operating profit margin and net profit margin both of which have been steadily increasing over the years. We can clearly show that McDonald's makes more per dollar of sale then its

competitors. Through our research we can also analyze that McDonald's is not involved in what we consider any direct pricing wars with any of its competitors which generally helps these ratios in the long term.

Through this analysis we can see that McDonald's has a strong profit margin. Although we believe that that gross profit margin shown here for McDonald's compared to its competitors and the industry are somewhat skewed we also believe that they can improve this figure by improving their inventory management.

Analysis of Return on Investments Ratios								
Measure	2004	2003	2002	2001	2000	Wendy's	Yum Yum	Industry
1. Return on Assets (ROA)	5.52%	3.84%	2.50%	4.81%	6.93%	4.49%	1.05	5.57
2. Return on Common Equity (ROCE)	17.40%	13.22%	9.04%	17.51%	23.17%	11.90%	0.55	14.2
3. Equity Growth Ratio	12.10%	8.70%	6.03%	14.43%	19.88%	na	na	
4. Disaggregation of ROCE	17.40%	13.22%	9.04%	17.51%	23.17%	na	na	

#### Analysis of Return on Investments:

In order to better evaluate McDonald's leadership we notice that the management has been able to squeeze more income from each dollar worth of its assets when compared to its competitors. We also come to realize that this figure has steadily increased over the years and currently at its industry average. This shows us that McDonald's is less asset intensive than its competitors and therefore requires less money to be reinvested into it to continue generating earning relative to its competitors. As a general rule however anything below 5% is considered asset heavy.

By analyzing McDonald's ROE we can determine that the company is more capable of generating more cash internally with the money shareholders have invested in the company. This improvement shows us how management is effectively reinvesting their capital.

McDonald's is a company with a higher return on assets and common equity than any other competitors and the industry average. Furthermore, McDonald's has been able to increase its equity growth rate over the last couple of years. Overall we believe the company is showing a strong return on investment, which we think will also improve once they have settled in with their domestic and global restructuring projects.

Market Measures								
Measure	2004	2003	2002	2001	2000	Wendy's	Yum Yum	Industry
1. P/E (Range)	High 16.84 Low 12.70	High 18.57 Low 8.66	High 23.22 Low 11.73	High 25.52 Low 18.40	High 29.28 Low 18.49	High 26.49 Low 21	High 20 Low 13	35.55
2. Earnings Yield	6.36%	5.67%	3.29%	4.20%	3.82%	3.38%	na	
3. Dividend Yield	1.93%	1.96%	1.13%	0.76%	0.56%	1.13%	0.87	7.44
4. Dividend Payout Ratio	30.39%	34.48%	34.29%	18.11%	14.77%	na	15.36	

*Analysis of Market Measure:*

We believe that the current market measures for McDonald's do not show the high potential for the future growth that McDonald's is currently preparing for. The dividend payout ratio supports the earning growth that McDonald's has had over the last couple of years. Although McDonald's is a mature company we feel that the earning growth and the dividend payout ratio supports future expected growth the company is expecting to take in.

McDonald's recent financial performance has been relatively safe despite the economic slowdown that the U.S. had suffered in 2001. The good news here seems to be that the economy seems to be improving. McDonald's shareholders should be somewhat pleased with the financial results that McDonald's Business Strategy has produced.

With the appropriate adjustments McDonald's has already made and continues to make along with their initiative with social responsibility and its relationships with its customers we should see continued success. The company is currently achieving low productivity from its inventory and fixed assets. It is also not collecting from its customers as quickly as the industry. It needs to improve its sales and/or reduce inventories and fixed assets to better match its competitors. As we have stated previously we also believe these figures are underachieving compared to the industry due to the growth that McDonald's is accounting for through its global expansion as well as its domestic revitalization plans.

## **XIV. Valuation**

### **Relative Valuation (PE Valuation)**

In conducting our PE valuation, we use the expected earnings for 2005 and an expected P/E ratio derived from a regression analysis with the P/E of the S&P 500 and MCD itself. We believe that the current P/E for MCD of 14.8 is very low both based on the historical PE ratios of the company and its current financial position.

### **Expected P/E for 2005**

In order to derive the expected P/E we ran several regressions between the PE of the S&P 500 and that of MCD:

1. The first regression used the S&P 500 annual PE for the last 10 years. For MCD we found the monthly average PE and then based on the monthly averages PE we calculated the average annual PE.

	<b><u>SPX</u></b>	<b><u>MCD</u></b>
2004	20.962	17.324
2003	28.978	15.297
2002	41.449	16.664
2001	36.892	19.785
2000	29.267	23.183
1999	32.899	32.188
1998	26.703	26.19
1997	22.321	21.509
1996	19.213	23.378
1995	16.516	20.922
1994	19.588	18.857

Correlation	0.006
<b>Regression</b>	MCD = 21.293
<b>Line</b>	+0.004SPX
	<b>21.37</b>

From this regression we calculated the expected PE for 2005 (using S&P 500 forecasted PE as calculated by Standards & Poor's) at 21.37 which is close to the current industry average of 21.05. Nevertheless we believe that this P/E is too high given the nature of the company and we were surprised to find that the correlation between the two PEs was very low at .004. As a result we will not use this forecasted PE.

2. We then ran three different regressions in order to get a broader picture of the expected PE and the relation of S&P 500 PE and that of MCD.

Year	S&P	MCD (High PE+Low PE)/ 2	MCD high	MCD low
2004	20.962	16	18	14
2003	28.978	16.5	23	10
2002	41.449	30	40	20
2001	36.892	24	28	20
2000	29.267	24	30	18
1999	32.899	31	36	26
1998	26.703	28	36	20
1997	22.321	21	24	18
1996	19.213	22	25	19
1995	16.516	19.5	24	15
	<b>Correlation</b>	0.64	0.705	0.411
	<b>Regression Line</b>	MCD AVG = 11.690 +.418SPX	R-sq =40.66%	
		<b>20.22</b>		
		MCD HIGH = 11.454 +.616SPX	R-sq= 49.66%	
		<b>24.03</b>		

		MCD LOW = 11.927 +.221SPX	R-sq =16.92%	
		<b>16.44</b>		

The first regression we ran was between the S&P 500 PE and the annual high PE of MCD. We were surprised to find the highest correlation between these two PE at .705, and R-sq of 49.66%. Based on this regression we estimated MCD's high PE at 24.02. Despite the strong correlation we believe that this estimate of the High annual PE for MCD expresses the company's previous condition when it aggressively expanded abroad therefore we believe that MCD's high PE will be closer to the Industry average of 21.05.

