McDonald's Corporation

April 25, 2005

R.J. Reynolds………...Roufkes.A.Reynolds@ttu.edu
Andrew Spear……………...Drewspear@yahoo.com
Markie Stark………………… Starksisters@cox.net
Tyler Walbridge………... Tylerwttu@hotmail.com
Rob Watkins……………Robert.B.Watkins@ttu.edu

Table of Contents

Valuation of McDonald's Corporation

Investment Recommendation: Market Outperform   Date: April 1, 2005

MCD – NYSE (4/01/05)	$31.00
52 Week Price Range	$25.05 - $34.56
Revenue	$19.06B
Market Capitalization	$39.37B
Shares outstanding	1.27B
Dividend yield	1.77%
3 month Avg Daily Trading Volume	4,411,000
Percent Institutional Ownership	73.04%
Book Value Per Share (mrq)	11.183
ROE (most recent years)	12.28%
ROA (most recent years)	5.76%
Est. 5 year EPS Growth Rate	7.3%

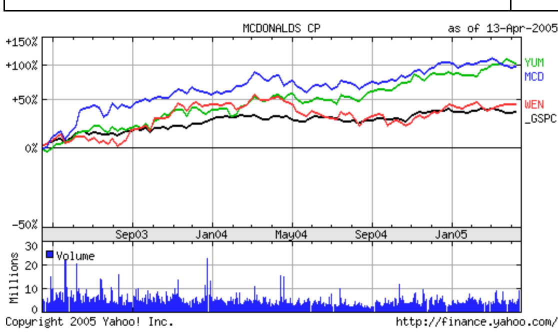
Cost of Capital Estimates	Beta	Ke
Ke Estimated		5.81%
5-year Beta	0.87	5.81%
3-year Beta	1.30	7.12%
2-year Beta	0.96	6.09%
Published Beta	0.79	5.57%
Kd		3.33%
WACC (bt)		5%

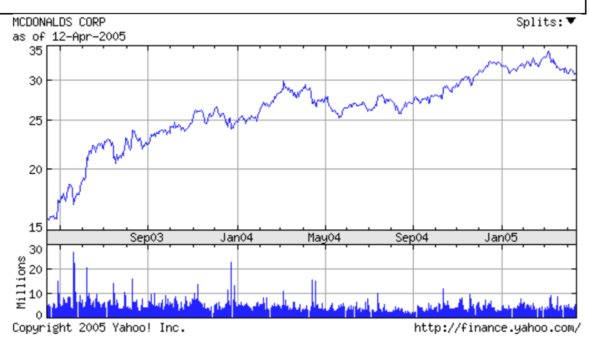
EPS Forecast

FYE	2004	2005	2006	2007
EPS	$1.80	$1.73	$1.93	$2.15

Valuation Ratio Comparison	McDonald's	Industry Average
Trailing P/E	17.15	19.38
Forward P/E	14.46	16.68
Forward PEG	1.82	1.40
M/B	14.77	5.99

Valuation Estimates	
Actual Current Price	$31.00
Ratio Based Valuation	
P/E trailing	$35.69
P/E forwarding	$35.53
PEG Forward	1.82
Dividend Yield	$51.16
M/B	$66.99
Ford Epic Valuation	$32.37
Intrinsic Valuation	
Discounted Dividends	$14.78
Free Cash Flows	$28.79
Residual Income	$43.24
Abnormal Earnings Growth	$42.04
Long-Run Residual Income Perpetuity	$34.28





- We rate McDonald's as a MARKET OUTPERFORM. McDonald's is noticeably undervalued according to our abnormal earnings and residual income models.
- McDonald's has created some positive momentum over the past couple years with the implementation of its new revitalization plan. Currently, McDonald's is continuing to streamline its operation and training processes as well as sustain its fiscal discipline.
- We project short-term revenue growth to gradually decline from 10%-11% in 2004 to 6%-7% in 2011 as the changes made during the revitalization have time to run their course.

Rating System:
BUY: A strong purchase recommendation with above average long-term growth potential.
MARKET OUTPERFORM: A purchase recommendation that is expected to marginally outperform the return of the market.
MARKET PERFORMER: A recommendation to maintain current positions with returns expected to match the market.
SELL: A recommendation to sell the security (or short the security) as it is expected to decrease in price in the medium term.

Executive Summary:

Recommendation—Undervalued Security:

After extensive research, analysis and valuation, it is found that McDonald's corporation is currently an undervalued company and rated as a Market Outperform and thus we recommend this stock as a "Buy.". McDonald's has a long standing history of business, and has built a loyal customers base with the company's continued dedication to customer service. The food service industry is one of high competition; however, McDonald's has been able to obtain the position as the leader in market capitalization with a market capital of $39.37B. While McDonalds has deployed high amounts of capital, the company manages its asset base with high inventory turnover while also maintaining cost efficiency. McDonald's also owes much of its success to product development to conform to customer needs and a changing society.

Industry Demand Drivers:

The market of the food service industry attributes much of its growth to global sales and revenue. McDonald's announced recently their first quarter earning per share of 0.56. When adjusted for a one time tax settlement of $179 million or $0.13 per share, McDonalds ended the quarter with EPS of $0.43 which is in line with consensus estimates of $0.44. This resulted in an adjusted earnings growth of 10% over the same quarter a year ago which is due to an outstanding increase of their global comparable sales by 4.6%, which in turn drove an increase in revenue of 9%. McDonald's customer relevance in the U.S. is attributed by their menu and prices, choices and variety, and customer service. Globally, McDonald's caters and adapts to different cultures and societies, while still providing them with the same McDonald's experience. With a significant portion of McDonalds sales derived from international stores, foreign denominated sales should generate additional earnings leverage given the weakening of the US dollar against other currencies.

McDonald's is Well Positioned:

McDonald's is able is maintained a loyal customer base, and compete with the existing competitors by introducing variation to their menu, such as the Dollar Value Menu. Also, in order to adhere to a more concerned health concise society, McDonald's has implemented a "Light and Healthy" menu. The Happy Meal, which has been a long standing child's favorite, now has options such as fruit instead of French Fries and all white meat chicken nuggets. As for one McDonald's company goals is to adhere to outstanding customer service, strengthens the maintenance of long standing customers, as well as develop new relationships with customers of a new generation.

McDonald's Corporation has also acquired Boston Market, and Chipotle Mexican Grill. With the acquisition of these two companies, McDonalds's has implemented a focused growth platform that is to bring long term growth and benefits to McDonald's.

Margin Expansion:

In 2004, McDonald's margin increased by 40 basis points and their profit margin is 11.95% for the trailing twelve months. The growth in global comparable sales is one of the main factors that has attributed to this extensive growth, because the increasing comparable sales helps offset high commodity costs. Throughout extensive valuation the margin for growth is looking promising, and in conjunction with such a large market capitalization this would result in a steady growth of large amounts of capital.

Healthy Financials:

One of the core competencies of McDonald's "Plan to Win," is a goal to strive and adhere to strict financial discipline. McDonald's is able to obtain Revenues of $4,802.8 million in just the first quarter of 2005, by managing costs and using their large amounts of cash flows to reinvest in the company. The reinforcement of this action enable McDonald's to strength their balance sheet, and company.

Recently, McDonald's has been a leader in adopting accounting polices such as FASB No. 123. In addition to the current expensing of stock options, they have also ceased using straight line depreciation for their rent expense and changed to an amortize improvements of the leased property. The end result of this change has accelerated recognition of rent expense, and also resulted in a tax benefit of $179 million.

Valuation:

After extensive valuation and analysis, it is conclusive that McDonald's actual share price is currently undervalued. The analysis conducted compared McDonald's to competitors in the industry on a number of relevant factor and ratios, as well as the use of past financial data to forecast and predict the future growth of McDonald's Corporation. As of April 1, 2005 the actual closing share price was $31.00; however, our valuations predict the company to grow as estimated 10-15% driving the growth of the share price to a range of $35-$40 per share. Foods are a defensive stock, being that they are usually that of slightly slower growth, but they are less susceptible to adverse market swings. With the recent quarter press release already showing favorable signs of growth, it makes McDonald's an attractive company to currently invest in with promising revenue and earnings growth.

Looking Good on other Criteria:

McDonald's stock prices have produced the highest percentage growth of the industry. The past year their stock prices grew by about 23.3%. Also, at the end of this quarter McDonald's announced that they had consecutive positive growth for the past twenty-four months.

Risks:

McDonald's did face litigation, over obesity claims, similar to that of the Tobacco industry. However, recently the law suits have been dismissed. Even with the recent litigation and legal fees, McDonald's was able to sustain a pace of positive and fortuitous growth. Corporate Responsibility of the food industry has prompted much of the menu changes for a more health concise society. Global economic risks are also associated with the wide globalization of McDonald's Corporation. The fact that the franchises are now spread across over 100 countries makes the economic stability of those countries vital to the success of the global market. Inflation and the current currency exchange could have a great effect on the global revenues of McDonald's. Furthermore, the global market has many factors that are important to monitor; however, much of the growth in revenues is due to the global sales.

Business and Industry Analysis:

Business Overview

McDonald's Corporation operates and franchises restaurants in the food service industry all over the world. They are the leading global food service retailer by means of over 30,000 restaurants in more than 119 countries, serving about 50 million people every day. Franchising plays a major role in McDonald's system with over 2,400 franchise owners, making up about 25% of their total revenue. Their total revenue in 2004 was $19.06 billion. McDonald's success in the fast food industry stems from their main success factors which are cost efficiency, product development, marketing and promotions. These success factors are used to promote McDonald's brand image, provide customers with quality products and differentiate themselves from other competitors. These main success factors are important to the company since the fast food industry is highly competitive and competitors compete for market share due to the fact it's easy to enter the industry. McDonald's also has operations in other fast food restaurants such as Boston Market and Chipotle who make about $800 million together in revenues a year and these additions provide McDonald's with growth opportunities.

Industry Overview

The food service industry continues to grow in volume and revenue every year and typically divides itself into two categories: full-service restaurants and fast-food restaurants. Each individual restaurant is in competition with other food service operations within the same geographical area. The fast food restaurant industry is highly competitive. McDonald's competes with other restaurants through the quality, variety and value perception of food products offered. McDonald's Corporation's main competition comes from other fast-food restaurants; most notably, YUM! Brands Inc, Wendy's International and Burger King.

Five Forces Model

Rivalry Among Firms:

Currently in the fast food industry, there is intense competition for growth in the market. The market growth is rising because of the convenience factor and busy consumers not having enough time to cook a meal. The restaurant industry is also growing rapidly due to opportunities in other global markets. In McDonald's case, they actually have a competitive advantage because they have already entered many different countries and are succeeding in these countries. Each firm within the food-service industry is susceptible to losing customers because there are relatively no switching costs for consumers, therefore the industry has to rely heavily on their brand image and quality of products. McDonald's has a number of competitors; however they are currently the leader of the industry in market capitalization with a cap of $39.31 billion.

Threat of New Entrants:

The threat of new entrants in the fast food industry is high because there are no legal barriers which would keep them from entering the industry. The major barriers in which a firm faces in the industry are the economies of scale and the access of the distribution. In order for a firm to enjoy success in the industry, they must spend a large amount of capital on advertising and marketing. The industry is very competitive because firms are always attempting to steal customers from each other. Access for distribution is crucial in the restaurant industry because if the customer can't see you or access you easily it's possible that they won't go out of there way to eat there. Franchise options also make is easier to enter the market, for example Subway has built their strategic plan around franchise options. Therefore, initially the only cost to enter the market is the starting capital required to open a restaurant. However, it can cost upwards of millions of dollars for all the equipment, licensing, and the property. This costly barrier is the most probable reason that people do not enter this business. The food-service industry doesn't have any exit barriers, which allow firms to easily leave the industry if they're not successful, at virtually only the cost incurred.

Threat of Substitute Products:

McDonald's is known for their famous French Fries, Big Macs, and Happy Meals. Competitors of the industry also try to compete with similar products; therefore, leading to price wars. McDonald's created a Dollar Value Menu, in response to competitors such as Wendy's 99 cent menu. Overall, the industry has tried various product differentiations in order to accumulate greater market share, but most consumers are drawn to the classics for which the establishment is known for. However, growing concern to achieve a healthier society has led McDonald's, as well as other competitors, to make extensive menu changes, in order to conform to a more concerned society. McDonald's is doing more and more to compete with health focused restaurants like Subway. Nutritionist and other leading experts have been hired to join the McDonald's team in order to ensure that the correct items are added to the menu, while still keeping and improving the classics that they are famous for. For example, the chicken nuggets that we all grew up on are now 100% white meat. McDonald's is flexible in their menu to conform to the changing tastes of society, but they always serve with a smile!

Bargaining Power of Customers:

McDonald's, and the industry, has attempted to gain market capitalization, by keeping the customer satisfied, due to the fact there are relatively no switching costs. For this reason, they have adopted the slogan, "the customer is always right." The industry must try to maintain a hold on the market by conforming to a changing society as well as maintaining high quality. One of the industry's most recent concerns is that of creating a healthier society and prevention of obesity. McDonald's corporation has faced previous law suits on being held accountable for obesity, similarly following the litigation process of cigarettes and tobacco companies. The courts ruled against this issue in McDonald's favor, making this a remote future risk factor. McDonald's has had to paid legal fees in order to defend itself in this type of litigation; however, even with this incremental cost they are still achieving a significant rate of earnings growth. In addition, McDonald's, in it's effort to be a more socially responsible corporate citizen by supporting a healthier society, has developed "light" and healthy menu items in order to give customers additional eating options and in doing so, broadening the array of its customer base while offering it's existing customer base with healthier menu options.

Bargaining Power of Suppliers:

It can be said that McDonald's has a large bargaining power because of the fact that they spend 4.852 billion dollars in food and paper in 2004. This can be argued that the companies that McDonald's buys from could be largely dependent on McDonald's business. Although in recent years the industry has had a small problem with beef, because of the outbreak of the mad cow disease. This problem raised the cost of beef in Europe tremendously but the cost actually went up around the world because of the beef shortage in Europe. In this case it can be argued that the suppliers of beef have a strong voice as well. The suppliers that sell to McDonald's have a strong voice also because of the fact that the switching cost for McDonald's as a whole would be so tremendous that they would not want to make that change, so any problems or disputes would be worked out with there suppliers. Also, with the competition and the number of buyers in the market place, losing a large company like McDonald's could destroy any supplier but there are other prospects out there to buy that product like Wendy's, Jack in the Box, Burger King and a few others that they may be able to salvage there losses. As for the paper goods that McDonald's buy from the manufacturers, if McDonald's were to change manufacturers the supplier could easily change there manufacturing to note book paper by just re-adjusting the machines but it would come at a great cost.

Key Success Factors

McDonald's key success factors are cost efficiency, product development, marketing, and promotions. To ensure McDonald's remained consistent with these factors, they sold Donatos Pizzeria, a company they owned for the past four and half years, due to the costly operations of running the company. This allowed McDonald's to address the issues of slumping sales they experienced in the past and focus their attention on their operations. In 2003, McDonald's introduced a new revitalization plan aimed to help market itself to today's health conscious consumers and to improve its financial position through discipline. In previous years, McDonald’s had been attempting to grow primarily by adding new restaurants. With the limited success of this strategy, the McDonald’s managers appeared they were more interested in expanding the empire than generating shareholder wealth. With the new campaign, McDonald’s has begun to look like the world’s food service industry leader once again. McDonald’s has introduced new products like salads and chicken options that have been well received by the more health conscience consumers. McDonald’s also streamlined and improved techniques its training and operations systems. This resulted in an even more enjoyable customer experience. Finally, McDonald’s has practiced impressive levels of financial discipline lately. They have paid down their own debt, reduced capital expenditures by starting less new restaurants, and reducing other expenses. As a result, McDonald’s was able to put more money in the pockets of its shareholders in the form of dividends. Because of the success of its newly implemented revitalization plan, McDonald’s forecasts a 3% to 5% growth of its total sales and revenues annually. We also expect McDonald’s to benefit from this new plan and experience a steady capitalization growth.

Accounting Analysis

For our accounting analysis we found the key accounting policies and related them to our identified key success factors. McDonald's most important factors include consolidation, financial statement estimates, revenue recognition, advertising costs, compensation from stocks, property and equipment, goodwill, long-lived assets, franchise revenues, and employee benefit plans. We determined that McDonald's has a large amount of flexibility in its accounting methods. Their depreciation methods and goodwill impairment practices are very important in their financial statements because the numbers are so substantial. McDonald's uses a standard accounting strategy that easily compares its financial statements with its competitors. When evaluating their quality of disclosure, we determined that the company does a great job of explaining the choices they make and their future estimates in the Letter to the Shareholders and the Management Discussion and Analysis. Their footnotes are also very easy to understand. There was nothing in our ratios that raised a red flag for us, as all the numbers convey clear patterns in the last five years. There was no reason to undo any accounting distortions because we did not find any skeptical information that was not explained in their disclosures.

