Identifying Ratios – McDonald’s Corporation

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This paper will identify McDonald Corporation's specific ratios related to its financial base. Comparisons with Wendy's International are also addressed. Data for financial ratios come from the balance sheet, the income statement, and the cash flow statement.

One of the first McDonald's restaurants was opened in Des Plaines, Illinois in 1955, when Ray Krock mortgaged his home and invested his entire life savings to become the exclusive distributor of a free-spindled milkshake maker called the multimixer. The first day's revenue was $366.12! (McDonald's History, 2006) This is quite a change from the McDonald's Corporation as we know it today.

In 1965, McDonald's went public with the company's first offering on the stock exchange. A hundred shares of stock costing $2,250 that day would have multiplied into 74,360 shares today, with a cost value of $1.8million as of December 31, 2003 (McDonald's History, 2006).

There are tons of thousands of McDonald restaurants severing millions of people daily around the world. The incredible growth and success of McDonald's can be summed up with the first thought that went through Ray Kroc's mind when he first saw McDonald's: "This will go any place" (McDonald's History, 2006).

McDonald's is listed as the world's first fast food company in sales, with more than 31,800 flagship restaurants serving burgers and fries in more than 100 countries. Almost 30% of its locations are company owned; the others are run by franchises. The Company's fifty years of success has been driven by the strength of McDonald's global brand and other unique business relations amount franchisees, suppliers and the Company (collectively referred to as the System). This strategic alignment enables the System to pursue innovative ideas that satisfy their customers and profitability for a successful business growth (McDonald's Corporation Annual 2005 Financial Report).

The Company's long-term goal is to create a differentiated customer experience, one that builds loyalty and delivers long-term profitable growth for all its shareholders and the System. Their long-term growth remains unchanged: average annual system wide sales and revenue growth of 3% to 5%, average operating income growth of 6% to 7%, and annual returns on invested capital in the high teens (McDonald's Corporation Annual 2005 Financial Report).

The Company generates significant cash from operations and has substantial credit capacity to fund operating and capital expenditures, debt repayments, dividends, and share repurchase. Cash from operating totaled $4.3 billion and exceeded capital expenditures by $2.7 billion in 2005. Cash from operations totaled $3.9 billion and exceeded capital expenditures by $2.5 billion in 2004. Cash provided by operations increased $433 million in 2005 and $635 million in 2004 due to strong operating results (McDonald's Corporation Annual 2005 Financial Report).

Financial ratios are useful indicators of a firm's performance and financial situation. Most ratios can be calculated from information provided by the financial statements. Financial ratios can be used to analyze trends and to compare a firm's financials to those of other firms.

To remain solvent, a company must have at least as much money coming as it has going out. The current ratio is defined as the number of dollars held in current assets per dollar of current liabilities. A positive correlation between measures of profitability and the current ratio is observed, which implies the more profitable companies are likely to have higher current ratio values.

The current ratio is calculated by taking total current assets divided by current liabilities. McDonald Corporation's current ratio is 2005 was 1.45 and .81 in 2004. Its quick ratio equaled 1.41 in 2005, and .77 in 2004 respectively. McDonald's cash flow showed significant growth in current assets in 2005 and 2004 (McDonald's Corporation 2005 Financial Report). These ratios indicate that McDonald's is in an adequate position to meet financial obligations as they occur. The quick ratio provides a liquidity measurement of how quickly inventory can be converted into cash. Both years define that McDonald's is in a good cash position.

Another very important measure of a business's success is profit. Without profit, dividends will not be paid, and no one will want to invest in the company's stock.

Profitability ratios give us relative measures of the firm's money making success (Lasher, W., 2005). For the past three years, McDonald's has returned a significant amount of cash to shareholders through shares repurchased and dividends paid to stockholders. Profitability ratios offer several different measures of the success of a firm.

For McDonalds, operating income, which excludes interest income, is used to compute return on average assets, while income before the cumulative effect of accounting changes is used to calculate return on average common equity. McDonald's return on assets in 2005 was 14.4% and 13.49% in 2004. Return on common equity was 17.8% in both 2005 and 2004 (McDonald's Corporation 2005 Annual Report). The return on equity was significantly impacted by higher cash and equivalent balances which was held as part of the company's planning.

The debt ratio uses the total debt concept and measures the relationship between total debt and equity in supporting the firm's assets (Lasher, W., 2005). It tells us how much of the firm's assets are supported by other people's money. A high debt ratio is often viewed as risky to investors.

McDonald's has incurred debt obligations through public and private offerings and bank loans. Total debt obligations for 2005 totaled $10,140 million. The debt ratio for 2005 was .69 and 1.23 in 2004 (McDonald's Corporation 2005 Annual Report). These financial ratios provide an indication of the long-term solvency of the company.