The second regression was between the S&P 500 PE and the annual low PE of MCD. Based on this regression we got a relatively low correlation of .411, R-sq of only 16.92%, and an expected PE of 16.43. We believe that the annual low is again somewhat above our expectations and we estimate the company's low PE given the current conditions at 15.

The third correlation used the average of MCD's high and low annual PE and the annual PE of the S&P 500. Based on this regression the correlation was relatively strong at 0.64, R-Sq of 40.66%, and an expected PE of 20.24.

3. The final regression we ran, which in our opinion is the most appropriate one used the annual S&P 500 PE for the last year and compared it to the discount or premium of the MCD PE for the same years. For this regression we got the highest correlation of .855. The R-sq was about 73% which is also high. We calculated that MCD's PE for 2005 will

be at -1.3161 discount to the S&P 500. As a result, the MCD PE was calculated to be at 19.

	<u>SPX</u>	<u>MCD</u> <u>(Premium/Discount)</u>
2004	20.962	3.638
2003	28.978	13.68
2002	41.449	24.875
2001	36.892	17.11
2000	29.267	6.084
1999	32.899	0.711
1998	26.703	0.513
1997	22.321	0.812
1996	19.213	-4.165
1995	16.516	-4.4762
1994	19.588	0.731
R-SQ		73%
Correlation		0.85
Regression Line MCD		=-21.378 +0.9996SPX
		19.039

We believe that this regression is the appropriate one to use since it shows a strong correlation and in fact it will probably become stronger over the long term given the stability that we believe the company will experience over the next years due to its maturity.

We use the 19 PE as our benchmark in estimating the expected PE for 2005.

Nevertheless, we want to adjust this P/E in order to be conservative and take into account the company's maturity compared to the industry which now trades at an average of 21.5.

As a result we believe that the company's PE for the next fiscal year will be 18 and this PE will gradually decrease over the years as follows.

Years	2005	2006	2007	2008	2009	2010	2011
Estimated P/E	18.00	17.50	17.00	16.50	16.00	16.00	15.50

### Expected Earnings 2005 –

We forecasted expected earnings for 2005 at 2.01 as described in our dividend discount model analysis below.

### Conclusion

Based on MCD's expected PE ratio and earnings for 2005 we estimate the company's target price in 2005 at: Target price:  $2.01 \times 18 = \mathbf{\$36.18}$ . Based on this valuation the company is significantly undervalued and we can achieve a return of 27% in 2005.

In addition this value is close but still lower than the S&P 12 month target price of \$38 and very close to the analysts median target of \$36.

#### PRICE TARGET SUMMARY

Mean Target:	35.58
Median Target:	36.00
High Target:	38.00
Low Target:	32.00
No. of Brokers:	12

Data provided by [Thomson/First Call](#)

- Discount Rate of Return(R)

In order to get R, we use Capital Asset Pricing Model (CAPM) which the formula is as following:

$$R = R_f + \beta_a * (R_m - R_f)$$

- $R_f$  : Risk free rate. We use current 10-year T-Bill rate which is 4.05%.
- $\beta_a$  : Beta of the security which McDonald's beta value is 0.83 from Yahoo.com/finance.
- $R_m$  : Expected market return. We use 9% which is based on S&P average return over past 20 years.

Thus, the  $R = 4.05\% + .83 * (9\% - 4.05\%) = 8.16\%$

## Revenue –

<b>McDonald's (Common Size) Consolidated Statement of Income</b>				
<i>IN MILLIONS, EXCEPT PER SHARE DATA</i>	<b>2004</b>	2003	2002	2001
<b>Total revenues</b>	11.23%	11.26%	3.60%	4.40%
<b>OPERATING COSTS AND EXPENSES</b>				
<b>Total operating costs and expenses</b>	8.50%	7.64%	9.20%	11.54%
<b>Operating income</b>	25.01%	34.04%	-21.66%	-19.00%
<b>Net income</b>	54.85%	64.88%	-45.41%	-17.23%

McDonald's management in the MD&A stated that the company is expected to generate long term systemwide sales and revenue growth of 3% to 5%. We believe that these figures accurately represent the company's potential long term growth given its maturity. Nevertheless, given the current developments within the company and the company's effective Plan to win growth with exceed those numbers for the next few years as it was already shown by the promising financial results of 2004 and Q1 2005. As a result, we adopt the management's expectation regarding revenue growth for the long term (3-5%) but we expect a short period of exceeding growth for fiscal years 2005, 2006 and 2007.

We are expecting that after 2007 the company will generate growth of 5% and slowly move towards growth of 3%.

For the next three fiscal years the company's "Plan to Win" will lead to revenue growth above the expected 3-5% long term growth but it will not be able to sustain the 11% rate that existed in the two previous years. Our expectation for exceeding revenues is based on the success of the new plan in the US market which we believe will continue to grow over the next two years, but also by the fact that the "Plan to Win" will also be implemented in the company's foreign operations more intensively therefore leading to a strong financial performance in the next couple of years.

Our expectation are reinforced by the company's financial results for Q1 2005 which were characterized by an increase of consolidated revenues by 9% compared to Q1 2004 (6% in constant currencies) and an increase in comparable sales by 4.6%. We believe that these trends of growth in revenues compared to 2004 will continue throughout the year. As shown on the next table the company revenue show some seasonality therefore greater revenues are expected in the next quarters. Nevertheless, we expect that growth compared to the same quarters of 2004 to be relatively constant at 9%.