Sales Manipulation Diagnostics

	2000	2001	2002	2003	2004
Net Sales	$14,243	$14,870	$15,406	$17,140	$19,065
Net Sales/Cash from Sales	5.18	5.53	5.33	5.24	4.88
Net Sales/Net Accounts Receivable	17.88	16.86	18.01	23.34	25.57
Net Sales/Unearned Revenue	0	0	0	0	0
Net Sales/Warranty Liablilities	0	0	0	0	0
Net Sales/Inventory	143.43	140.95	137.92	132.46	129.25

Core Expense Manipulation Diagnostics

	2000	2001	2002	2003	2004
Declining Asset Turnover (Sales/Asset)	0.66	0.66	0.64	0.67	0.68
Changes in CFFO/OI	0.83	1.00	1.37	1.15	1.10
Changes in CFFO/NOA	1.66	1.48	1.68	1.73	1.37
Total Accruals/Changes in Sales	0.05	0.07	0.08	0.07	0.07
Pension Expense/SG&A	1.69	1.75	1.80	1.86	1.88

Key Accounting Policies

As the largest company in the restaurant and food services industry, McDonald's Corporation has chosen to find its primary competitive advantage in the marketing and operational areas. As McDonald's continues to grow and improve as a company, it is committed to its key success factors of cost efficiency, product development, marketing, and promotions. By focusing on these factors McDonald's has derived its key accounting policies. The following is a summary of significant accounting policies identified by the managers of McDonald's.

- **Consolidation**: The consolidated financial statements include the accounts of the company and its subsidiaries.
- **Estimates in Financial Statements**: McDonald's uses accounting principles generally accepted in the U.S. which require management to make estimates and assumptions which could differ from actual results that affect the amounts reported in the financial statements.
- **Revenue Recognition**: The Company's revenues consist of sales by Company-operated restaurants and fees from restaurants operated by franchisees. Sales by Company-operated restaurants are recognized on a cash basis. Fees from franchised and affiliated restaurants include continuing rent and service fees, initial fees and royalties received from foreign affiliates and developmental licensees. Continuing fees and royalties are recognized upon opening of a restaurant, which is when the Company has performed substantially all initial services required by the franchise arrangement.
- **Advertising Costs**: Advertising costs included in costs of Company-operated restaurants primarily consist of contributions to advertising cooperatives. Production costs for radio and television advertising are expensed when the commercials are initially aired. These production costs as well as other marketing-related expenses are included in selling, general & administrative expenses.
- **Stock-Based Compensation**: The Company accounts for all stock-based compensation as prescribed by Accounting Principles Board Opinion No. 25. The Company discloses pro forma net income and net income per common share, as

provided by Statement of Financial Accounting Standards (SFAS) No. 123, as amended by SFAS No. 148, Accounting for Stock-Based Compensation.

- **Property and Equipment**: Property and equipment are stated at cost and are depreciated and amortized using the straight-line method. Building are given a useful life of up to 40 years and equipment three to 12 years.
- **Goodwill**: Goodwill represents the excess cost over the net tangible assets of acquired restaurant businesses. The Company's goodwill mainly consists of amounts paid above value of net tangible assets for purchases of restaurants from franchisees and appreciation of ownership in international subsidiaries such as McDonald's Japan.
- **Long-Lived Assets**: In accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, long-lived assets are reviewed for impairment annually in the fourth quarter and whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.
- **Franchise Revenues**: Individual franchise arrangements include a lease and a license. Revenue comes from initial fees and rent and service fees that are based on sales. There are minimum rent payments if the franchise does not earn enough in sales.
- **Employee Benefit Plans**: McDonald's Profit Sharing Plans for employees in the United States include profit sharing, 401 (k) and stock ownership benefits. All earnings can be invested in the common stock of McDonald's along with several other investment alternatives.

Due to McDonald's unique business strategy, certain accounting policies are more important than others. Its policies regarding goodwill are very important because goodwill is one of McDonald's largest assets. McDonald's also spends a great deal of resources on advertising and marketing itself.

Potential Accounting Flexibility

McDonald's Corporation has a fairly significant amount of flexibility in its accounting methods. One accounting practice that has a substantial effect on its financial statements is the depreciation method that McDonald's uses on its property and equipment. Property and equipment is by far McDonald's largest asset because the Company owns most of the property and buildings that make up all 30,000+ of its restaurant locations (including the franchised restaurants). McDonald's chooses to use straight-line depreciation on its property and equipment and assigns its buildings a useful life of up to 40 years and its equipment a useful life of three to 12 years. However, McDonald's could vastly overstate or understate income by using an alternative depreciation method. Another accounting policy that could potentially effect the McDonald's Corporation financial statements is the goodwill impairment practices that it uses. McDonald's Corporation has substantial amounts of goodwill through the purchasing of franchised restaurants for above the value of net tangible assets. In 2004, McDonald's goodwill amounted to $1.8 billion. Occasionally, this goodwill will become impaired, primarily in Latin America operations, and the accounting policy that McDonald's implements will become important. McDonald's complies with SFAS No. 141 and SFAS No. 142 when accounting for goodwill. The McDonald's Corporation also has a large amount of flexibility when it comes to estimations. The preparation of financial statements in conformity with G.A.A.P. in the U.S. requires management to make estimations that may or may not reflect reality, especially in regards to long-term assets such as property and equipment.

Accounting Strategy

Based on our review we conclude that McDonald's corporation uses standard accounting policies in the industry. Wendy's does not do a good job of explaining their policies but the YUM Corporation is easy to compare. Both of the companies report their revenues in the period that they are earned. The companies deal with franchising similarly as they both have a startup fee and collect additional fees based on sales performance. McDonald's financial statements will be comparable with other companies in this industry segment with similar accounting policies. In addition, these accounting policies are crucial for congruency and measuring profitability across the restaurant franchises and other branches of the firms, such as Boston Market and Chipotle Mexican grill domestically and internationally.

General Accounting Policies:

The consolidated financial statements are inclusive of the company and subsidiaries, where the equity method is used to account for investments of 50% or less. McDonald's is fairly conservative in making their accounting policies. Estimations of the financial statement are in compliance with GAAP and realistic of the companies standing. McDonald's revenue recognition is a combination of cash basis of company operated restaurants, as well as franchises fees and royalties complying with the matching principle of recording when earned in that current period. All foreign currency is translated to the U.S. dollar except for the countries who currently use the dollar, in order to ensure that dollar amounts are all on the same monetary scale.

Stock Based Compensation:

McDonald's is conservative in giving compensation from their stocks. They give out dividends once a year and are not currently expensing stock based compensation. Instead, McDonald's is currently using the pro forma method in compliance with the current accounting principles as set forth in SFAS No. 123 and SFAS No. 148. The pro forma impact of stock based compensation for the last three years is $0.17, $0.20 and $0.15 per share on a fully diluted basis. Similar amount will actually appear in McDonald's Income Statement beginning in 2005 where expense will be recorded by computing the fair value of the options vested during the accounting period by the use of one of two option pricing models.

Advertising:

One of the key investment areas of the McDonald's corporation is in the advertising area. They are very aggressive in there advertising methods but put a lot of hard work into making sure that they don't fail in this category. In order to be competitive in the fast food industry, the advertising expense has been growing increasing over the years, with the most recent in 2003 of $596.7 million. McDonald's corporation finds that advertising is an important aspect to invest into in order to ensure standards are upheld throughout the franchisees and to create a competitive advantage of brand loyalty.

Property and Equipment:

McDonald's has a lot of property and equipment, but have become more conservative in the past few years. They have not spent as much money on new property in recent years and have spent more on the restaurants that they already own. Property and Equipment are consistent with industry standards and are depreciated by the method of straight line depreciation over their useful life. However, long lived assets of the company are tested for impairments annually, or also when there is a red flag that an assets current carrying value may not be recoverable. This sector of McDonald's financial statements are crucial in valuing this company due to the vast percentage that long lived assets accounts for an asset rich company such as this. Long lived asset roughly account for 80% of $20 billion worth of total assets. Ensuring that long lived assets are valued fairly is imperative in the understanding the true value of the firm and crucial to stockholder and prospective investors.

In general, there were not that many changes in accounting policies besides those that were implemented due to industry policy. For example, with the FASB implementation of SFAS No. 141 and No. 142 companies were required to no longer amortize goodwill, but rather revalue it from year to year. McDonald's was in compliance with the new change, even though it provided for a deduction in net income of approximately $30 million. With the many franchises and outlets of the McDonald's corporation it is also important in the financial statements to ensure that the long lived assets are reported at fair value. In order to comply with industry regulations, McDonald's assets are reviewed for any type of impairment by grouping the assets together according to their television market level in the United States, as well as internationally.

Financial Instruments and Hedging:

In order to mitigate both interest rate and foreign currency risks, McDonalds does utilize both fair value and cash flow hedges. With approximately $9.3 in long term debt or 36% of its total capitalization, interest rate risk is significant thus; hedging and derivatives are used as part of their overall financial strategy dispersed among several different financial institutions. Derivative and hedging instruments are currently valued at fair market value in compliance with SFAS No. 133. However, in coordinating with the SFAS No. 133 McDonald's had to record a reduction in income on $17 million, but no material affect on consolidated income.

Franchise Arrangements:

Franchise Arrangements, as they represent approximately 25% of McDonald's revenue stream, is a continuing vital asset of steady momentum. The McDonald's corporation is entitled to a constant flow of revenues including those of initial payment, rent, and service fees as well as a percentage of sales.

Overall, McDonald's corporation implements accounting policies that are typical of the industry. Chairman Wayne Havers stated in a press release, "We felt that the current appeal of corporate honesty and the continued infatuation with the stock market made this the prime time for being open with our stockholders and customers." According to, Havers upon reflection of their financial statements and accounting policies the McDonald's corporation wants to continue to have transparent financial statements so that honesty in their accounting policies will result in further trust in the company.

Quality of Disclosure

McDonald's does a great job of presenting its information to the public about its operations. The managers go far beyond the minimum requirements of disclosure and make it very easy for shareholders and others who are interested to get any valuable information that they want.

The Letter to the Shareholders is written by Jim Cantalupo, who became the Chairman and CEO of McDonald's at the beginning of 2003. He discusses the turnaround that they made in 2003 that reestablished McDonald's as an industry leader. He talks about their new ad campaign and the addition of new menu items that helped cash flow from operations to reach a record $3.3 billon, as well as raising annual dividends 70 percent to $500 million. He says that there is more to do in 2004, including improving service, extending value menus to more markets, and reinvesting in existing restaurants. He estimates revenue growth of three to five percent, and annual operating income growth of six to seven percent starting in 2005.

The company's footnotes lay out all of the significant accounting policies and make them easy to understand. The statements are broken up and the information given on each is easy to comprehend. The notes give detailed charts of payments, expenses, revenues, and other aspects of the financial statements that may warrant further explanation.

The Management Discussion and Analysis section of the annual report gives a good description of the business and describes the direction that McDonald's is going. It explains that 2001 and 2002 did not offer good returns on investment because they focused too much on adding new restaurants. Their new strategy in 2003 focused on adding more customers to existing restaurants. It presents highlights for the year and what they look to accomplish in 2004. It discusses its successes in foreign countries and shows charts to compare sales in all the countries that McDonald's restaurants are located. The Analysis does a good job of explaining their plans on expenses in 2004 and beyond.

Potential Red Flags

In conjunction with our sales and expenditure analysis, the financial statements do not show very many unexplained changes in the numbers. Many things such as sales increase a great amount which could put up a red flag. The sales/accounts receivable ratio goes up a lot also in 2003 from 18.01 to 23.34. However, as it is explained in the Management's Discussion and Analysis section, the reason is the different style of approach that McDonald's began at the beginning of 2003. In the past years the company spent a lot of money on growth by adding new restaurants which had high levels of capital expenditures and increased debt financing. In 2003 the company came up with a new revitalization plan to emphasis growth by adding more customers to existing restaurants. This new approach brought sales up while keeping expenses down.

Undo Accounting Distortions

McDonald's does a good job in their footnotes and other statements of explaining why changes have occurred and give no reason for investors to be worried about their accounting practices. The financial reports are broken down and explained well in the footnotes and the company explains changes it has made in the Letter to the Shareholders and Management's Discussion and Analysis. Being that there are no red flags indicated by the financial statements, there is no reason to undo any accounting information.

Ratio Analysis and Forecasting

Introduction to Ratio and Forecasting Analysis

In order to get an accurate perspective of McDonald's and provide some perspective on the future of the company, a ratio analysis was conducted to assess the value of the company. By conducting ratio analysis, we're able to analyze the financial trends of previous years and extrapolate those trends into future years for McDonald's and its core competitors within the industry. Ratio analysis allows users to dissect and analyze the financial statements into three areas: profitability, liquidity, and capital structure of the company. Liquidity ratios are used to determine how liquid the firm is, and how it will meet its obligations. This also helps us determine how risky the firm is by determining if the company is employing an adequate amount of liability or risk to generate profit. Profitability ratios give us a perspective of how profitable the firm is operating. Is the firm operating efficiently or is money being wasted? Lastly, capital structure ratios give a view of how well the company has thought-out its capitalization plans by the use of debt and equity. With the use of these ratios, we'll be able to accurately value the company at its current condition, compare its performance against competitors, and project the future results of the company.

Ratios

	2000	2001	2002	2003	2004
Liquidity Analysis					
Current Ratio	0.70	0.81	0.71	0.76	0.81
Quick asset ratio	0.66	0.76	0.66	0.71	0.77
Accounts recievable turnove	17.88	16.86	18.01	23.34	25.57
Days supply of receivables	20.41	21.65	20.26	15.64	14.27
Inventory turnover	35.82	36.04	35.07	33.34	32.90
Days supply of inventory	10.19	10.13	10.41	10.95	11.09
Working capital turnover	-20.39	-34.66	-21.79	-28.55	-28.77
Profitability Analysis					
Gross profit margin	75.03%	74.43%	74.57%	74.83%	74.55%
Operating expense ratio	76.62%	81.86%	86.28%	83.48%	81.43%
Net profit margin	13.88%	11.01%	5.80%	8.58%	11.95%
Asset turnover	0.66	0.66	0.64	0.66	0.68
Return on assets	9.12%	7.26%	3.73%	5.69%	8.19%
Return on equity	21.48%	17.25%	8.69%	12.28%	16.04%
Capital Structure Analysis					
Debt to equity ratio	1.36	1.37	1.33	1.16	0.96
Times interest earned	7.75	5.96	5.65	7.30	9.88
Debt service margin	9.99	14.54	9633.67	N/A	N/A
Other Relevant Ratios					
NOPAT Margin	16.90%	14.05%	8.23%	10.85%	13.83%
Dividend Payout ratio	14.20%	17.58%	33.28%	34.22%	30.50%
Substantial Growth Rate	18.43%	14.22%	5.80%	8.08%	11.15%

Ratio Analysis

In our ratio analysis we conducted the 14 ratios for Liquidity, Profitability, and Capital Structure. We also included the **NOPAT Margin Ratio** because it's a relevant ratio for McDonald's and the entire fast food industry. The NOPAT Margin Ratio gives us a better perspective of the company's overall operating efficiency by including net income, net interest expense, and sales.