Wendy's International, Inc. is a fierce competitor of McDonald's and is also one of the largest restaurants in the country. Wendy's stock price rose 41% during 2005 and reached an all time height of $56.40 in December 2005. Total revenues grew to a record of $3.8 million (Wendy's International 2005 Annual Report). Although, these are accomplishments, Wendy shared other disappointing financial results. There was a 3.7% decline in Wendy's United States companies compared to one year ago (Wendy's International 2005 Annual Report). Several of the restaurants not making a profit closed their doors.

In summary, both restaurants are strong competitors in the industry. Each has a strategic plan in place to achieve goals and success in the market. Financial ratios are used to evaluate the condition of a business as a unit. Each specific ratio concentrates attention upon specific details of the company. One of the objectives in using ratios is to detect strengths and weaknesses of the business. Comparisons of ratios from previous years are used to tell the progress of the business. As the size of the business increases and debt goes up, a means of evaluating the conditions becomes more critical. Financial ratios are a beneficial tool to any business.

References

Lasher, W. R. *Practical Financial Management* (4th ed.). R.R. Donnelly, Inc. Willard, OH, 2005.

McDonald's History. www.mcdonalds.com/conp/about/mcd_history_pgl.html. (Retrieved May 22, 2006).

McDonald's Corporation 2005 Annual Report.

Wendy's International, Inc. 2005 Annual Report.

MCDONALD'S CORPORATION
CONSOLIDATED BALANCE SHEET
(In Millions)

	December 31, 2005	December 31, 2004
ASSETS		
Current assets		
Cash equivalents	4,260.4	1,379.8
Accounts and notes receivable	795.9	745.5
Inventories, at cost, not in excess of market	147.0	147.5
Prepaid expenses and other current assets	646.4	585.0
Total current assets	5,849.7	2,857.8
Other assets		
Investments in and advances to affiliates	1,035.4	1,109.9
Goodwill, net	1,950.7	1,828.3
Miscellaneous	1,245.0	1,338.4
Total other assets	4,231.1	4,276.6
Property and equipment		
Property and equipment, at cost	29,897.2	30,507.8
Accumulated depreciation and amortization	-9,989.2	-9,804.7
Net property and equipment	19,908.0	20,703.1
Total assets	29,988.8	27,837.5
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Notes payable	544.0	0.0
Accounts payable	689.4	714.3
Income taxes	567.6	331.3
Other taxes	233.5	245.1
Accrued interest	158.5	179.4
Accrued payroll and other liabilities	1,184.6	1,188.2
Current maturities of long-term debt	658.7	862.2
Total current liabilities	4,036.3	3,520.5
Long-term debt	8,937.4	8,357.3
Other long-term liabilities	892.3	976.7
Deferred income taxes	976.7	781.5
Shareholders' equity		
Preferred stock, no par value		
Common stock, $.01 par value	16.6	16.6
Additional paid-in capital	2,797.6	2,186.0
Unearned ESOP compensation	-77.4	-82.8
Retained earnings	23,516.0	21,755.8
Accumulated other comprehensive income (loss)	-733.1	-96.0
Common stock in treasury, at cost	-10,373.6	-9,578.1
Total shareholder's equity	15,146.1	14,201.5
Total liabilities and shareholder's equity	29,988.8	27,837.5

MCDONALD'S CORPORATION
CONSOLIDATED BALANCE SHEET
(In Millions)

	December 31,		
	2005	**2004**	**2003**
REVENUES			
Sales by company-operated restaurants	15,351.7	14,223.8	12795.4
Revenues from franchised and affiliated restaurants	5,108.5	4,840.9	4345.1
Total revenues	20,460.2	19,064.7	17,140.5
OPERATING COSTS AND EXPENSES			
Company operated restaurant expenses			
Food and paper	5,207.2	4,852.7	4314.8
Payroll and employee benefits	4,039.2	3,726.3	3411.4
Occupancy and other operating expenses	3,867.7	3,520.8	3279.8
Franchised restaurants - occupancy expenses	1,021.9	1,003.2	937.7
Selling, general & administrative expenses	2,220.6	1,980.0	1833
Impairment and other charges (credits), net	-28.4	290.4	407.6
Other operating expense, net	110.4	150.8	124
Total operating costs and expenses	16,438.6	15,524.2	14,308.3
Operating income	4,021.6	3,540.5	2,832.2
Interest expense	356.1	358.4	388
Nonoperating (income) expense, net	-36.1	-20.3	97.8
	3,701.6	3,202.4	2,346.4
Provision for income taxes	1,099.4	923.9	838.2
Income before cumulative effect of accounting change	2,602.2	2,278.5	1,508.2
Cumulative effect of accounting change, net of tax benefit			-36.8
Net income	2,602.2	2,278.5	1,471.4

	2005	2004	Wendy's
Liquidity			
Current Ratio	1.45	0.81	1.3
Quick Ratio	1.41	0.77	0.11
Debt			
Debt Ratio	0.69	1.23	
Debt: Equity			30%
Profitability			
Return on Sales	17%	16%	
Return on Assets	14.40%	13.40%	7.00%
Return on Equity	17.80%	17.80%	11.90%