Revenues/Earnings Data  
Fiscal year ending December 31 (From Annual Reports)

Revenues (Million \$)	2005	2004	2003	2002	2001	2000
1Q	4,803	4,400	3,800	3,597	3,512	3,344
2Q	--	4,729	4,281	3,862	3,708	3,561
3Q	--	4,926	4,505	4,047	3,879	3,749
4Q	--	5,010	4,555	3,899	3,772	3,590
Yr.	--	19,065	17,141	15,406	14,870	14,243

At the same time revenues for 2006 are expected to achieve above average growth but the effect of the Plan to Win will slowly decrease therefore we believe that a slow down in growth to 7% is safe to assume.

Based on this analysis we estimate expected revenues for the next 5 years to be as follows:

Years	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Rev % Growth	4.40%	3.60%	11.26%	11.23%	9.00%	8.00%	6.50%	5.00%	4.00%	5.00%	4.00%

#### Expenses:

<b>McDonald's Income Statement – Percentage Change</b>					
<i>IN MILLIONS, EXCEPT PER SHARE DATA</i>	2004	2003	2002	2001	2000
<b>REVENUES</b>					
Total revenues	100.00%	100.00%	100.00%	100.00%	100.00%
<b>OPERATING COSTS AND EXPENSES</b>	0.00%	0.00%	0.00%	0.00%	0.00%
Total operating costs and expenses	81.43%	83.48%	86.28%	81.86%	76.62%
Operating income	18.57%	16.52%	13.72%	18.14%	23.38%
Income before provision for income taxes and cumulative effect of accounting changes	16.80%	13.69%	10.79%	15.67%	20.24%
Provision for income taxes	4.85%	4.89%	4.35%	4.66%	6.35%
Income before cumulative effect of accounting changes	11.95%	8.80%	6.44%	11.01%	13.88%
Net income	11.95%	8.58%	5.80%	11.01%	13.88%

The common size income statement reveals the company's stability, since expenses do not fluctuate much and their percentage of the total revenue remains in the low 80s. In fact, the management tactic in improving its operations and reducing debt has led to a gradual drop in the operating costs and expenses as a percentage of total revenue.

<b>McDonald's (Common Size) Consolidated Statement of Income</b>				
<i>IN MILLIONS, EXCEPT PER SHARE DATA</i>	<b>2004</b>	2003	2002	2001
<b>Total revenues</b>	11.23%	11.26%	3.60%	4.40%
<b>OPERATING COSTS AND EXPENSES</b>				
<b>Total operating costs and expenses</b>	8.50%	7.64%	9.20%	11.54%
<b>Operating income</b>	25.01%	34.04%	-21.66%	-19.00%
<b>Net income</b>	54.85%	64.88%	-45.41%	-17.23%

The improvement in the company's margins is also revealed in the above table which shows that the percentage growth in revenues leads to a less growth in operating costs. Overall, improvement in margins was also sustained in Q1 2005 according to the company's 10Q (70 basis point improvement for franchise restaurants but the basis drop in company operated restaurants). We believe that the improvement in margins will be sustained for the next two years due to improvement in comparables sales and therefore the spread between the percentage growth in revenues and percentage growth in expenses will increase. Nevertheless, over the long term these improvements will not be sustained and the expenses as a % of revenue will move closer to the 10 year average of 78.66%. In fact management emphasized improvement in margins in its MD&A report for the company's outlook and believed that MCD can increase operating income 6% to 7% annually by increasing store count about 2%, boosting same-store sales 1% to 3%, and improving operating margins.

Given our expected revenues, the expense as percentage of revenues is forecasted as follows:

<b>Years</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
<b>Rev % Growth</b>	4.40%	3.60%	11.26%	11.23%	9.00%	8.00%	6.50%	5.00%	4.00%	5.00%	4.00%
<b>Exp as % of rev</b>	81.66%	86.28%	83.48%	81.43%	80.50%	79.50%	78.50%	78.50%	78.66%	78.66%	78.66%

**Tax rate:**

Tax rate for 2005 as per management's outlook will be between 29 and 30%, therefore we will be conservative and use the 30% figure.

Description(\$Thou)	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	Average
Tax Rate(%)	34.20%	30.14%	31.77%	32.82%	32.46%	31.40%	29.75%	40.31%	35.72%	28.85%	<b>32.82%</b>

We believe that this tax rate is not sustainable as the company's earnings and dividend distributions will increase over time. As a result we believe that the tax rate will slowly move toward the 10 year average of 32.82%. Due to uncertainty involved in the prediction of the tax rate we decided to be very conservative and use the 10 year average for all years after 2005 which is a conservative figure since the increase to that level will probably be slow. As a result our tax rate figures look as follows:

year	2005	2006	2007	2008	2009	2010	2011	Terminal Value
		30%	32.82%	32.82%	32.82%	32.82%	32.82%	32.82%

**EPS Denominator Growth Rate:** although under the company's \$5billion buyback plan that is still in effect EPS denominator growth rate should be beneficial to our valuation we decided to assume growth rate of 0.

**Interest expense:** Although interest expense is expected to decrease due to the management's strategy to pay down debt we will assume it will remain in last year's figures representing 1.88% of total revenues.