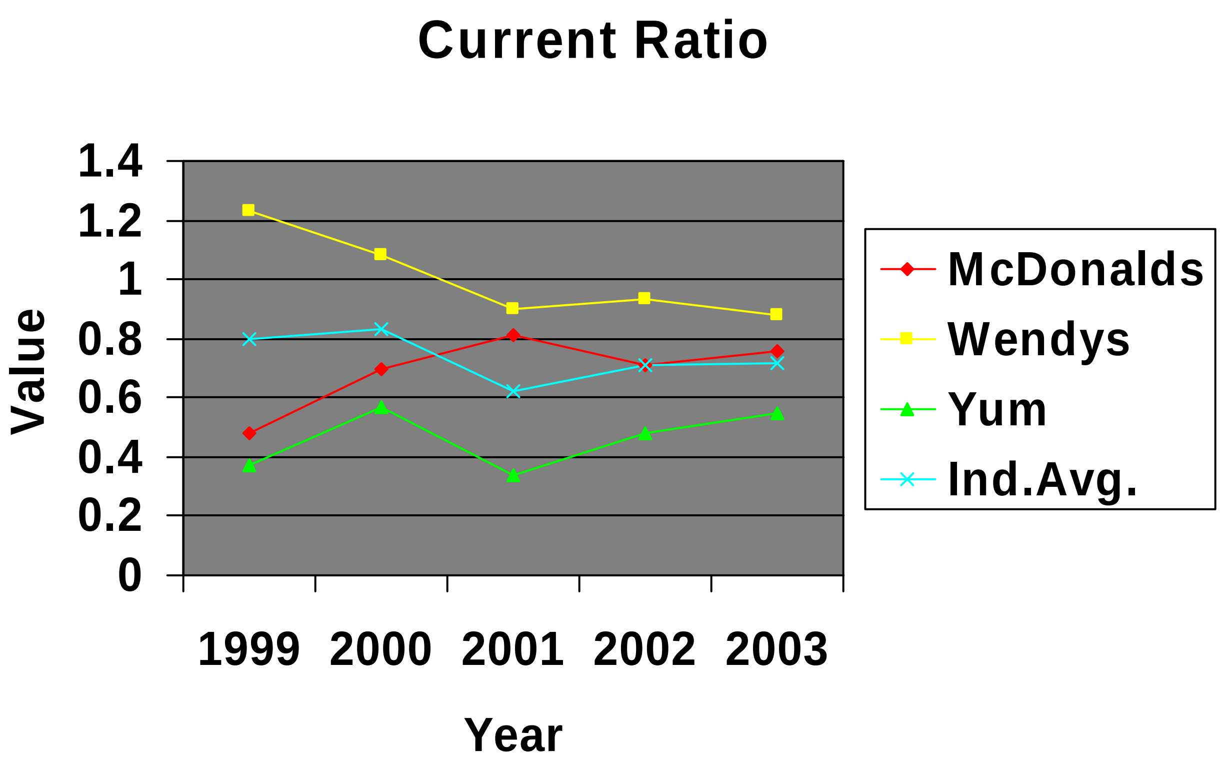
The Liquidity Ratios are very important to our company because the fast food industry has a high turnover of goods. The **current ratio** and the **quick asset ratio** enable us to see McDonald's capabilities in covering their current liabilities. Over the five year analysis, these two ratios increased every year, except for a slight decrease from 2001 to 2002. The large increase over time shows current assets are increasing faster than current liabilities which is good for the company. The **accounts receivable turnover** decreases between 1999 and 2001, but then substantially increases over the next two years, which shows McDonald's capabilities in collecting accounts receivables. This shows the inverse relationship of the **days' supply of receivables** decreasing over time, resulting in a positive impact on cash. The **inventory turnover** steadily decreased over time which implies the company invested more money in inventory relative to sales at an increasing rate every year. This creates an increase in **days' supply of inventory** from 1999 to 2003, because inventory is being turned over at a slow rate. McDonald's working capital is negative in all five years because they continue to have more current liabilities than current assets. Therefore the **working capital turnover** is negative and decreases over time. This isn't necessarily bad for the company because of the industry's high turnover of current assets and the company's steady increase in sales.

The Profitability Ratios examine the Income Statement to see how efficiently the company is operating. In this highly competitive industry, it's crucial to maintain efficiency in order to have a competitive edge. The **gross profit margin** remains fairly constant as it only decreases 1% over the five years. The steady ratio indicates that McDonald's maintains a consistent balance between profit and sales. The **operating expense ratio** increases by about 10% from 1999 to 2002, and then decreases 3% in 2003 to 83.48%. The high percentage of expenses to sales is not too large relative to other companies in the industry. The high cost of operating expenses is necessary to create a large amount of incremental sales. The **net profit margin**, which indicates the amount of income generated for every dollar of sales, decreased about 9% from 1999 to 2002 and then increased 3% in 2003. The four year decrease wasn't a good sign for the company, but the increase to 8.58% suggests a promising future. The **asset turnover** remains extremely steady and only increases 0.04 to 0.67 in 2003. This 0.67 of sales that each dollar of assets produces is relatively low in the industry and raises questions on their amount of assets. The **return on assets** declines significantly from 1999 to 2002 and increases slightly in 2003. This ratio is also very low for the fast food industry and shows that the company could be using their assets more efficiently. The **return on equity** is high in 1999 and goes down about half to 2002, and then increases 4% to 2003. This possibly indicates that McDonald's isn't relying on equity to generate income as much as in previous years. The pattern for most of the profitability ratios was a decrease from 1999 to 2002 and an increase from 2002 to 2003. This shows that the company has changed the way they utilize their resources in a positive way.

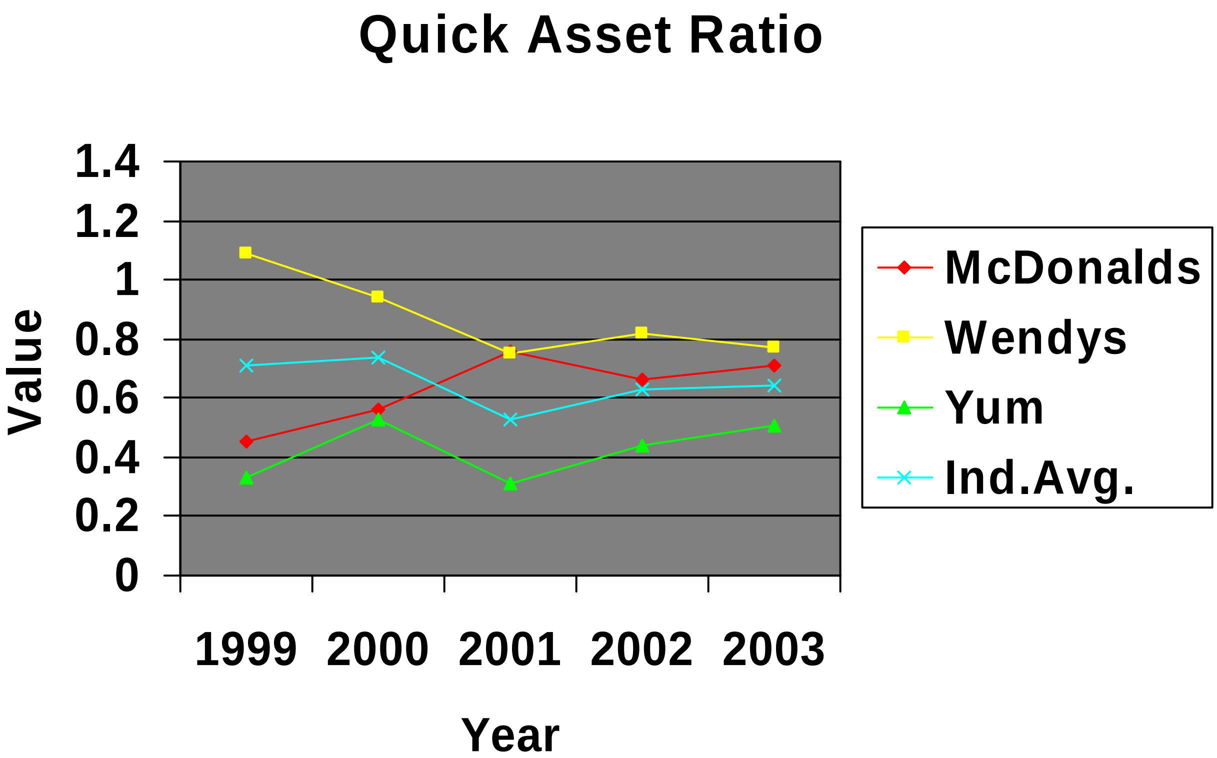
The Capital Structure Ratios allow us to get a perspective on how well McDonald's is managing their debt and equity. The **debt to equity ratio** increased for several years, but has slightly decreased over time. The decline to 1.13 is a good indication that their equity funds have grown and allowed them to hold on to less debt. The **times interest earned** slightly decreased over time with a small increase between 2002 and 2003. However, with a ratio of 6.05 in 2003, it proves that their income from operations is more than enough to cover their interest expense. The **debt service margin** goes from 2.8 in1999, to 14.54 in 2001, and then drastically jumps to 9633.67 in 2002. This is because in 2002, their notes payable declined to just $300,000. By 2003, there was no current notes payable, providing a much greater profit in operating cash flow. Conclusively, McDonald's capital structure has strengthened, making it easier to cover their debt.

Cross Sectional (Benchmark) Analysis

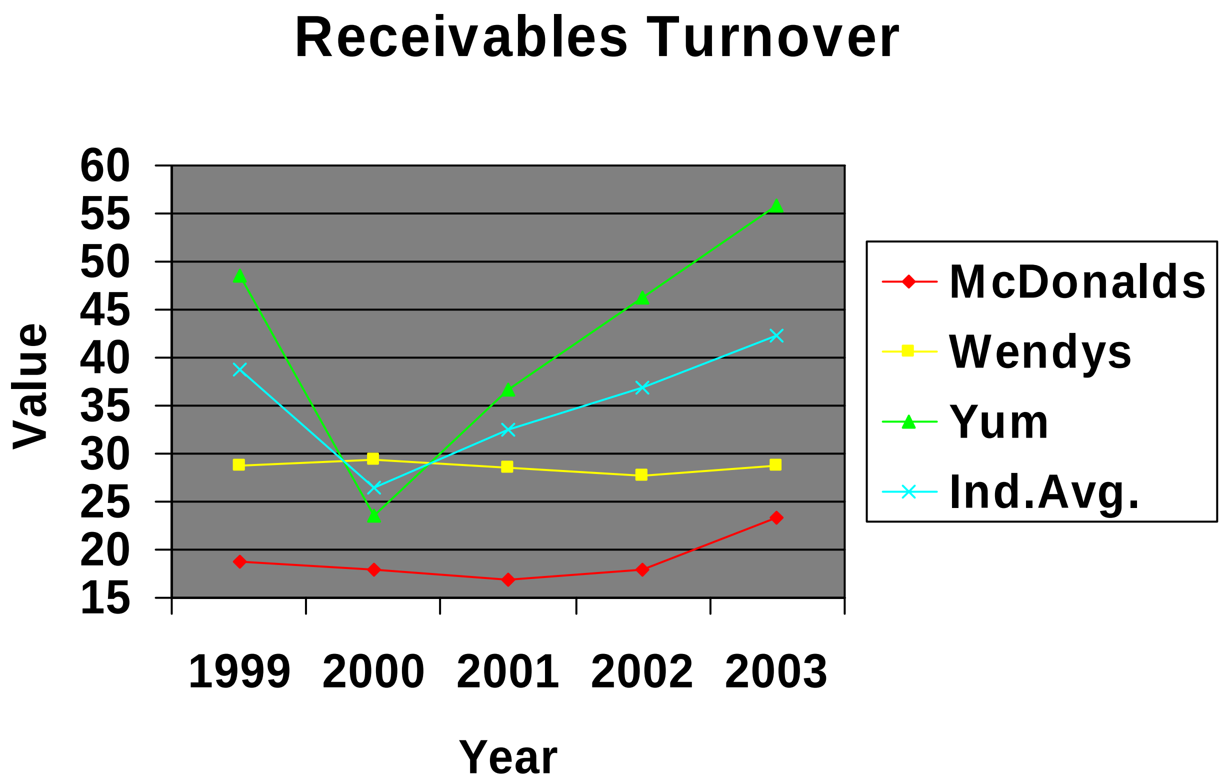
Liquidity Charts:



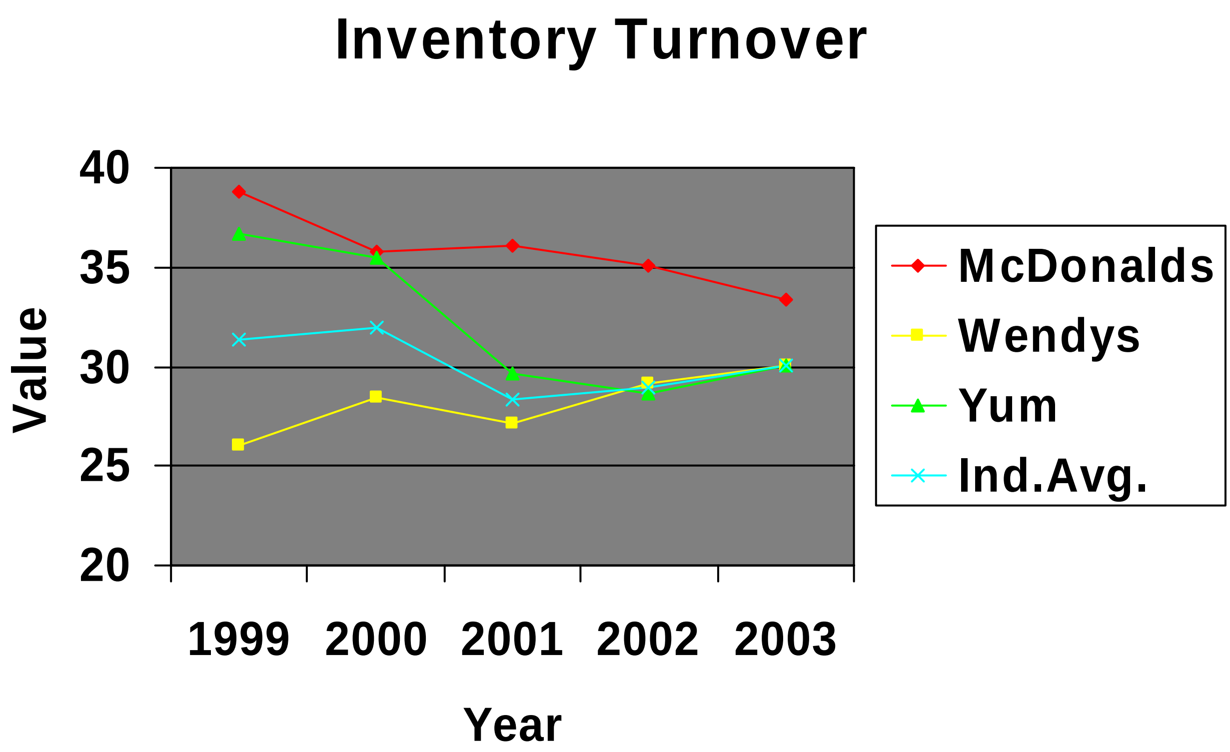
Since 1999, McDonald's has experienced a steady increase in their current ratio. This increase shows that McDonald's has more ability to pay off their short term debts from the sale of their currents assets. McDonald's current ratio is just above the industry average but below Wendy's current ratio. Overall, McDonald's is in fairly good shape because their current ratio is improving and their above the industry. Meanwhile, Wendy's current ratio has dropped steadily over the past five years.



McDonald's quick asset ratio has also increased steadily over the past five years just like their current ratio showing similar results. This ratio is important because it shows how much of McDonald's quick assets (excluding inventory) can cover their current liabilities in the case of an emergency where cash is needed. McDonald's is above the industry average but below Wendy's quick asset ratio. Overall, McDonald's is improving and they're in very similar shape as their current ratio.



McDonald's has consistently been well below the industry average and their competitors with accounts receivables turnover. This means that they aren't collecting their accounts receivables as fast as their competitors. This prevents McDonald's from reinvesting and expanding their restaurants which is a major source of revenue for them. This also allows for a greater chance of default on their accounts receivables.

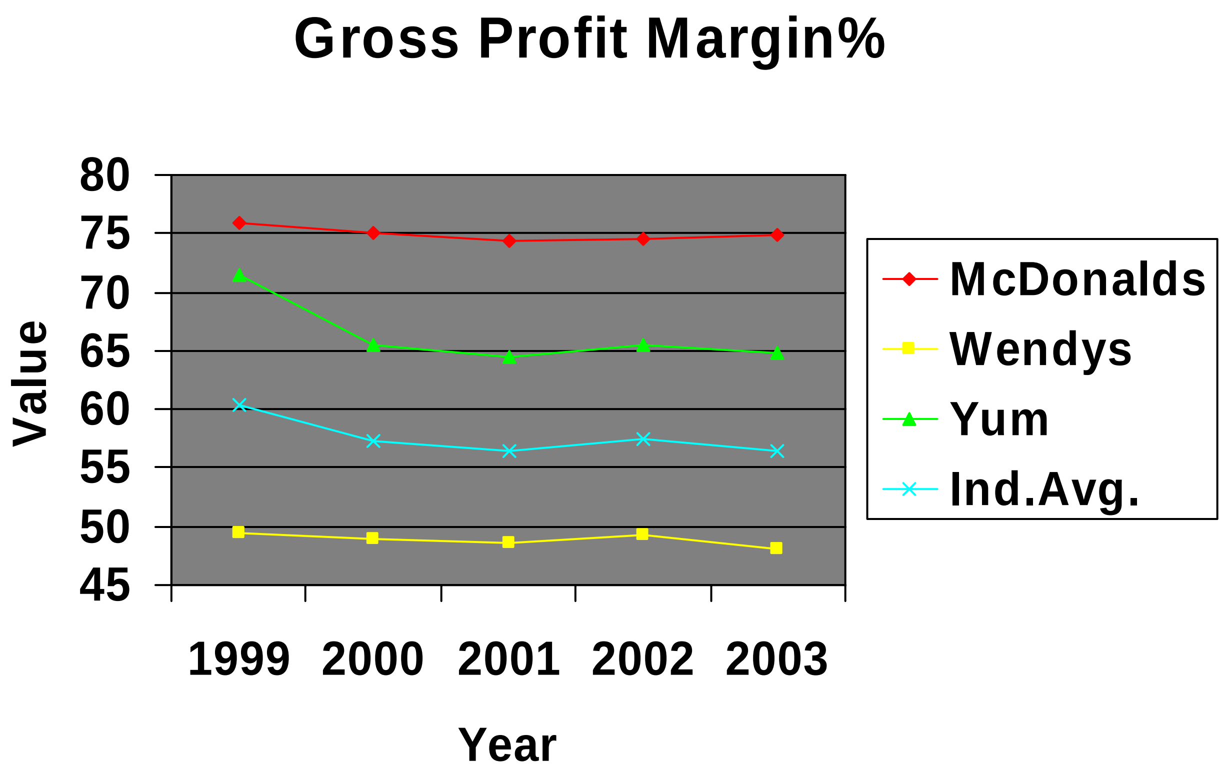


McDonald's inventory turnover has been consistently above the industry average and their competitors. This ratio is important because it shows how well the company's products are succeeding in the industry and how fast their selling them. Overall, McDonald's is in very good shape in inventory turnover despite a slight decrease in turnover.

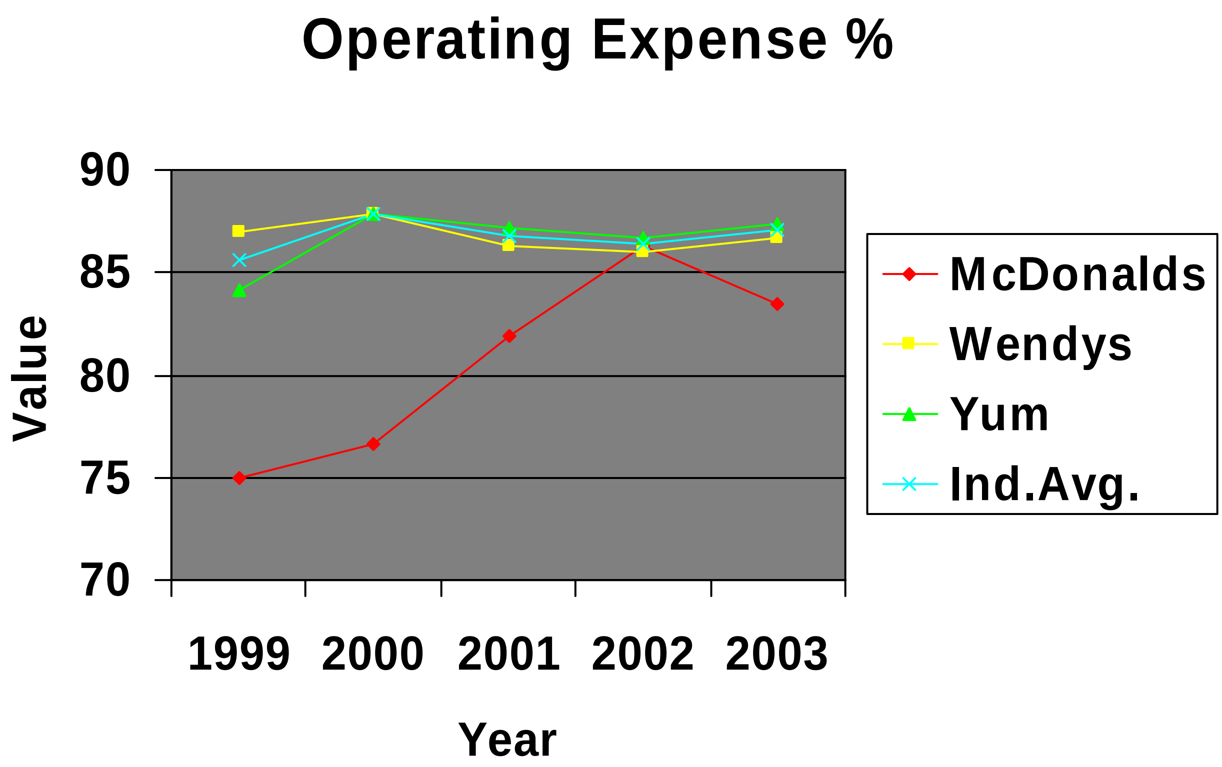
Working Capital Turnover

The working capital ratio didn't contain any relevant information about the industry or the competitors since everyone had a negative ratio. This is due to the fact that current assets were less than current liabilities. This is caused by the increase of firms in the industry and lack of current assets.

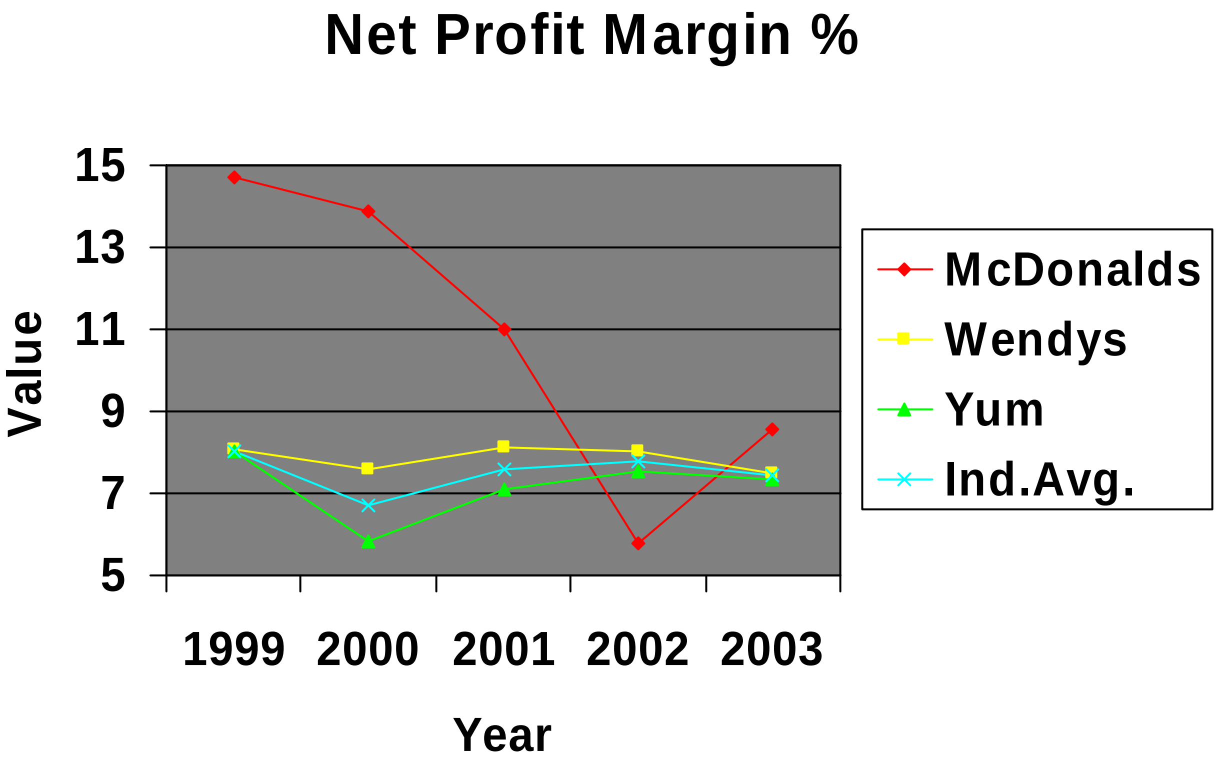
Profitability Charts:



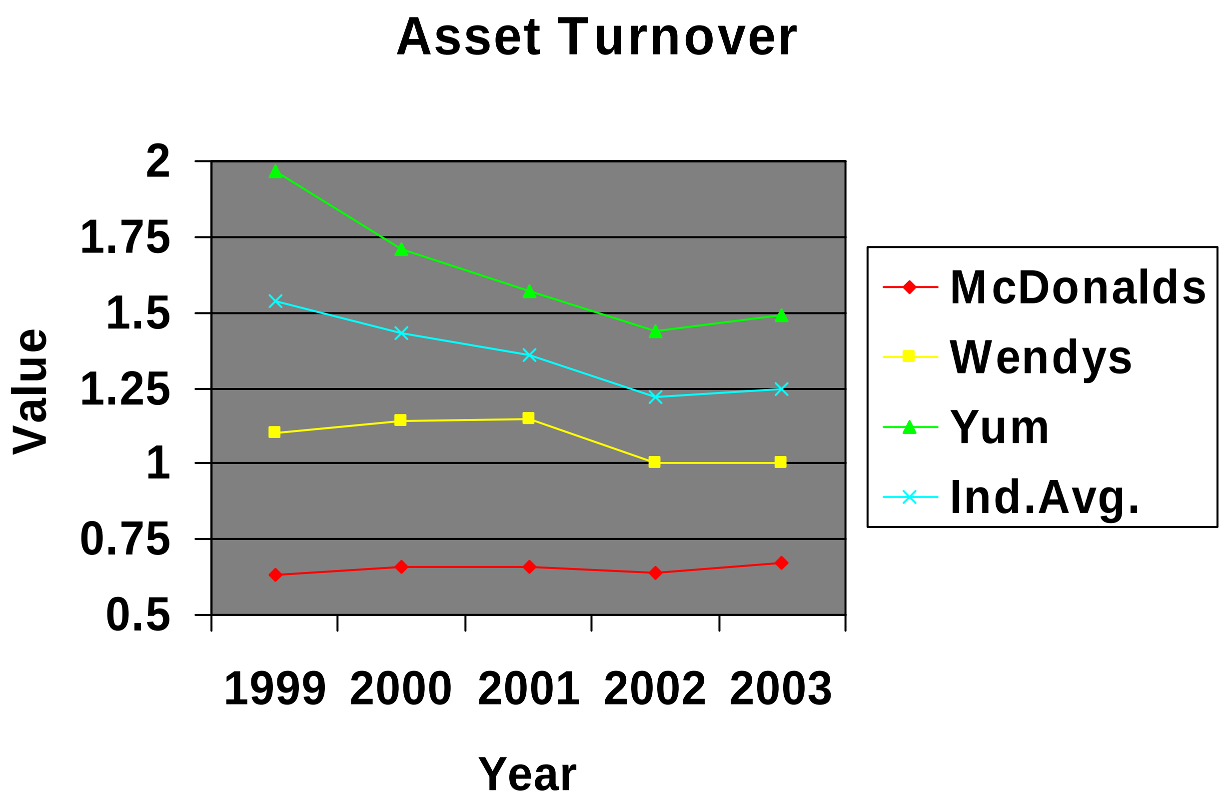
McDonald's gross profit margin is greatly above the industry average and competitors. This shows that McDonald's is turning about 75% of its sales into gross profit. Overall, McDonald's is in excellent shape and appear to have competitive advantage in this area.



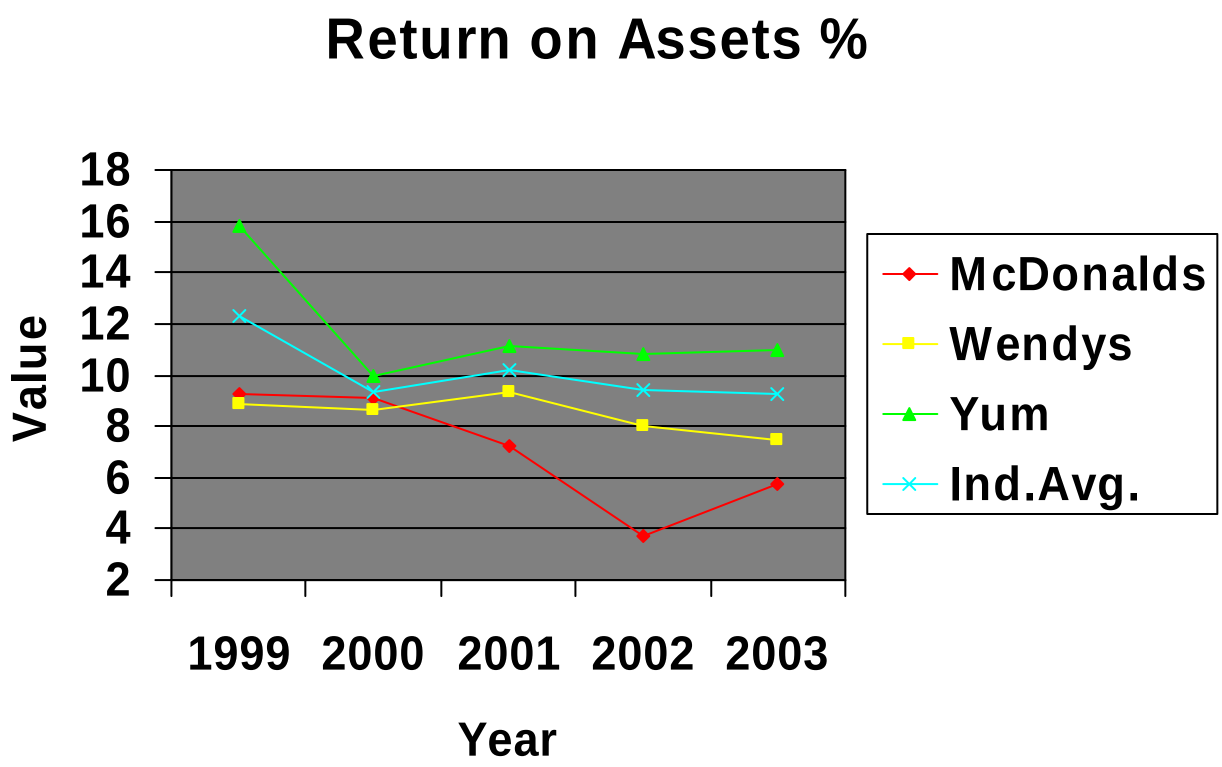
McDonald's operating expense ratio has been consistently below the industry average and competitors. This is a good sign since their expenses aren't taking up much of their sales compared to the industry average and competitors. However, McDonald's should be concerned since their operating expenses have increased from 75% in 1999 to about 83% in 2003 decreasing the gap between themselves and the rest of the industry.



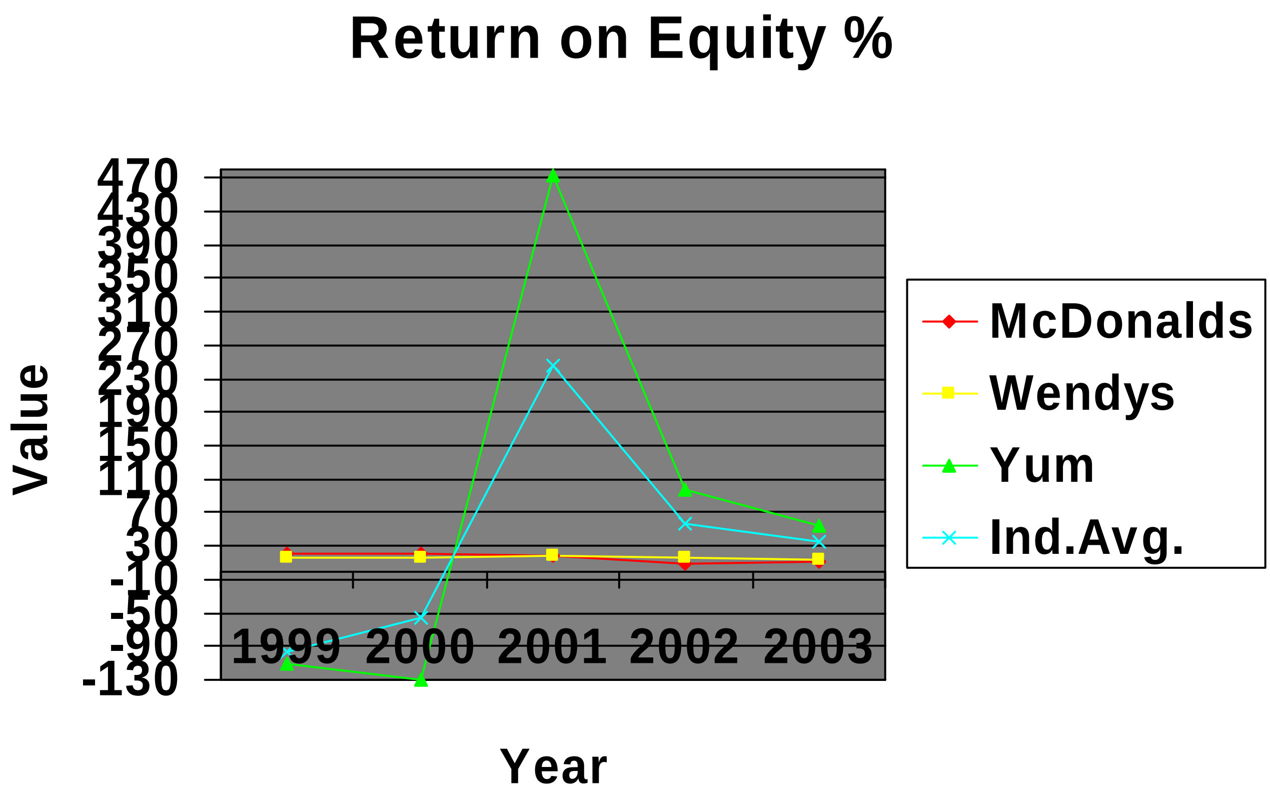
McDonald's over the past five years have been above the industry average and competitors in net profit margin except for one year, where they were below the industry average and competitors. This decrease in net profit margin from 2001 to 2002 is due to a 62% decrease in net income. McDonald's net income increased 53% in 2003 which lead to an increase in net profit margin.