Based on our previous forecasts, EPS Growth is forecasted as follows:

Years	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Terminal Value
<b>Rev % Growth</b>	4.40%	3.60%	11.26%	11.23%	9.00%	8.00%	6.50%	5.00%	4.00%	5.00%	4.00%
<b>Exp as % of rev</b>	81.66%	86.28%	83.48%	81.43%	80.50%	79.50%	78.50%	78.50%	78.66%	78.66%	78.66%
<b>Interest Exp % of Rev</b>			1.88%	1.88%	1.88%	1.88%	1.88%	1.88%	1.88%	1.88%	1.88%
<b>Tax rate</b>				30%	32.82%	32.82%	32.82%	32.82%	32.82%	32.82%	32.82%
<b>Estimated P/E</b>				18.00	17.50	17.00	16.50	16.00	16.00	15.50	
<b>Actual Payout Ratio</b>	16.52%	21.26%	33.84%	30.74%							
<b>Dividend</b>	0.23	0.24	0.4	0.55							
<b>Estimate</b>											
EPS Estimate				2.01	2.2	2.34	2.59	2.67	2.82	2.92	
Payout				31.50%	32.00%	32.50%	33.00%	33.50%	34.00%	34.50%	
Dividend				0.63	0.7	0.76	0.85	0.89	0.95	1	45.32
<b>PV Factor(8.16%-CAPM)</b>				0.9246	0.8548	0.7903	0.7307	0.6756	0.6246	0.5775	0.5775
<b>PV</b>				0.58	0.6	0.6	0.62	0.6	0.59	0.58	26.17
						<b>Present Value</b>	<b>30.34</b>				

### DCF Valuation Spreadsheet

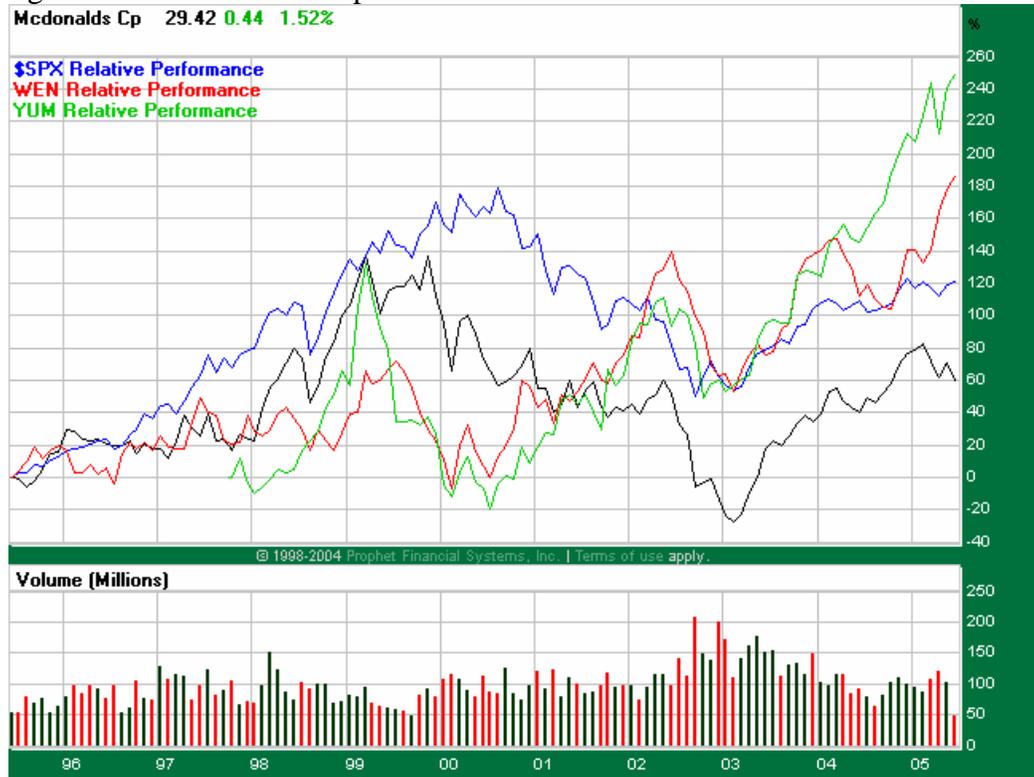
According to our valuation the company will maintain positive earnings for the next 5 years. The company's EPS Growth will be relatively strong given the improvement in margins and the expected revenue growth.

Despite our conservative valuation MCD's shares are undervalued at the current price of \$28.28 and we can expect a 7% growth within the year. In addition we believe that this valuation is relatively conservative since we analyze McDonald's as a mature company with limited growth, despite the potential to expand further in the foreign markets, and receive a boost from operations in its partner brands such as Chipotle which can bring renewed growth to the company.

CONCLUSION – Based on the two valuation methods we calculated target prices of \$30.34 and \$36.14 . In order to be conservative and because we believe that the DDM provided a very conservative valuation we see as the appropriate target price for the next year at \$33 which means that we can derive a return of 16.7%.

## XV. Stock Performance and Technical Analysis

### 1. Long-term Performance Comparison



Above chart is McDonald's 10-year stock price movement (in %) compared with S&P500 and major two competitors – Wendy's & Yum Brands. We can see MCD is under performed all others. This indicates McDonald's disappointed investor in the past. However, it is an opportunity with enough space to increase for McDonald's which is always the industry's giant. Thus, we score MCD's long-term performance comparison as modest negative.

### 2. Major Support and Resistance



Above is McDonald's 10-year stock price monthly candlestick chart. The blue line value is \$24.81 and \$32.95, respectively. They are MCD's long-term support and resistance line. Current MCD price is between this range indicates the equal performance which breakout neither resistance nor support.

### 3. Technical Indicator



Above chart includes several important technical indicators:

- ❖ **Bollinger Bands:** it plots two standard deviations away from a simple moving average. The current MCD price is in the upper and lower level of Bollinger band range and the band does not change any direction. This means MCD overall performance is equal.
- ❖ **MACD:** The "MACD" is a trend following momentum indicator that shows the relationship between two moving averages of prices. The current MCD's MACD(Hist.) value is  $-0.454$  and MACD(hist.+2 lines) has a potential to downward crossover. This is a sell signal and the MCD performance is modest negative.
- ❖ **RSI:** It is Relative Strength Index that compares the days that a stock finishes up against when it finishes lower. The current MCD's RSI value is  $57.98$  which is around 50 indicates the stock performance is equal.
- ❖ **Stochastic:** It compares where a security's price closed relative to its price range over a given time period. The current MCD's Stochastic value is  $63.62$  which is around 50 indicates the stock performance is equal.

#### 4. Weighted Score and Conclusion

We will give each performance a score as following:

Strong positive: 1; modest positive: 2; equal: 3; modest negative: 4; strong negative:5.

Then we use weighted method to evaluate each technical indicator. The details are as following:

	Score	Weighted	Weighted Score
comparison	4	0.1	0.4
support and resistance	3	0.3	0.9
Bollinger Band	3	0.2	0.6
MACD	4	0.2	0.8
RSI	3	0.2	0.6
Total:		1	3.3

Therefore, we conclude the overall MCD technical performance is equal and current below \$30 stock price is neither attractive nor risky.

## XVI. Analyst Covering and Insiders Transactions

Here are some recent market transactions placed by some relatively well know institutional investors. As you can see from the chart below we have some mixed positions around the market place based on current company, market and economic conditions.

MCD Upgrades			
Date	Analyst	Rating	Target
22-Apr	AG Edwards	Buy	\$35
28-Apr	Piper Jaffray	Outperform	
MCD Downgrades			
Date	Analyst	Rating	Target
9-Mar	CSFB	Neutral	
1-Feb	Piper Jaffray	Market Perform	
3-Nov	AG Edwards	Hold	
20-Oct	Bear Stearns	Peer Perform	

2-Jun	Prudential	Neutral	
14-Apr	CIBC	Sector Perform	
Recent Upgrades - General			
Date	Company	Analyst	Rating
23-Jun	BLX	Smith Barney Citigroup	Buy

A majority of investors agree that McDonald's Corporation post a strong outlook based on fundamental conditions surrounding the company. These conditions include strength of previous year's financial statements, current management strategies along with a positive outlook on the Company's future earnings and overall development as it seeks to strengthen its domestic position as well as expand globally

We also noticed by analyzing some large investors in McDonald's that shares of the company are not being accumulating or sold heavily. The technical evaluations are indeed bearish with most investors holding on to the stock.

Most of the analyst opinions on the stock rate McDonalds at either a "BUY" at the current market price or "HOLD" due to the relatively low risk McDonald's poses.

**INSIDER Trading among officers for 2005**

Date	Insider	Shares	Type	Transaction	Value*
4-May-05	<u>STONE, ROGER W.</u> Director	2,000	Direct	Planned Sale	\$59,600 <sup>1</sup>
4-May-05	<u>STONE, ROGER W.</u> Director	2,000	Direct	Sale at \$30.13 - \$30.14 per share.	\$60,000 <sup>2</sup>
4-May-05	<u>STONE, ROGER W.</u> Director	2,000	Direct	Option Exercise at \$18.125 per share.	\$36,250
4-May-05	<u>ROBERTS, MICHAEL J.</u> President	167	Direct	Disposition (Non Open Market) at \$0 per share.	N/A

3-May-05	<u>ROBERTS, MICHAEL J.</u> President	2,000	Direct	Sale at \$29.98 per share.	\$59,960
3-May-05	<u>ROBERTS, MICHAEL J.</u> President	2,000	Direct	Option Exercise at \$18.125 per share.	\$36,250
3-May-05	<u>ROBERTS, MICHAEL J.</u> Director	2,000	Direct	Planned Sale	\$59,140 <sup>1</sup>
2-May-05	<u>SKINNER, JAMES A.</u> Vice Chairman	52,000	Direct	Sale at \$29.44 per share.	\$1,530,880
2-May-05	<u>SKINNER, JAMES A.</u> Vice Chairman	52,000	Direct	Option Exercise at \$18.125 - \$24.625 per share.	N/A
2-May-05	<u>SKINNER, JAMES A.</u> Director	52,000	Direct	Planned Sale	\$1,524,120 <sup>1</sup>
25-Apr-05	<u>LUBIN, DONALD G.</u> Director	2,000	Direct	Option Exercise at \$18.125 per share.	\$36,250
25-Apr-05	<u>LUBIN, DONALD G.</u> Director	2,000	Direct	Sale at \$30.26 per share.	\$60,520
25-Apr-05	<u>MCMILLAN, CARY D</u> Director	3,000	Direct	Purchase at \$29.98 - \$29.99 per share.	\$90,000 <sup>2</sup>
25-Apr-05	<u>ROGERS, JOHN W. JR.</u> Director	20,000	Direct	Purchase at \$30.36 per share.	\$607,200
22-Apr-05	<u>LUBIN, DONALD G.</u> Director	2,000	Direct	Planned Sale	\$59,700 <sup>1</sup>
18-Mar-05	<u>ALVAREZ, RALPH</u> President	8	Direct	Statement of Ownership	N/A
18-Mar-05	<u>ALVAREZ, RALPH</u> Officer	16,381	Indirect	Statement of Ownership	N/A
11-Mar-05	<u>ADAMS, HALL JR.</u> Director	2,000	Direct	Sale at \$32.58 - \$32.59 per share.	\$65,000 <sup>2</sup>
11-Mar-05	<u>ADAMS, HALL JR.</u> Director	2,000	Direct	Option Exercise at \$18.125 per share.	\$36,250
11-Mar-05	<u>ADAMS, HALL JR.</u> Director	2,000	Direct	Planned Sale	\$65,500 <sup>1</sup>
10-Feb-05	<u>MCMILLAN, CARY D</u> Director	2,500	Direct	Purchase at \$32.10 per share.	\$80,250
3-Feb-05	<u>ECKERT, ROBERT</u> Director	5,000	Indirect	Purchase at \$31.40 - \$32.1 per share.	\$159,000 <sup>2</sup>

31-Jan-05 ROGERS, JOHN W. JR. 10,000 Direct Purchase at \$32.41 per share. \$324,099  
Director

Data Provided by Edgar Online

## **XVII. Current News**

On June 22 2005, it was announced that effective July 1 2005, Jim Skinner, the vice chairman and CEO of McDonalds Corp will be joining the board of directors of Walgreen Corp. He will be the 11<sup>th</sup> board member. On June 8 2005, McDonalds Reported May Global comparable sales. Global comparable sales increased by 1.8% in May while U.S. comparable sales went up by 4.2%.

On May 9 2005, McDonalds and Vivendi Universal Games announced that they will be partnering to offer electronic hand held video games based on the crash and spyro video games. This strategy would attract more kids to their restaurants thereby increasing sales for the company.