McDonald's Asset Turnover has consistently been lower than the industry average and its competitors since 1999. This shows that the company doesn't turn over their assets well in relation to the industry. It raises questions on how well McDonald's is utilizing their assets because they're staying steady at the bottom of the industry in this category and don't look to be improving.

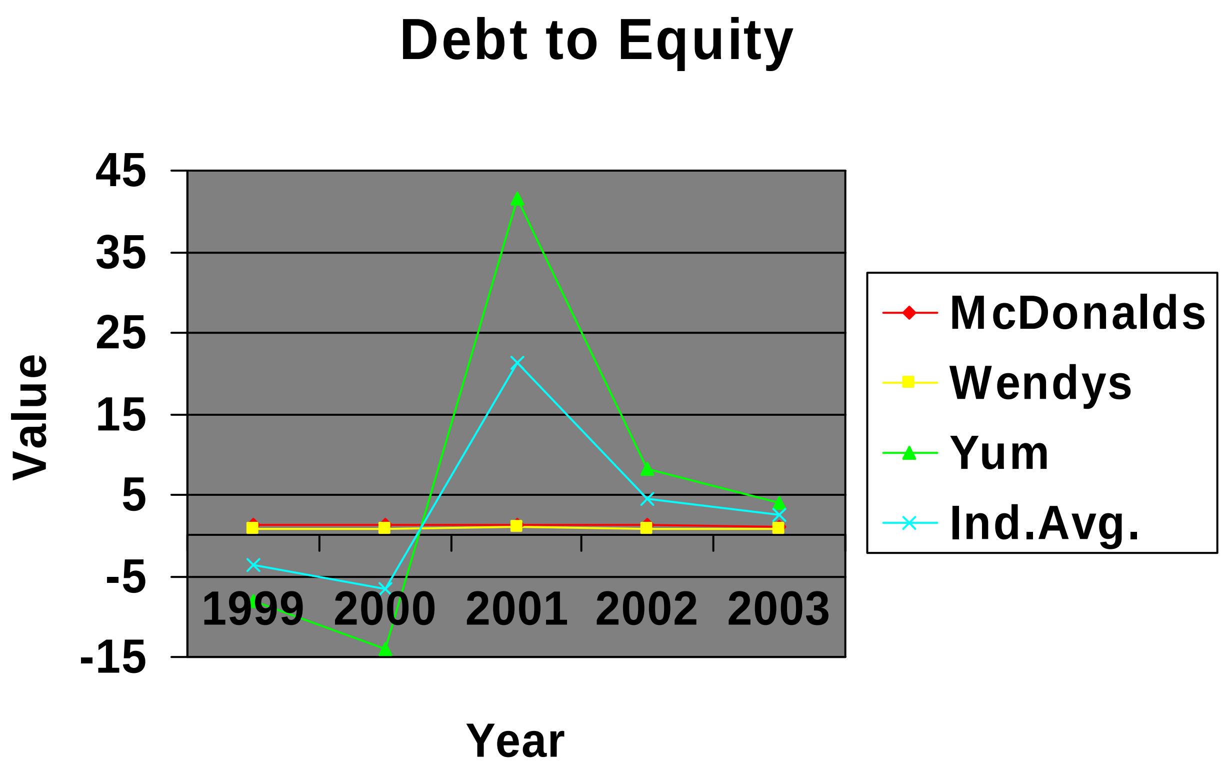


McDonald's Return on Assets was somewhat close to the industry average in 1999 but has since declined every year up to 2002. This goes along with the Asset turnover in that they don't seem to be using their assets as well as other companies in the same industry. The goal for them should be to maximize profitability since they seem to be way behind in asset utilization. From 2002 to 2003, return on assets increase which gives a little hope they can continue this increase in future periods.

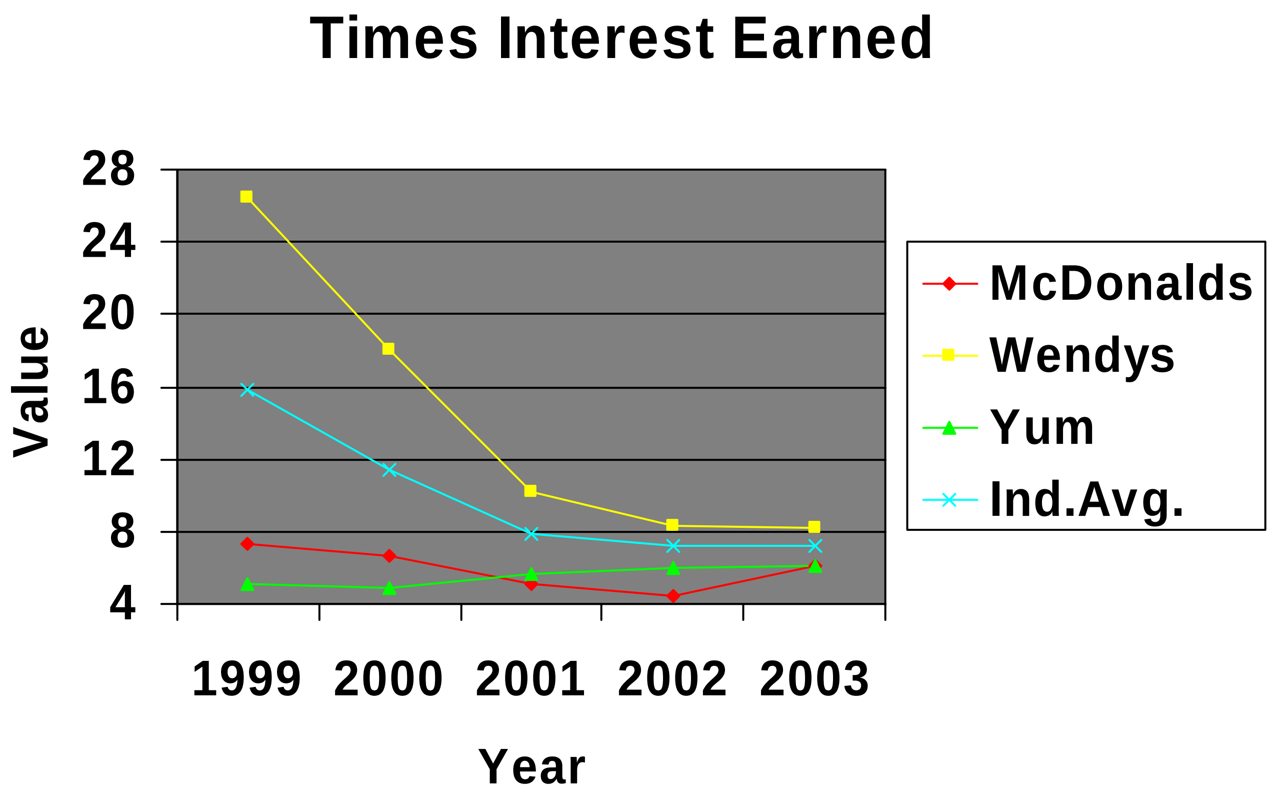


McDonald's looks to be far behind Yum Brands on this graph but the reason Yum had a 470% increase is because they had negative percentages in equity for 1999 and 2000. Therefore, the best way to measure McDonald's is against Wendy's. In 1999 and 2000, McDonald's had a higher return on equity. Beginning in 2001, Wendy's had a higher return than McDonald's. This means they have been able to generate more equity in the past few years.

<u>Capital Structure Charts</u>:



McDonald's has maintained a fairly low Debt to Equity Ratio which is good because it means that the company has an efficient amount of equity that can cover the cost of its liabilities. The Yum Company's ratio increases a great deal because of the negative ratio it had in past years. Wendy's maintains a lower ratio than McDonald's which means they may be utilizing their resources a little better. McDonald's declines 0.2 from 2002 to 2003 so they are looking good for the future.

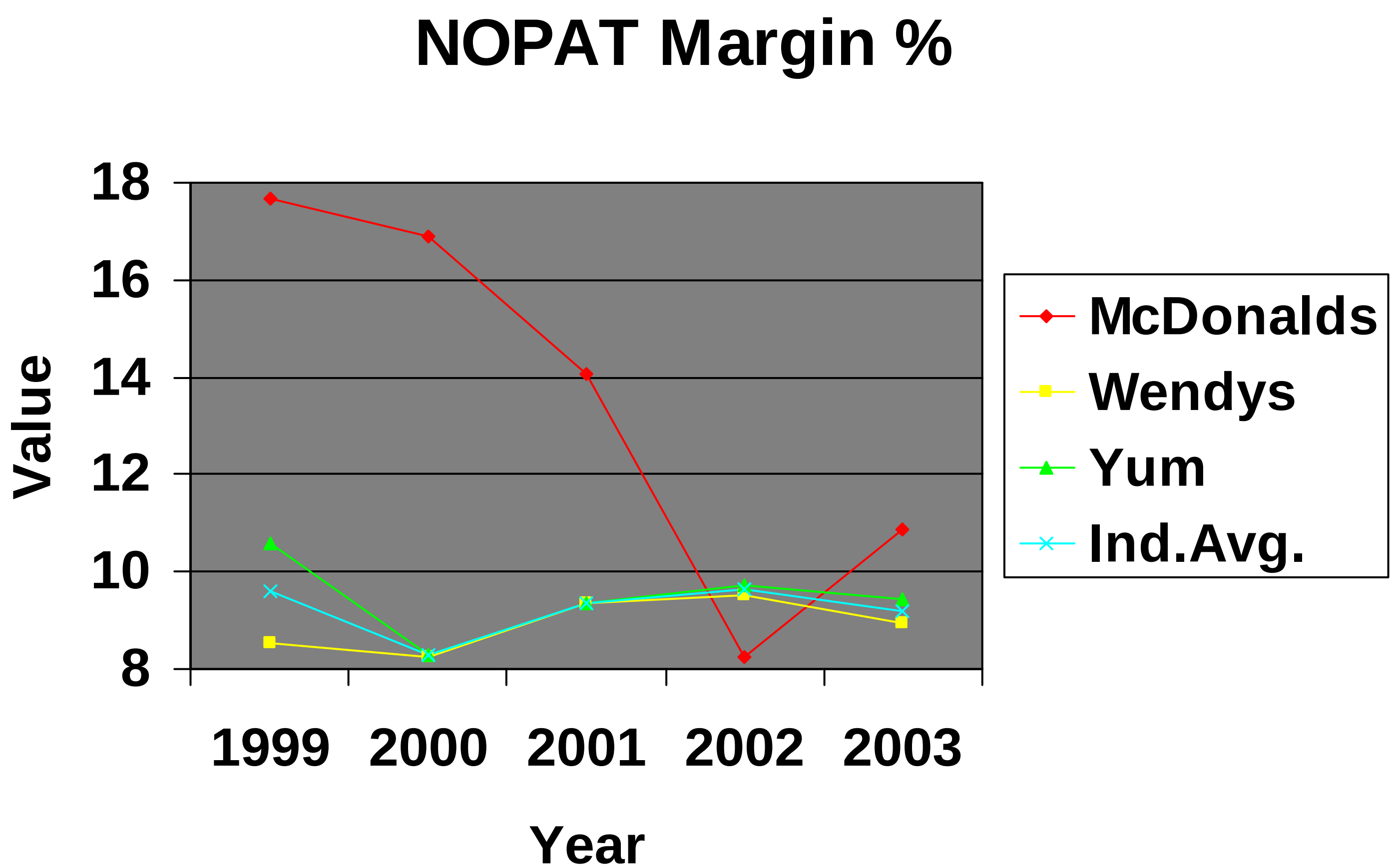


McDonald's Times interest earned has consistently been low compared to Wendy's and the industry average. It decreased from 1999 to 2002 and then increased near the industry average in 2003. This shows that Wendy's is keeping its operations income at a greater spread above its interest expense than McDonald's is. McDonald's numbers in this ratio are very good but just not compared to some other industry leaders.

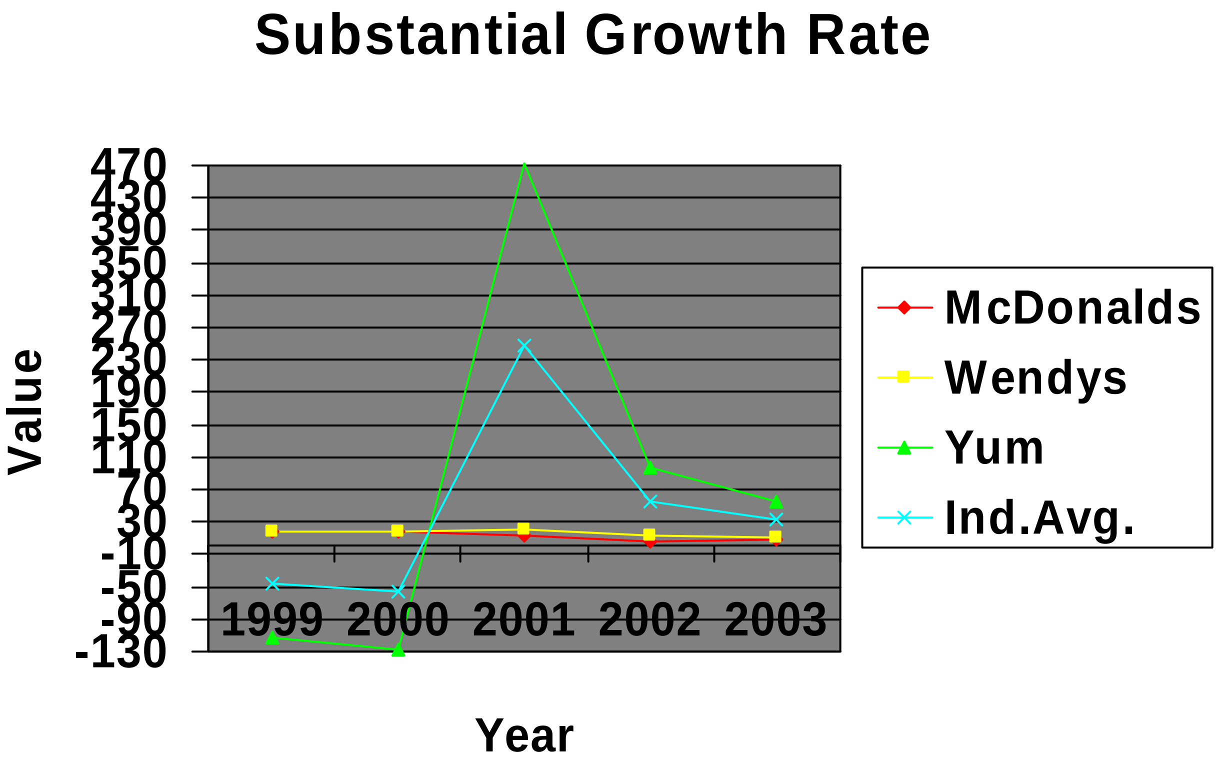
Debt Service Margin

We do not have a chart for Debt Service Margin because neither Wendy's nor Yum Brands has notes payable in any of the five years, and McDonald's does not have any for 2003.

<u>Other Relevant Charts</u>:



The NOPAT Margin gives an overall perspective of McDonald's operating efficiency by including net income, net interest expense, and sales. McDonald's margin begins much higher than its competitors and then rapidly declines under the industry average in 2002. It finds its way back above the industry in 2003 which means it is beginning to increase its NOPAT to where it was before which is a good thing.



McDonald's growth rate has declined since 1999 whereas Yum Brand's rate has greatly increased. This is due to the negative growth that they reported in 1999 and 2000. McDonald's has been well known for so long that it is already getting a huge amount of business and any growth at all will just add to the wealth. A very positive sign is that it does increase slightly from 2002 to 2003 as its competitors and the industry all decrease in growth rate.

Forecasting

When we began forecasting it was important to examine what McDonald's has done to achieve a large growth the past two years and if the growth will be sustained for the next ten years. In 2003, McDonald's started their revitalization plan which focused on growth in their existing restaurants and paying off their debt. We found McDonald's experienced an 11.26% growth in sales after this plan took effect.

Using this information, we came to the conclusion that the growth in sales would be sustained for a few years and decline slowly the next 10 years. We used this as a guideline to forecast the cash flow statement, balance sheet, and the income statement. We analyzed data from the past five years to find patterns in growth which would have correlation with McDonald's future growth. We used various formulas to assist us in our forecasting method such as the sustainable growth rate (SGR). This is a fairly simple formula calculated by ROE*(1-pay out ratio) as shown in the figure below.

ROE	21.48%	17.25%	8.69%	12.28%	16.04%	0.16
DPR	14.20%	17.58%	33.28%	34.22%	30.50%	0.31
SGR	18.43%	14.22%	5.80%	8.08%	11.15%	0.11

Although this method seems to be sound, we felt that it wasn't the best method, since it doesn't appear to be as accurate as the implied method. The implied method is the growth in percentage from year to year that allows you to see any patterns in the industry. The implied method also allows you to find the average growth in percentage for the last few years.

Implied Method

	2000	2001	2002	2003	2004
sales	$10,467,000,000	$11,040,700,000	$11,499,600,000	$12,795,400,000	$14,223,800,000
		5%	4%	11%	11%

After we determined the growth rate, we used an average basis method for the income statement. This was good for determining expenses and revenue in respect to total sales. We also used the average basis method for the balance sheet. We decided to use the average basis method, because it was the most accurate and conservative method to forecast the financial statements.

2000-2004 Actual

2000	2001	2002	2003	2004
$10,467,000,000	$11,040,700,000	$11,499,600,000	$12,795,400,000	$14,223,800,000

2005-2009 Forecast

2005	2006	2007	2008	2009
11.00%	11.00%	11.00%	9.00%	9.00%
$15,788,418,000	$17,525,143,980	$17,525,143,980	$17,525,143,980	$17,525,143,980

Overall, we feel very confident in our forecasted numbers. We like the changes that McDonald's has made since 2002 and we feel that it will continue to adapt to ever-changing customer needs. We also feel that while McDonald's is reaching its market saturation point in the United Sates, it has plenty of room to grow globally. Evidence for this room to grow are the first quarter global sales results for 2005. Global sales were up 4.9% which helped boost total revenues up 9% compared to the first quarter of 2004. McDonald's should not become completely saturated in foreign markets for at least ten years and at this point its growth will slow. For this reason we projected a 0% growth rate in the perpetuities of our valuation models.

Valuation Analysis

In order to greater evaluate our firm; a valuation analysis was conducted using various ratio and comparative valuations. Previously forecast data was used along with varying other factors to derive an estimation of the intrinsic value of McDonald's Corporation. First of all, the implementation of the Method of Comparable was conducted, which included analyzing McDonald's in comparison to other companies of the fast food market segment. Wendy's and the Yum Corporation were the two publicly traded companies used in our comparative analysis. The Industry Average was found for each ratio analysis, within differing variable and factors, and then used to extract a derived expected share price for McDonald's. Further analysis was conducted by the use of the Intrinsic Valuation Method. For this segment of our valuation varying models were created such as: Discounted Dividends, Discounted Free Cash Flow, Discounted Residual Income, Abnormal Earnings Growth, and Long Run Average Residual Income Perpetuity based on the Price/Book Ratio. The cost of equity, cost of debt, and the weighted average cost of capital were calculated and used in coordinates with varying factor to project the Intrinsic Valuation Models. The valuations that were conducted enables us to view the market, with an array of different factors that effect the market, and grasp what intrinsic value the current market should hold.

Discussion and Analysis of Method of Comparables

Forward Price/Earnings Ratio Valuation- (Table 1)

- **Derived Value: $35.53**

In our analysis of the forward price to earnings ratio, we found that our derived value was fairly close to McDonald's Corporation stock trading at about $31.00. The expected share price was found by finding the industry average of the publicly traded fast food companies. Wendy's and YUM Corporation are the two that we use in our analysis. The YUM Corporation's price per share $51.81 is much higher in comparison to the others; however, they are now a merged conglomerate of many different fast food companies such as Pizza Hut, Taco Bell, and KFC. Furthermore, YUM's higher price per share could have been the cause that slightly drove up the industry average, and with only having two publicly traded companies to use in comparison it is fairly accurate.

<u>Trailing Price/Earnings Ratio Valuation</u>-(Table 2)

- **Derived Value: $35.69**

In the trailing price to earnings ratio, our calculation resulted in an expected share price of $35.69 in comparison to McDonald's current share price of $31.00. We included the same to competitors of Wendy's and Yum to calculate the industry average. The Yum Corporation's Trailing P/E was 20.88X which was moderated by Wendy's Trailing P/E of 18.77X. The average Trailing P/E for the sector was 19.83X.

<u>Price/Book Ratio Valuation</u>-(Table 3)

- **Derived Value: $66.99**

The Price/Book ratio gave us a derived value that was much higher, by being nearly double of what McDonald's actual price of $31.00. The industry average was calculated by using Yum and Wendy's for our two competitors. The range between the book value per share was fairly large for comparison purposes. The Yum corporations had a book value per share of $5.5, while on the other hand Wendy's book value per share was $15.263. This then gave us our benchmark of our industry average to be 5.99. Given the wide range of the book values per share, the derived value of $66.97 may not an accurate indicator of value by itself.

<u>Dividends/Price ratio Valuation</u>-(Table 4)

- **Derived Value: $51.16**

The dividends/price ratio analysis resulted in an extremely high expected share price, especially in comparison to McDonald's actual share price. The same two competitors were used in our valuation. The range of the competitors Dividends per share was fairly close; Yum being $0.40 per share and Wendy's $0.54 per share. With these two components of dividends per share and price per share, the industry average calculated was 0.01075. McDonald's dividends per share were marginally higher than that of the competitors at $0.55 per share.

Price/Sales Ratio Valuation-(Table 5)

- **Derived value: $23.03**

The price to sales ratio analysis gave a result significantly lower than McDonald's current price of $31.00. Wendy's and Yum were used to compute and find the industry average. There was a close range of the competitors Sales per Share between Wendy's sales per share was at 28.01 and Yum at 30.93. Consequentially, the price to sales ratios was also found to be within a fairly close range leading to an industry average of 1.53. McDonald's Sales per Share of 15.011 seemed to be slightly lower that the leading industry; therefore, driving down the expected share price using this value benchmark.

P.E.G. Price Earnings Growth Valuation-(Table 6)

The Price Earnings Growth Valuation resulted in a ratio of 1.82, which is the same as the published five year expected PEG. The industry had an average of 1.4, which is still a reasonable estimate. The Price Earnings growth ratio is a tool that is used to help investors find undervalued stock. If the PEG ratio is greater than or equal to one, then that implies that the market price fully reflects the Earnings per Share Growth of the stock. The industry average of the PEG was 1.4, which is slightly lower than the S&P's PEG of 1.47.

Ratio Conclusions

In our ratio analysis, while using the method of comparable it is conclusive that the forward price/earnings ratio as well as the price earnings growth valuation provided the closest results to the actual share price of the McDonald's corporation of $31.00X. The trailing price to earnings ratio was also close in comparison; however, the price/book and the dividends/price were far too high while the price/sales ratio was too low. Furthermore, the price earnings growth valuation is the closest in nature to that of McDonald's, henceforth providing the best valuation tool to determine a new price.

Cost of Capital Calculations

In order to run many of our models, particularly with intrinsic valuations, we first needed to find a few cost of capital estimations. The following is how we calculated K_e, K_d and WACC.

Finding K_e :

$R_j = R_f + B_j (R_m - R_f)$

R_f = 2% (3yr. T-Bill)
R_m = 5% (S&P 500)
B_j = .869 (Estimated Beta)
R_j = 5.814% (K_e)

The K_e (Cost of equity) is found by adding the risk-free rate to a multiple of the firm's beta and the market risk premium. Using this formula we found a K_e of 5.814%.

Finding K_d:

To find the K_d we simply took a weighted average of all of the firms debt.

Finding WACC:

$$WACC = \frac{V_d}{V_d + V_e}\left(r_d(1-T)\right) + \frac{V_e}{V_d + V_e} r_e$$

V_d = 1.3636 billion (Total Debt)
V_e = 4.0716 billion (Total Equity)
r_d = 3.33% (K_d)
r_e = 5.81% (K_e)
WACC = 5.19%

The WACC, as its name implies, is a weighted average of the cost of equity. We found that 75% of the firm is financed by debt and 25% is financed by debt. The WACC is 5.19%.

Intrinsic Valuation Methods

Discounted Dividends:

Sensitivity Analysis

		g			
		0	0.01	0.02	0.03
Ke	0.038	$23.72	$30.20	$43.86	$91.69
	0.048	$18.33	$21.76	$27.64	$40.06
	0.058	$14.78	$16.87	$19.99	$25.34
	0.068	$12.37	$13.68	$15.54	$18.38
	0.078	$10.56	$11.45	$12.64	$14.34

The Discounted Dividends model uses the forecasted future dividends and the cost of equity to find the estimated value per share. By using our calculated cost of equity of 5.8% and a 0% growth rate, the estimated value per share came out to $14.78 per share. This price is considerably less than the actual current stock price of $32.06. The estimated values only begin to get close to the actual price per share when the K_e is dropped to 3.8% and the growth rate is raised to 1%. McDonald's however, is not a company that's estimated price should include a growth rate because its business has remained steady for several years. A growth rate should typically be used if something extreme occurs in the company such as the acquisition of another company or combining with another company.

The cost of equity should not be lowered because 5.8% is an accurate estimate of its cost and the short horizon estimate, which could be considered more accurate, is estimated at 6.8%. If the K_e is lowered, as the sensitivity analysis suggest, than it would go against the two major estimates that we used to determine what cost of equity should be valued at. The other valuation models and the industry average ratios all contrast with the discounted dividends model's estimate that McDonald's is an extremely overvalued company. Therefore, we have determined that the discounted dividends model is a bad method for determining what McDonald's Corporation should be valued at and are not going to use the model in our decision.

Discounted Free Cash Flows:

Sensitivity Analysis

	g				
		0	0.01	0.02	0.03
WACC	0.04	$41.77	$55.53	$83.06	$165.64
	0.05	$30.29	$37.87	$50.49	$75.75
	0.06	$22.71	$27.35	$34.31	$45.90
	0.07	$17.35	$20.40	$24.66	$31.05
	0.08	$13.38	$15.48	$18.28	$22.20

The discounted free cash flows model uses WACC to find the estimated value per share. This is the only model that uses the WACC, so it gave us a good idea on how accurate it is in determining the value of McDonald's. When using a 0% growth rate and the calculated 5.17% WACC, the estimated value per share came out to $30.29. This amount is less than a $2 difference with the actual value per share of $31.00. This means that our discounted free cash flows model gives the best estimate of the current price of the stock. The sensitivity analysis shows that if the growth rate or WACC is changed by just 1%, the estimate of the price changes drastically. This means that this model will not always be as accurate as it is in the current period. We will compare this model to our other effective models to decide the value of our company. The discounted free cash flows model currently shows that McDonald's is a fairly valued company when using our calculated WACC.

Residual Income Valuation:

Sensitivity Analysis

		g			
		0	0.01	0.02	0.03
Ke	0.038	$75.22	$89.75	$120.42	227.76
	0.048	$55.73	$62.09	$72.98	95.97
	0.058	$43.24	$46.23	$50.78	58.59
	0.068	$34.64	$36.05	$38.03	$41.06
	0.078	$28.42	$19.02	$29.83	$30.97

The discounted residual income value is the sum of the current book value, forecasted residual incomes for the next ten years, and a terminal value after the ten years all discounted back to a present value. We began this model by taking the current book value of $22. We then added the earnings per share and subtracted the dividends per share to give us an ending book value for the year. We repeated this process until we had forecasted ten years of beginning of the year book values. Then, in order to calculate normal income, or the income shareholders expect on assets in possession at the beginning of the year, we multiplied the beginning of the year book value and the K_e (5.8%). To find the residual income for each of the ten years, we simply subtracted the normal income from the forecasted earnings per share. After we had determined the residual income for ten years we calculated the terminal value of the continuous residual income at various growth rates. Finally, to arrive at an estimated value, we added the present values of the current book value, the ten years of residual income, and the terminal value of continuous residual income. At almost every K_e and growth rate combination we found McDonalds to be undervalued.

We expect the growth rate for McDonalds to be modest and we calculated a K_e of 5.8% that we feel to be fairly accurate. According the residual income model, even at a 0% growth rate, McDonalds is undervalued with an estimated value of 43.24 and an actual value of 31.00. We feel this is strong evidence that McDonalds is undervalued. The current book value of McDonalds makes up about half or 51% of its estimated value according to this model. The present value of the ten years of residual income make up 16% and the final 33% comes from the terminal value. This means that an increased growth rate would only raise the estimated value of the firm, more evidence that McDonalds is undervalued.

Abnormal Earnings Growth:

Sensitivity Analysis

		g			
		0	**0.01**	**0.02**	**0.03**
Ke	**0.0381**	**$64.11**	**$64.75**	**$65.39**	**$66.03**
	0.0481	**$50.78**	**$51.29**	**$51.79**	**$36.94**
	0.0581	**$42.04**	**$42.46**	**$42.88**	**$43.30**
	0.0681	**$35.86**	**$36.22**	**$36.58**	**$36.94**
	0.0781	**$31.27**	**$31.59**	**$31.90**	**$32.21**

The Abnormal Earning Growth Valuation provided fairly close range of valuation estimates when compared to other valuation methods set out in Tables 1 through 6. McDonald's cost of equity capital of 5.81% implies a valuation range of $42.04 to $43.30 depending on varying growth assumptions. This also compares to a range of $23.03 to $66.99 with a weighted average of $37.13 using valuation methods set out in Tables 1 though Table 6. This compares to McDonald's current actual share price in December 2004 of $32.06.

The extracted present value of the firm was calculated using the forecasted earnings per and dividends per share from our forecasted statement of cash flows. The cost of equity calculation of 5.81% was used in analyzing the Dividend per Share, and also using in calculating the present value factor that was adjusted for each forecasted year. The average perpetuity was computed to be $2.44 was found by using the core earnings per share of 2005 valued at $1.73, the total present value of the abnormal earnings growth, and the present value of the abnormal earnings growth. The average perpetuity was then used with the cost of equity to determine the present value of the expected share price of $42.04. The Future Value was determined by using the calculated present value and forecasting the value by the cost of equity, also it was valued on a one-forth basis due so as to correct the valuation from the end of 2004 to the end of the first quarter of 2005. Conclusively, the abnormal growth valuation projected values that were fairly close in nature with respect to the other valuation models. The sensitivity analysis revealed that our calculated cost of equity provided values that were close in range of the actual share price. The cost of equity at 7.81% inconclusively provided a range that was the closest to the actual share price of $31.27-$32.21. The abnormal earnings growth model is useful in seeing the effect of the dividends per share as they are forecasted at the present value for each year. This provides a better view of the possible growth that could occur of the years if the dividends are reinvested into the firm. The calculation in this model relies heavily on the forecasts found in our statement and cash flows and the calculation of the cost of equity capital for McDonald's. However, in conjunction with the values determined the present value and future value expected share price still are slightly higher than McDonald's current share price implying that McDonald's is undervalued.

Long Run Average Residual Income Perpetuity based on the P/B Ratio:

$$P = B + B\left[\frac{(ROE-Ke)}{(Ke-g)}\right]$$

Sensitivity Analysis

		g			
		0	0.01	0.02	0.03
Ke	0.0381	$52.09	$66.64	$97.28	203.59
	0.0481	$41.26	$49.15	$62.66	91.11
	0.0581	$34.16	$38.93	$46.22	58.69
	0.0681	$29.14	$32.23	$36.61	$43.28
	0.0781	$25.41	$27.50	$30.31	$34.28

The long run average residual income perpetuity based on the price/sales ratio enabled us to see how the growth of the return of equity at our calculated cost of equity would reflect the expected market price in respect to the book value of equity. The calculations of this model projected an extracted share price value of $34.16. This share price is relatively close in nature, but larger than the actual share price of McDonald's of $31.00 according to the market price as of April 2005. The Sensitivity analysis revealed price reflections in considering differing growth rates and values of Cost of Equity. The range of values at the Cost of Equity at 6.81% proved to be the closest to the actual share price. This model relies heavily on the book value of equity as well as the Return of Equity, which are calculated using information provided directly by the financial statements. Therefore, with keeping those factors into consideration this model seems be a strong tool of estimation. The derived value of $34.16, would then lead to a conclusion that McDonalds's is slightly undervalued.