On June 14 2005, McDonald's was honored by Black Enterprise as one of the best companies for Diversity in America. This diversity is an important part of their global business industry, and would serve as a competitive advantage against other food industry business.

On February 11, 2005, McDonald's reported recorded \$3.9 billion cash from operations and a \$2.5 Billion free cash flow for 2004. This was as a result of higher sales and profits at existing restaurants. McDonalds Corps main aim is to increase sales by providing a more improved restaurant experience for their customers.

## **XVIII. Conclusion**

Through our analysis we found that McDonald's Corporation remains the premier player in the fast food industry. We believe that McDonald's is well prepared for future growth. McDonald's is tinkering with various possibilities in technology and design to try to ensure it is a hangout of choice in the future. McDonald's has undergone an image change in more ways than one since a time 2 1/2 years ago when its sales and reputation were sagging amid complaints about its service and food. Same-store sales have increased for 25 straight months in the key U.S. market. Its stock price nearly tripled over a two-year period, hitting a four-year high of \$34.56 per share in March, but has since settled around \$29. McDonald's has built one of the most successful fast food franchises in the world, with incredible growth for over three decades. The company's long-term strategy has focused on uniformity in its product, service, and the consistency of its information systems. However, with a slew of recent challenges, McDonald's has been able to adjust with each challenge and economic condition. The company's main new concern is portraying their sense of healthy eating habits and staying ahead of the competition.

## **IX. Appendix**

### **Appendix A**

CONDENSED CONSOLIDATED INCOME SHEET

Quarter Ended  
March 31, 2005

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**Dollars in millions, except per common share data**

	Amount	% Increase / (Decrease)
<b>Revenues</b>		
Sales by Company-operated restaurants	\$ 3,599.5	10
Revenues from franchised and affiliated restaurants	1,203.3	8
<b>Total revenues</b>	<b>4,802.8</b>	<b>9</b>
<b>Operating costs and expenses</b>		
Company-operated restaurant expenses	3,109.1	10
Franchised restaurants – occupancy expenses	257.0	4
Selling, general & administrative expenses	520.1	14
Other operating expense, net	7.0	(30)
<b>Total operating costs and expenses</b>	<b>3,893.2</b>	<b>10</b>
<b>Operating income</b>	<b>909.6</b>	<b>6</b>
Interest expense	89.8	(2)
Nonoperating (income) expense, net	(10.4)	n/m
<b>Income before provision for income taxes</b>	<b>830.2</b>	<b>10</b>
Provision for income taxes	102.3	(58)
<b>Net income</b>	<b>\$ 727.9</b>	<b>42</b>
<b>Net income per common share</b>	<b>\$ 0.57</b>	<b>39</b>
<b>Net income per common share–diluted</b>	<b>\$ 0.56</b>	<b>40</b>

**CONDENSED CONSOLIDATED BALANCE SHEET**

In millions, except per share data	March 31, 2005	December 31, 2004
<b>Assets</b>		
<b>Current assets</b>		
Cash and equivalents	\$ 1,356.5	\$ 1,379.8
Accounts and notes receivable	686.3	745.5
Inventories, at cost, not in excess of market	137.7	147.5
Prepaid expenses and other current assets	617.0	585.0
<b>Total current assets</b>	<b>2,797.5</b>	<b>2,857.8</b>
<b>Other assets</b>		
Investments in and advances to affiliates	1,136.6	1,109.9
Goodwill, net	1,815.8	1,828.3
Miscellaneous	1,301.2	1,338.4
<b>Total other assets</b>	<b>4,253.6</b>	<b>4,276.6</b>
<b>Property and equipment</b>		
Property and equipment, at cost	30,042.8	30,507.8
Accumulated depreciation and amortization	(9,859.9)	(9,804.7)
<b>Net property and equipment</b>	<b>20,182.9</b>	<b>20,703.1</b>
<b>Total assets</b>	<b>\$27,234.0</b>	<b>\$ 27,837.5</b>
<b>Liabilities and shareholders' equity</b>		
<b>Current liabilities</b>		
Accounts payable	\$ 495.4	\$ 714.3
Income taxes	201.5	331.3
Other taxes	243.2	245.1
Accrued interest	169.2	179.4
Accrued payroll and other liabilities	1,056.3	1,188.2
Current maturities of long-term debt	503.6	862.2
<b>Total current liabilities</b>	<b>2,669.2</b>	<b>3,520.5</b>
<b>Long-term debt</b>	<b>8,155.2</b>	<b>8,357.3</b>
<b>Other long-term liabilities</b>	<b>926.3</b>	<b>976.7</b>
<b>Deferred income taxes</b>	<b>845.7</b>	<b>781.5</b>
<b>Shareholders' equity</b>		
Preferred stock, no par value; authorized – 165.0 million shares; issued – none		
Common stock, \$.01 par value; authorized – 3.5 billion shares; issued – 1,660.6 million	16.6	16.6
Additional paid-in capital	2,391.4	2,186.0
Unearned ESOP compensation	(83.2)	(82.8)
Retained earnings	22,484.0	21,755.8
Accumulated other comprehensive income (loss)	(301.9)	(96.0)
Common stock in treasury, at cost; 393.1 and 390.7 million shares	(9,869.3)	(9,578.1)
<b>Total shareholders' equity</b>	<b>14,637.6</b>	<b>14,201.5</b>