Discussion and Summary of Valuation Results

In our overall analysis of McDonald's Corporation using a variation of methods and models, we have conclusively found that McDonald's is currently undervalued in the market. The Method of Comparables was used, which included such ratios as: Price/Earnings, Price/Book, Dividends/Price, Price/Sales, and Price Earnings growth ratio valuations. The ratio valuations were calculated by finding the industry average and using a varying of other factors to project an expected share price. Wendy's and the Yum Corporation were the two main competitors that were used to find the industry average. The Yum Corporation has a higher Price per Share in comparison with the industry due to the fact that it is now a merged conglomerate of fast food franchises. With keeping this factor in consideration this could make the method of comparables analysis not as strong, as it is relying heavily of the current market. In our further analysis of McDonald's, the Intrinsic Valuation Methods were used to evaluate the inherent value of the firm. The Intrinsic Valuation Analysis consisted of creating various valuation models such as: Discounted Dividends, Discounted Free Cash Flows, Discounted Residual Income, Abnormal Earnings Growth, and the Long Run Average Residual Income Perpetuity based on the P/B ratio. These valuation models enabled us to find an expected share price, relying heavily on our calculated Cost of Equity, Cost of Debt, and Weighted Averaged Cost of Capital. The cost of capital estimations were calculated by the use of previous and projected market data, making these calculations a strong benchmark for the valuation models.

On average, in comparison between the actual share price of $31.00 as of April 1, 2005 and different valuation models, the expected share price was undervalued in the current market to the tune of 10-15%; henceforth, when the market realizes the undervaluation of McDonald's, the stock price should appreciate to the implied value of an estimated range of $35-$38 per share. This value should then appreciate at the rate of return making the share price equivalent to the market place. McDonald's is a company that is in the fast food segment of the market, which is a market place with slightly slower growth; however, it is less susceptible to adverse market swings, such as low betas. If the current market was that of an efficient market, a market place with perfect conditions, the share price would be correctly valued. However, today's market is one that is not perfect causing abnormalities in share prices. Many trades in the market are done psychologically, and the market could impose a potential discount rate relative to risk given the current share price. McDonald's corporation has faced previous law suits on being held accountable for obesity, similarly following the litigation process of cigarettes and tobacco companies. The courts ruled against this issue in McDonald's favor, making this a remote future risk factor. McDonald's has had to paid legal fees in order to defend itself in this type of litigation; however, even with this incremental cost they are still achieving a significant rate of earnings growth. In addition, MCD in it's effort to be a more socially responsible corporate citizen, by supporting a healthier society, has developed "light" and healthy menu items in order to give customers additional eating options and in doing so, broadening the array of its customer base while offering it's existing customer base with healthier menu options. In conclusion, in conjunction with our valuations and assumption, we conclude that McDonald's, as it is currently undervalued, would be an attractive company to invest as they are shown to be a company that will have steady large capital growth.

Z-Score

Working Capital: -662700

Retained Earnings: 21,755,800

EBIT: 3,560,800

MV of Equity: 14,201,500

BV of Liabilities: 19,064,700

Total Assets: 27,837,500

1.2(-.02381)	-.02381
+	+
1.4(.78153)	1.0941
+	+
3.3(.12791)	.42212
+	+
.6(1.04147)	.62488
+	+
1(.68486)	.68486
	2.80 = Z-score

After using the Altman method for calculating Z-score, we found that McDonald's had a score of 2.80. The model states that a company between 2.7 and 2.99 should be on alert and show caution because they could go bankrupt. McDonald's had a z-score of 2.80 due to the fact they a negative working capital. We feel that this method isn't very consistent because McDonald's is the leader in the fast food industry in sales and is far from going bankrupt.

Appendix: Table of Contents

Forecast Ratios and Assumptions

McDonald's Ratio's	2000	2001	2002	2003	2004	Avg.	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Sales Growth							11.00%	11.00%	11.00%	9.00%	9.00%	9.00%	7.00%	7.00%	7.00%	7.00%
Liquidity Analysis																
Current Ratio	0.70	0.81	0.71	0.76	0.81	0.81	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Quick asset ratio	0.66	0.76	0.66	0.71	0.77	0.77	0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.70
Accounts recievable turnover	17.88	16.86	18.01	23.34	25.57	25.57	25.00	25.00	25.00	26.00	26.00	26.00	27.00	27.00	27.00	27.00
Days supply of receivables	20.41	21.65	20.26	15.64	14.27	14.27	14.00	14.00	14.00	14.00	13.00	13.00	13.00	12.00	12.00	12.00
Inventory turnover	35.82	36.04	35.07	33.34	32.90	32.90	32.00	32.00	32.00	31.00	31.00	31.00	30.00	30.00	30.00	30.00
Days supply of inventory	10.19	10.13	10.41	10.95	11.09	11.09	10.20	10.20	10.20	10.20	10.20	10.20	10.20	10.20	10.20	10.20
Working capital turnover	-20.39	-34.66	-21.79	-28.55	-28.77	-28.77	-26.00	-26.00	-26.00	-26.00	-26.00	-26.00	-26.00	-26.00	-26.00	-26.00
Profitability Analysis																
Gross profit margin	75.03%	74.43%	74.57%	74.83%	74.55%	0.75	75.00%	75.00%	75.00%	75.00%	75.00%	75.00%	75.00%	75.00%	75.00%	75.00%
Operating expense ratio	76.62%	81.86%	86.28%	83.48%	81.43%	0.81	82.00%	82.00%	82.00%	82.00%	82.00%	82.00%	82.00%	82.00%	82.00%	82.00%
Net profit margin	13.88%	11.01%	5.80%	8.58%	11.95%	0.12	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%
Asset turnover	0.66	0.66	0.64	0.66	0.68	0.68	0.66	0.66	0.66	0.66	0.66	0.66	0.66	0.66	0.66	0.66
Return on assets	9.12%	7.26%	3.73%	5.69%	8.19%	0.08	7.00%	7.00%	7.00%	7.00%	7.00%	7.00%	7.00%	7.00%	7.00%	7.00%
Return on equity	21.48%	17.25%	8.69%	12.28%	16.04%	0.16	15.00%	15.00%	15.00%	15.00%	15.00%	15.00%	15.00%	15.00%	15.00%	15.00%
Capital Structure Analysis																
Debt to equity ratio	1.36	1.37	1.33	1.16	0.96	0.96	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30	1.30
Times interest earned	7.75	5.96	5.65	7.30	9.88	9.88	7.30	7.30	7.30	7.30	7.30	7.30	7.30	7.30	7.30	7.30
Debt service margin	9.99	14.54	9633.67	N/A	N/A	N/A		N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Other Relevant Ratios																
NOPAT Margin	16.90%	14.05%	8.23%	10.85%	13.83%	0.14	13.00%	13.00%	13.00%	13.00%	13.00%	13.00%	13.00%	13.00%	13.00%	13.00%
Dividend Payout ratio	14.20%	17.58%	33.28%	34.22%	30.50%	0.31	30.00%	30.00%	30.00%	32.00%	32.00%	32.00%	33.00%	33.00%	33.00%	33.00%
Sustainable Growth Rate	18.43%	14.22%	5.80%	8.08%	11.15%	0.11	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%
Operating Cash Flow as % Op. Inc	82.64%	99.68%	136.78%	115.42%	110.26%	1.10	110.00%	110.00%	110.00%	110.00%	110.00%	110.00%	110.00%	110.00%	110.00%	110.00%

Pro Forma Income Statement

MCDONALDS CORP 10-K 2004-12-31: Income Statement

	2000/12/31	2001/12/31	2002/12/31	2003/12/31	2004/12/31	AVG
REVENUES						
Total revenues	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
OPERATING COSTS AND EXPENSES						
Company-operated restaurant expenses						
Food & paper	24.97%	25.57%	25.43%	25.17%	25.45%	25.32%
Payroll & employee benefits	18.89%	19.51%	19.98%	19.90%	19.55%	19.57%
Occupancy & other operating expenses	17.57%	18.50%	18.90%	19.13%	18.47%	18.51%
Franchised restaurants occupancy expenses	5.42%	5.38%	5.45%	5.47%	5.26%	5.40%
Selling, general & administrative expenses	11.14%	11.17%	11.12%	10.69%	10.39%	10.90%
Other operating expense, net	-1.38%	0.39%	5.41%	3.10%	2.31%	1.97%
Total operating costs and expenses	76.62%	81.86%	86.28%	83.48%	81.43%	81.94%
Operating income	23.38%	18.14%	13.72%	16.52%	18.57%	18.06%
Interest expense net of capitalized	3.02%	3.04%	2.43%	2.26%	1.88%	2.53%
Nonoperating (income) expense, net	0.12%	0.35%	0.50%	0.57%	-0.11%	0.29%
Income before provision for income taxes and cumulative effect of accounting changes	20.24%	15.67%	10.79%	13.69%	16.80%	15.44%
Provision for income taxes	6.35%	4.66%	4.35%	4.89%	4.85%	5.02%
Net income	13.88%	11.01%	5.80%	8.58%	11.95%	10.24%

Income Statement

	2000/12/31	2001/12/31	2002/12/31	2003/12/31	2004/12/31
REVENUES					
Sales by Company-operated restaurants	$10,467,000,000	$11,040,700,000	$11,499,600,000	$12,795,400,000	$14,223,800,000
Revenues from franchised and affiliated restaurants	$3,776,000,000	$3,829,300,000	$3,906,100,000	$4,345,100,000	$4,840,900,000
Total revenues	$14,243,000,000	$14,870,000,000	$15,405,700,000	$17,140,500,000	$19,064,700,000
OPERATING COSTS AND EXPENSES					
Company-operated restaurant expenses					
Food & paper	$3,557,100,000	$3,802,100,000	$3,917,400,000	$4,314,800,000	$4,852,700,000
Payroll & employee benefits	$2,690,200,000	$2,901,200,000	$3,078,200,000	$3,411,400,000	$3,726,300,000
Occupancy & other operating expenses	$2,502,800,000	$2,750,400,000	$2,911,000,000	$3,279,800,000	$3,520,800,000
Franchised restaurants occupancy expenses	$772,300,000	$800,200,000	$840,100,000	$937,700,000	$1,003,200,000
Selling, general & administrative expenses	$1,587,300,000	$1,661,700,000	$1,712,800,000	$1,833,000,000	$1,980,000,000
Other operating expense, net	($196,400,000)	$57,400,000	$833,300,000	$531,600,000	$441,200,000
Total operating costs and expenses	$10,913,300,000	$12,173,000,000	$13,292,800,000	$14,308,300,000	$15,524,200,000
Operating income	$3,329,700,000	$2,697,000,000	$2,112,900,000	$2,832,200,000	$3,540,500,000
Interest expense net of capitalized	$429,900,000	$452,400,000	$374,100,000	$388,000,000	$358,400,000
Nonoperating (income) expense, net	$17,500,000	$52,000,000	$76,700,000	$97,800,000	($20,300,000)
Income before provision for income taxes and cumulative effect of accounting changes	$2,882,300,000	$2,329,700,000	$1,662,100,000	$2,346,400,000	$3,202,400,000
Provision for income taxes	$905,000,000	$693,100,000	$670,000,000	$838,200,000	$923,900,000
Net income	$1,977,300,000	$1,636,600,000	$893,500,000	$1,471,400,000	$2,278,500,000

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
REVENUES										
Sales by Company-operated restaurants	$15,788,418,000	$17,525,143,980	$19,452,909,818	$21,203,671,701	$23,112,002,155	$25,192,082,348	$26,955,528,113	$28,842,415,081	$30,861,384,136	$33,021,681,026
Revenues from franchised and affiliated restaurants	$5,373,399,000	$5,964,472,890	$6,620,564,908	$7,216,415,750	$7,865,893,167	$8,573,823,552	$9,173,991,201	$9,816,170,585	$10,503,302,526	$11,238,533,703
Total revenues	$21,161,817,000	$23,489,616,870	$26,073,474,726	$28,420,087,451	$30,977,895,322	$33,765,905,901	$36,129,519,314	$38,658,585,666	$41,364,686,662	$44,260,214,728
OPERATING COSTS AND EXPENSES										
Company-operated restaurant expenses										
Food & paper	$5,358,109,930	$5,947,502,022	$6,601,727,245	$7,195,882,697	$7,843,512,140	$8,549,428,232	$9,147,888,208	$9,788,240,383	$10,473,417,210	$11,206,556,415
Payroll & employee benefits	$4,140,408,196	$4,595,853,098	$5,101,396,939	$5,560,522,663	$6,060,969,703	$6,606,456,976	$7,068,908,965	$7,563,732,592	$8,093,193,874	$8,659,717,445
Occupancy & other operating expenses	$3,917,749,922	$4,348,702,413	$4,827,059,679	$5,261,495,050	$5,735,029,604	$6,251,182,269	$6,688,765,027	$7,156,978,579	$7,657,967,080	$8,194,024,775
Franchised restaurants occupancy expenses	$1,142,295,577	$1,267,948,091	$1,407,422,381	$1,534,090,395	$1,672,158,531	$1,822,652,799	$1,950,238,494	$2,086,755,189	$2,232,828,052	$2,389,126,016
Selling, general & administrative expenses	$2,307,352,916	$2,561,161,737	$2,842,889,528	$3,098,749,585	$3,377,637,048	$3,681,624,382	$3,939,338,089	$4,215,091,755	$4,510,148,178	$4,825,858,551
Other operating expense, net	$416,116,540	$461,889,359	$512,697,189	$558,839,936	$609,135,530	$663,957,728	$710,434,769	$760,165,203	$813,376,767	$870,313,141
Total operating costs and expenses	$17,338,957,942	$19,246,243,316	$21,363,330,081	$23,286,029,788	$25,381,772,469	$27,666,131,991	$29,602,761,231	$31,674,954,517	$33,892,201,333	$36,264,655,426
Operating income	$3,822,859,058	$4,243,373,554	$4,710,144,645	$5,134,057,663	$5,596,122,852	$6,099,773,909	$6,526,758,083	$6,983,631,149	$7,472,485,329	$7,995,559,302
Interest expense net of capitalized	$534,656,385	$593,468,587	$658,750,132	$718,037,643	$782,661,031	$853,100,524	$912,817,561	$976,714,790	$1,045,084,825	$1,118,240,763
Nonoperating (income) expense, net	$60,714,580	$67,393,184	$74,806,434	$81,539,014	$88,877,525	$96,876,502	$103,657,857	$110,913,907	$118,677,881	$126,985,332
Income before provision for income taxes and cumulative effect of accounting changes	$3,266,510,085	$3,625,826,194	$4,024,667,075	$4,386,887,112	$4,781,706,952	$5,212,060,578	$5,576,904,818	$5,967,288,155	$6,384,998,326	$6,831,948,209
Provision for income taxes	$1,062,340,239	$1,179,197,665	$1,308,909,408	$1,426,711,255	$1,555,115,268	$1,695,075,642	$1,813,730,937	$1,940,692,103	$2,076,540,550	$2,221,898,389
Net income	$2,167,995,030	$2,406,474,483	$2,671,186,676	$2,911,593,477	$3,173,636,890	$3,459,264,210	$3,701,412,705	$3,960,511,594	$4,237,747,406	$4,534,389,724

Pro Forma Balance Sheet

ASSETS						AVG
Current assets						
Cash and equivalents	1.94%	1.86%	1.38%	1.91%	4.96%	2.41%
Accounts and notes receivable	3.67%	3.91%	3.57%	2.84%	2.68%	3.34%
Inventories, at cost, not in excess of market	0.46%	0.47%	0.47%	0.50%	0.53%	0.48%
Prepaid expenses and other current assets	1.59%	1.84%	1.74%	2.05%	2.10%	1.86%
Total current assets	7.67%	8.07%	7.16%	7.30%	10.27%	8.09%
Other assets						
Investments in and advances to affiliates	3.80%	4.39%	4.33%	4.22%	3.99%	4.15%
Goodwill, net	5.89%	5.86%	6.51%	6.44%	6.57%	6.25%
Miscellaneous	4.02%	4.95%	4.48%	4.93%	4.81%	4.64%
Total other assets	13.71%	15.20%	15.32%	15.59%	15.36%	15.04%
Property and equipment						
Property and equipment, at cost	108.70%	106.97%	109.38%	111.23%	109.59%	109.17%
Accumulated depreciation and amortization	-30.08%	-30.25%	-31.85%	-34.12%	-35.22%	-32.30%
Net property and equipment	78.62%	76.72%	77.53%	77.11%	74.37%	76.87%
Total assets	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
LIABILITIES AND SHAREHOLDERS EQUITY						
Current liabilities						
Notes Payable	1.27%	0.82%	N/A	N/A	N/A	1.05%
Accounts payable	3.16%	3.06%	2.65%	2.23%	2.57%	2.73%
Income taxes	0.43%	0.09%	0.07%	1.29%	1.19%	0.61%
Other taxes	0.90%	0.80%	0.80%	0.86%	0.88%	0.85%
Accrued interest	0.69%	0.76%	0.83%	0.75%	0.64%	0.73%
Accrued restructuring and restaurant closing costs	0.00%	0.64%	1.37%	0.45%	0.26%	0.54%
Accrued payroll and other liabilities	2.81%	3.02%	3.23%	3.55%	4.01%	3.32%
Current maturities of long-term debt	1.63%	0.79%	1.15%	1.50%	3.10%	1.63%
Total current liabilities	10.89%	9.98%	10.11%	9.62%	12.65%	10.65%
Long-term debt	36.17%	37.97%	40.48%	36.16%	30.02%	36.16%
Other long-term liabilities	2.26%	2.79%	2.34%	2.71%	3.51%	2.72%
Deferred income taxes	5.00%	4.94%	4.19%	4.12%	2.81%	4.21%
Shareholders equity						
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 shares	0.08%	0.07%	0.07%	0.06%	0.06%	0.07%
Additional paid-in capital	6.65%	7.06%	7.29%	7.11%	7.85%	7.19%
Unearned ESOP compensation	-0.53%	-0.47%	-0.41%	-0.35%	-0.30%	-0.41%
Retained earnings	79.60%	82.58%	80.12%	78.07%	78.15%	79.70%
Accumulated other comprehensive income (loss)	-5.94%	-7.58%	-6.68%	-2.46%	-0.34%	-4.60%
Common stock in treasury, at cost	-37.41%	-39.55%	-37.49%	-36.07%	-34.41%	-36.98%
Total shareholders equity	42.45%	42.11%	42.89%	46.37%	51.02%	44.97%
Total liabilities and shareholders equity	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