**Appendix B****Common Size Consolidated Statement of Income**

<i>IN MILLIONS, EXCEPT PER SHARE DATA</i>	<b>2004</b>	2003	2002	2001	2000
<b>REVENUES</b>					
Sales by Company-operated restaurants	<b>74.61%</b>	<b>74.65%</b>	<b>74.65%</b>	74.25%	73.49%
Revenues from franchised and affiliated restaurants	<b>25.39%</b>	<b>25.35%</b>	<b>25.35%</b>	25.75%	26.51%
<b>Total revenues</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	100.00%	100.00%
<b>OPERATING COSTS AND EXPENSES</b>	<b>0.00%</b>	0.00%	0.00%	0.00%	0.00%
Company-operated restaurant expenses	<b>0.00%</b>	0.00%	0.00%	0.00%	0.00%
Food & paper	<b>25.45%</b>	<b>25.17%</b>	<b>25.43%</b>	25.57%	24.97%
Payroll & employee benefits	<b>19.55%</b>	<b>19.90%</b>	<b>19.98%</b>	19.51%	18.89%
Occupancy & other operating expenses	<b>18.47%</b>	<b>19.13%</b>	<b>18.90%</b>	18.50%	17.57%
Franchised restaurants – occupancy expenses	<b>5.26%</b>	<b>5.47%</b>	<b>5.45%</b>	5.38%	5.42%
Selling, general & administrative expenses	<b>10.39%</b>	<b>10.69%</b>	<b>11.12%</b>	11.17%	11.14%
Other operating expense, net	<b>2.31%</b>	<b>3.10%</b>	<b>5.41%</b>	1.73%	-1.38%
<b>Total operating costs and expenses</b>	<b>81.43%</b>	<b>83.48%</b>	<b>86.28%</b>	81.86%	76.62%
<b>Operating income</b>	<b>18.57%</b>	<b>16.52%</b>	<b>13.72%</b>	18.14%	23.38%
Interest expense	<b>1.88%</b>	<b>2.26%</b>	<b>2.43%</b>	3.04%	3.02%
McDonald's Japan IPO gain	<b>0.00%</b>	<b>0.00%</b>	<b>0.00%</b>	-0.92%	0.00%
Nonoperating (income) expense, net	<b>-0.11%</b>	<b>0.57%</b>	<b>0.50%</b>	0.35%	0.12%
<b>Income before provision for income taxes and cumulative effect of accounting changes</b>	<b>16.80%</b>	<b>13.69%</b>	<b>10.79%</b>	15.67%	20.24%
Provision for income taxes	<b>4.85%</b>	<b>4.89%</b>	<b>4.35%</b>	4.66%	6.35%
<b>Income before cumulative effect of accounting changes</b>	<b>11.95%</b>	<b>8.80%</b>	<b>6.44%</b>	11.01%	13.88%
Cumulative effect of accounting changes	<b>0.00%</b>	<b>-0.21%</b>	<b>-0.64%</b>	0.00%	0.00%

<b>Net income</b>	<b>11.95%</b>	<b>8.58%</b>	<b>5.80%</b>	11.01%	13.88%
<b>Per common share – basic:</b>	<b>0.00%</b>	<b>0.00%</b>	<b>0.00%</b>	0.00%	0.00%
Income before cumulative effect of accounting changes	<b>0.01%</b>	<b>0.01%</b>	<b>0.01%</b>	0.01%	0.01%
Cumulative effect of accounting changes	<b>0.00%</b>	<b>0.00%</b>	<b>0.00%</b>	0.00%	0.00%
Net Income	<b>0.01%</b>	<b>0.01%</b>	<b>0.00%</b>	0.01%	0.01%
<b>Per common share – diluted:</b>	<b>0.00%</b>	<b>0.00%</b>	<b>0.00%</b>	0.00%	0.00%
Income before cumulative effect of accounting changes	<b>0.01%</b>	<b>0.01%</b>	<b>0.00%</b>	0.01%	0.01%
Cumulative effect of accounting changes	<b>0.00%</b>	<b>0.00%</b>	<b>0.00%</b>	0.00%	0.00%
Net Income	<b>0.01%</b>	<b>0.01%</b>	<b>0.00%</b>	0.01%	0.01%
<b>Dividends per common share</b>	<b>0.00%</b>	<b>0.00%</b>	<b>0.00%</b>	0.00%	0.00%
<b>Weighted-average shares outstanding – basic</b>	<b>6.61%</b>	<b>7.41%</b>	<b>8.26%</b>	8.67%	9.29%
<b>Weighted-average shares outstanding – diluted</b>	<b>6.68%</b>	<b>7.45%</b>	<b>8.32%</b>	8.80%	9.52%

## Appendix C

### Common Size Consolidated Balance Sheet

*IN MILLIONS, EXCEPT PER SHARE DATA*  
December 31, 2004

	2004	2003	2002	2001	2000
<b>ASSETS</b>					
<b>Current assets</b>					
Cash and equivalents	<b>4.96%</b>	<b>1.91%</b>	1.38%	1.86%	1.94%
Accounts and notes receivable	<b>2.68%</b>	<b>2.84%</b>	3.57%	3.91%	3.67%
Inventories, at cost, not in excess of market	<b>0.53%</b>	<b>0.50%</b>	0.47%	0.47%	0.46%
Prepaid expenses and other current assets	<b>2.10%</b>	<b>2.05%</b>	1.74%	1.84%	1.59%
<b>Total current assets</b>	<b>10.27%</b>	<b>7.30%</b>	7.16%	8.07%	7.67%
<b>Other assets</b>					
Investments in and advances to affiliates	<b>3.99%</b>	<b>4.22%</b>	4.33%	4.39%	3.80%
Goodwill, net	<b>6.57%</b>	<b>6.44%</b>	6.51%	5.86%	6.66%
Miscellaneous	<b>4.81%</b>	<b>4.93%</b>	4.48%	4.95%	3.26%
<b>Total other assets</b>	<b>15.36%</b>	<b>15.59%</b>	15.32%	15.20%	13.71%
<b>Property and equipment</b>					
Property and equipment, at cost	<b>109.59%</b>	<b>111.23%</b>	109.38%	106.97%	108.70%
Accumulated depreciation and amortization	<b>-35.22%</b>	<b>-34.12%</b>	-31.85%	-30.25%	-30.08%
<b>Net property and equipment</b>	<b>74.37%</b>	<b>77.11%</b>	77.53%	76.72%	78.62%
<b>Total assets</b>	<b>100.00%</b>	<b>100.00%</b>	100.00%	100.00%	100.00%
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>					
<b>Current liabilities</b>					
Notes Payable	<b>0.00%</b>	<b>0.00%</b>	0.00%	0.82%	1.27%
Accounts payable	<b>2.57%</b>	<b>2.23%</b>	2.65%	3.06%	3.16%
Income taxes	<b>1.19%</b>	<b>1.29%</b>	0.07%	0.09%	0.43%

Other taxes	0.88%	0.86%	0.80%	0.80%	0.90%
Accrued interest	0.64%	0.75%	0.83%	0.76%	0.69%
Accrued restructuring and restaurant closing costs	0.26%	0.45%	1.37%	0.64%	0.00%
Accrued payroll and other liabilities	4.01%	3.55%	3.23%	3.02%	2.81%
Current maturities of long-term debt	3.10%	1.50%	1.15%	0.79%	1.63%
<b>Total current liabilities</b>	<b>12.65%</b>	<b>10.64%</b>	10.11%	9.98%	10.89%
<b>Long-term debt</b>	<b>30.02%</b>	<b>36.16%</b>	40.48%	37.97%	36.17%
<b>Other long-term liabilities</b>	<b>3.51%</b>	<b>2.71%</b>	2.34%	2.79%	2.26%
<b>Deferred income taxes</b>	<b>2.81%</b>	<b>4.12%</b>	4.19%	4.94%	5.00%
Common equity put options and forward contracts	0.00%	0.00%	0.00%	2.22%	3.23%
<b>Shareholders' equity</b>	<b>0.00%</b>	<b>0.00%</b>	0.00%	0.00%	0.00%
Preferred stock, no par value; authorized—165.0 million shares; issued—none	0.00%	0.00%	0.00%	0.00%	0.00%
Common stock, \$.01 par value; authorized—3.5 billion shares; issued—1,660.6 million shares	0.06%	0.06%	0.07%	0.07%	0.08%
Additional paid-in capital	7.85%	7.11%	7.29%	7.06%	6.65%
Unearned ESOP compensation	-0.30%	-0.35%	-0.41%	-0.47%	-0.53%
Retained earnings	78.15%	78.07%	80.12%	82.58%	79.60%
Accumulated other comprehensive income (loss)	-0.34%	-2.46%	-6.68%	-7.58%	-5.94%
Common stock in treasury	-34.41%	-36.07%	-37.49%	-39.55%	-37.41%
<b>Total shareholders' equity</b>	<b>51.02%</b>	<b>46.37%</b>	42.89%	42.11%	42.45%
<b>Total liabilities and shareholders' equity</b>	<b>100.00%</b>	<b>100.00%</b>	100.00%	100.00%	100.00%

## **Appendix D**

### **Common Size Consolidated Statement of Cash Flows**

<i>IN MILLIONS</i>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>
<b>Operating activities</b>					
Net income	43.20%	32.65%	17.29%	31.00%	33.12%
Adjustments to reconcile to cash provided by operations					
Cumulative effect of accounting changes	0.00%	0.82%	1.91%	0.00%	0.00%
Depreciation and amortization	22.77%	25.47%	20.34%	20.58%	16.93%
Deferred income taxes	-3.26%	4.02%	-0.86%	-1.66%	1.01%
Changes in working capital items	0.00%	0.00%	0.00%	0.00%	0.00%
Accounts receivable	-0.68%	1.42%	0.03%	-1.98%	-1.13%
Inventories, prepaid expenses and other current assets	-0.28%	-0.67%	-0.74%	-1.19%	-0.50%
Accounts payable	1.64%	-1.72%	-0.22%	0.19%	1.50%
Income taxes	1.60%	0.52%	2.69%	5.12%	-0.77%
Other accrued liabilities	1.33%	-3.79%	5.98%	0.00%	0.00%
Other (including noncash portion of impairment and other charges)	7.69%	13.80%	9.51%	-1.14%	-4.09%
<b>Cash provided by operations</b>	<b>74.01%</b>	<b>72.52%</b>	<b>55.93%</b>	50.93%	46.09%
<b>Investing activities</b>					
Property and equipment expenditures	-26.91%	-29.01%	-38.78%	-36.11%	32.58%
Purchases of restaurant businesses	-2.84%	-8.34%	-10.61%	-6.28%	-7.13%
Sales of restaurant businesses and property	5.81%	8.67%	7.15%	7.12%	5.07%
Other	-2.28%	-1.71%	-5.49%	-3.91%	-2.43%

<b>Cash used for investing activities</b>	<b>-26.22%</b>	<b>-30.39%</b>	<b>-47.74%</b>	-39.18%	37.06%
<b>Financing activities</b>					
Net short-term borrowings (repayments)	<b>0.68%</b>	<b>-11.84%</b>	<b>-11.74%</b>	-4.70%	0.99%
Long-term financing issuances	<b>4.28%</b>	<b>8.83%</b>	<b>29.08%</b>	32.10%	39.89%
Long-term financing repayments	<b>-20.42%</b>	<b>-16.78%</b>	<b>-14.52%</b>	-17.42%	12.76%
Treasury stock purchases	<b>-11.77%</b>	<b>-8.68%</b>	<b>-12.97%</b>	-20.23%	33.89%
Common stock dividends	<b>-13.18%</b>	<b>-11.17%</b>	<b>-5.76%</b>	-5.45%	-4.70%
Proceeds from stock option exercises	<b>11.01%</b>	<b>3.80%</b>	<b>3.77%</b>	0.00%	0.00%
Other	<b>-1.56%</b>	<b>-2.70%</b>	<b>2.24%</b>	3.88%	1.49%
<b>Cash used for financing activities</b>	<b>-30.97%</b>	<b>-38.53%</b>	<b>-9.89%</b>	-11.81%	-8.99%
<b>Cash and equivalents increase (decrease)</b>	<b>16.82%</b>	<b>3.60%</b>	<b>-1.70%</b>	-0.07%	0.04%
Cash and equivalents at beginning of year	<b>9.34%</b>	<b>7.33%</b>	<b>8.09%</b>	7.99%	7.03%
<b>Cash and equivalents at end of year</b>	<b>26.16%</b>	<b>10.93%</b>	<b>6.39%</b>	7.92%	7.06%

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