Balance Sheet

	2000	2001	2002	2003	2004
ASSETS					
Current assets					
Cash and equivalents	$421,700,000	$418,100,000	$330,400,000	$492,800,000	$1,379,800,000
Accounts and notes receivable	$796,500,000	$881,900,000	$855,300,000	$734,500,000	$745,500,000
Inventories, at cost, not in excess of market	$99,300,000	$105,500,000	$111,700,000	$129,400,000	$147,500,000
Prepaid expenses and other current assets	$344,900,000	$413,800,000	$418,000,000	$528,700,000	$585,000,000
Total current assets	$1,662,400,000	$1,819,300,000	$1,715,400,000	$1,885,400,000	$2,857,800,000
Other assets					
Investments in and advances to affiliates	$824,200,000	$990,200,000	$1,037,700,000	$1,089,600,000	$1,109,900,000
Goodwill, net	$1,278,200,000	$1,320,400,000	$1,559,800,000	$1,665,100,000	$1,828,300,000
Miscellaneous	$871,100,000	$1,115,100,000	$1,074,200,000	$1,273,200,000	$1,338,400,000
Total other assets	$2,973,500,000	$3,425,700,000	$3,671,700,000	$4,027,900,000	$4,276,600,000
Property and equipment					
Property and equipment, at cost	$23,569,000,000	$24,106,000,000	$26,218,600,000	$28,740,200,000	$30,507,800,000
Accumulated depreciation and amortization	($6,521,400,000)	($6,816,500,000)	($7,635,200,000)	($8,815,500,000)	($9,804,700,000)
Net property and equipment	$17,047,600,000	$17,289,500,000	$18,583,400,000	$19,924,700,000	$20,703,100,000
Total assets	$21,683,500,000	$22,534,500,000	$23,970,500,000	$25,838,000,000	$27,837,500,000
LIABILITIES AND SHAREHOLDERS EQUITY					
Current liabilities					
Notes Payable	$275,500,000	$184,900,000	$300,000	N/A	N/A
Accounts payable	$684,900,000	$689,500,000	$635,800,000	$577,400,000	$714,300,000
Income taxes	$92,200,000	$20,400,000	$16,300,000	$334,200,000	$331,300,000
Other taxes	$195,500,000	$180,400,000	$191,800,000	$222,000,000	$245,100,000
Accrued interest	$149,900,000	$170,600,000	$199,400,000	$193,100,000	$179,400,000
Accrued restructuring and restaurant closing costs		$144,200,000	$328,500,000	$115,700,000	$71,500,000
Accrued payroll and other liabilities	$608,400,000	$680,700,000	$774,700,000	$918,100,000	$1,116,700,000
Current maturities of long-term debt	$354,500,000	$177,600,000	$275,500,000	$388,000,000	$862,200,000
Total current liabilities	$2,360,900,000	$2,248,300,000	$2,422,300,000	$2,485,800,000	$3,520,500,000
Long-term debt	$7,843,900,000	$8,555,500,000	$9,703,600,000	$9,342,500,000	$8,357,300,000
Other long-term liabilities	$489,500,000	$629,300,000	$560,000,000	$699,800,000	$976,700,000
Deferred income taxes	$1,084,900,000	$1,112,200,000	$1,003,700,000	$1,065,300,000	$781,500,000
Shareholders equity					
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 shares	$16,600,000	$16,600,000	$16,600,000	$16,600,000	$16,600,000
Additional paid-in capital	$1,441,800,000	$1,591,200,000	$1,747,300,000	$1,837,500,000	$2,186,000,000
Unearned ESOP compensation	($115,000,000)	($106,700,000)	($98,400,000)	($90,500,000)	($82,800,000)
Retained earnings	$17,259,400,000	$18,608,300,000	$19,204,400,000	$20,172,300,000	$21,755,800,000
Accumulated other comprehensive income (loss)	($1,287,300,000)	($1,708,800,000)	($1,601,300,000)	($635,500,000)	($96,000,000)
Common stock in treasury, at cost	($8,111,100,000)	($8,912,200,000)	($8,987,700,000)	($9,318,500,000)	($9,578,100,000)
Total shareholders equity	$9,204,400,000	$9,488,400,000	$10,280,900,000	$11,981,900,000	$14,201,500,000
Total liabilities and shareholders equity	$21,683,500,000	$22,534,500,000	$23,970,500,000	$25,838,000,000	$27,837,500,000

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
ASSETS										
Current assets										
Cash and equivalents	772,241,295	857,187,837	951,478,500	1,037,111,565	1,130,451,605	1,232,192,250	1,318,445,707	1,410,736,907	1,509,488,490	1,615,152,685
Accounts and notes receivable	1,069,360,805	1,186,990,493	1,317,559,448	1,436,139,798	1,565,392,380	1,706,277,694	1,825,717,132	1,953,517,332	2,090,263,545	2,236,581,993
Inventories, at cost, not in excess of market	155,365,310	172,455,494	191,425,599	208,653,903	227,432,754	247,901,702	265,254,821	283,822,658	303,690,245	324,948,562
Prepaid expenses and other current assets	597,558,972	663,290,459	736,252,409	802,515,126	874,741,487	953,468,221	1,020,210,997	1,091,625,767	1,168,039,570	1,249,802,340
Total current assets	2,594,526,382	2,879,924,284	3,196,715,955	3,484,420,391	3,798,018,226	4,139,839,867	4,429,628,657	4,739,702,663	5,071,481,850	5,426,485,579
Other assets										
Investments in and advances to affiliates	1,329,243,091	1,475,459,831	1,637,760,412	1,785,158,849	1,945,823,146	2,120,947,229	2,269,413,535	2,428,272,482	2,598,251,556	2,780,129,165
Goodwill, net	2,005,471,625	2,226,073,504	2,470,941,590	2,693,326,333	2,935,725,703	3,199,941,016	3,423,936,887	3,663,612,469	3,920,065,342	4,194,469,916
Miscellaneous	1,486,625,560	1,650,154,372	1,831,671,353	1,996,521,775	2,176,208,734	2,372,067,520	2,538,112,247	2,715,780,104	2,905,884,711	3,109,296,641
Total other assets	4,821,340,276	5,351,687,707	5,940,373,355	6,475,006,956	7,057,757,583	7,692,955,765	8,231,462,669	8,807,665,055	9,424,201,609	10,083,895,722
Property and equipment										
Property and equipment, at cost	35,005,022,502	38,855,574,977	43,129,688,225	47,011,360,165	51,242,382,580	55,854,197,012	59,763,990,803	63,947,470,159	68,423,793,070	73,213,458,585
Accumulated depreciation and amortization	-10,357,530,069	-11,496,858,377	-12,761,512,799	-13,910,048,950	-15,161,953,356	-16,526,529,158	-17,683,386,199	-18,921,223,233	-20,245,708,859	-21,662,908,479
Net property and equipment	24,647,492,433	27,358,716,600	30,368,175,426	33,101,311,214	36,080,429,224	39,327,667,854	42,080,604,604	45,026,246,926	48,178,084,211	51,550,550,106
Total assets	32,063,359,091	$35,590,328,591	$39,505,264,736	$43,060,738,562	$46,936,205,033	$51,160,463,486	$54,741,695,930	$58,573,614,645	$62,673,767,670	$67,060,931,407
LIABILITIES AND SHAREHOLDERS EQUITY										
Current liabilities										
Notes Payable	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Accounts payable	876,705,795	973,143,433	1,080,189,210	1,177,406,239	1,283,372,801	1,398,876,353	1,496,797,697	1,601,573,536	1,713,683,684	1,833,641,541
Income taxes	196,695,961	218,332,517	242,349,093	264,160,512	287,934,958	313,849,104	335,818,541	359,325,839	384,478,648	411,392,153
Other taxes	272,023,890	301,946,518	335,160,635	365,325,092	398,204,350	434,042,741	464,425,733	496,935,535	531,721,022	568,941,494
Accrued interest	235,475,205	261,377,478	290,129,000	316,240,610	344,702,265	375,725,469	402,026,252	430,168,090	460,279,856	492,499,446
Accrued restructuring and restaurant closing costs	174,102,760	193,254,064	214,512,011	233,818,092	254,861,720	277,799,275	297,245,224	318,052,390	340,316,057	364,138,181
Accrued payroll and other liabilities	1,065,991,247	1,183,250,284	1,313,407,815	1,431,614,518	1,560,459,825	1,700,901,209	1,819,964,294	1,947,361,794	2,083,677,120	2,229,534,518
Current maturities of long-term debt	523,996,282	581,635,873	645,615,819	703,721,242	767,056,154	836,091,208	894,617,592	957,240,824	1,024,247,682	1,095,945,019
Total current liabilities	3,413,966,028	3,789,502,291	4,206,347,543	4,584,918,821	4,997,561,515	5,447,342,052	5,828,655,995	6,236,661,915	6,673,228,249	7,140,354,226
Long-term debt	11,594,231,389	12,869,596,841	14,285,252,494	15,570,925,218	16,972,308,488	18,499,816,252	19,794,803,389	21,180,439,627	22,663,070,401	24,249,485,329
Other long-term liabilities	872,333,653	968,290,355	1,074,802,294	1,171,534,500	1,276,972,605	1,391,900,139	1,489,333,149	1,593,586,470	1,705,137,522	1,824,497,149
Deferred income taxes	1,350,282,848	1,498,813,962	1,663,683,497	1,813,415,012	1,976,622,363	2,154,518,376	2,305,334,662	2,466,708,088	2,639,377,655	2,824,134,090
Shareholders equity										
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 shares	22,017,958	24,439,933	27,128,326	29,569,876	32,231,164	35,131,969	37,591,207	40,222,591 0	43,038,173	46,050,845
Additional paid-in capital	2,306,264,845	2,559,953,978	2,841,548,915	3,097,288,318	3,376,044,266	3,679,888,250	3,937,480,428	4,213,104,058	4,508,021,342	4,823,582,836
Unearned ESOP compensation	-132,232,997	-146,778,627	-162,924,276	-177,587,461	-193,570,332	-210,991,662	-225,761,079	-241,564,354	-258,473,859	-276,567,029
Retained earnings	25,555,506,996	28,366,612,765	31,486,940,170	34,320,764,785	37,409,633,615	40,776,500,641	43,630,855,686	46,685,015,584	49,952,966,675	53,449,674,342
Accumulated other comprehensive income (loss)	-1,475,204,391	-1,637,476,874	-1,817,599,330	-1,981,183,270	-2,159,489,764	-2,353,843,843	-2,518,612,912	-2,694,915,816	-2,883,559,923	-3,085,409,118
Common stock in treasury, at cost	-11,858,507,646	-13,162,943,487	-14,610,867,271	-15,925,845,325	-17,359,171,404	-18,921,496,831	-20,246,001,609	-21,663,221,722	-23,179,647,242	-24,802,222,549
Total shareholders equity	14,417,844,764	16,003,807,688	17,764,226,534	19,363,006,922	21,105,677,545	23,005,188,524	24,615,551,721	26,338,640,341	28,182,345,165	30,155,109,327
Total liabilities and shareholders equity	32,063,359,091	$35,590,328,591	$39,505,264,736	$43,060,738,562	$46,936,205,033	$51,160,463,486	$54,741,695,930	$58,573,614,645	$62,673,767,670	$67,060,931,407

Pro Forma Cash Flow

	12/31/2000	12/31/2001	12/31/2002	12/31/2003	12/31/2004	AVG
Operating activities						
Net income	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
Adjustments to reconcile to cash provided by operations						
Cumulative effect of accounting changes			11.04%	2.50%		6.77%
Depreciation and amortization	51.12%	66.38%	117.60%	78.03%	52.71%	73.17%
Deferred income taxes	3.06%	-5.35%	-4.99%	12.33%	-7.54%	-0.50%
Changes in working capital items						
Accounts receivable	-3.40%	-6.40%	0.18%	4.35%	-1.58%	-1.37%
Inventories, prepaid expenses and other current assets	-1.50%	-3.84%	-4.26%	-2.05%	-0.65%	-2.46%
Accounts payable	4.54%	0.62%	-1.25%	-5.27%	3.81%	0.49%
Income taxes	-2.32%	16.52%	15.56%	1.60%	3.70%	7.01%
Other accrued liabilities	-12.35%	-3.67%	34.58%	-11.60%	3.08%	2.01%
Other (including noncash portion of impairment and other charges)			55.01%	42.27%	17.81%	38.36%
Cash provided by operations	139.15%	164.26%	323.46%	222.16%	171.32%	204.07%
Investing activities						
Property and equipment expenditures	-98.37%	-116.47%	-224.26%	-88.85%	-62.29%	-118.05%
Purchases of restaurant businesses	-21.52%	-20.26%	-61.38%	-25.54%	-6.57%	-27.05%
Sales of restaurant businesses and property	15.31%	22.97%	41.35%	26.55%	13.44%	23.93%
Other	-7.32%	-12.61%	-31.77%	-5.23%	-5.28%	-12.44%
Cash used for investing activities	-111.90%	-126.37%	-276.06%	-93.08%	-60.70%	-133.62%
Financing activities						
Net short-term borrowings (repayments)	2.99%	-15.15%	-67.91%	-36.26%	1.58%	-22.95%
Long-term financing issuances	120.43%	103.55%	168.17%	27.06%	9.90%	85.82%
Long-term financing repayments	-38.53%	-56.18%	-83.97%	-51.39%	-47.27%	-55.47%
Treasury stock purchases	-102.33%	-65.26%	-75.01%	-26.57%	-27.25%	-59.29%
Common stock dividends	-14.20%	-17.58%	-33.28%	-34.22%	-30.50%	-25.96%
Proceeds from stock option exercises			21.82%	11.64%	25.48%	19.65%
Other	4.50%	12.51%	12.97%	-8.28%	-3.62%	3.62%
Cash used for financing activities	-27.14%	-38.11%	-57.21%	-118.04%	-71.69%	-62.44%
Cash and equivalents increase (decrease)	0.11%	-0.22%	-9.82%	11.04%	38.93%	8.01%
Cash and equivalents at beginning of year	21.22%	25.77%	46.79%	22.45%	21.63%	27.57%
Cash and equivalents at end of year	21.33%	25.55%	36.98%	33.49%	60.56%	35.58%
Supplemental cash flow disclosures						
Interest paid	23.75%	27.31%	40.26%	29.01%	16.25%	27.32%
Income taxes paid	43.20%	47.28%	64.04%	41.36%	44.66%	48.11%

Cash Flow

	2000/12/31	2001/12/31	2002/12/31	2003/12/31	2004/12/31
Operating activities					
Net income	$1,977,300,000	$1,636,600,000	$893,500,000	$1,471,400,000	$2,278,500,000
Adjustments to reconcile to cash provided by operations					
Cumulative effect of accounting changes			$98,600,000	$36,800,000	
Depreciation and amortization	$1,010,700,000	$1,086,300,000	$1,050,800,000	$1,148,200,000	$1,201,000,000
Deferred income taxes	$60,500,000	($87,600,000)	($44,600,000)	$181,400,000	($171,900,000)
Changes in working capital items					
Accounts receivable	($67,200,000)	($104,700,000)	$1,600,000	$64,000,000	($35,900,000)
Inventories, prepaid expenses and other current assets	($29,600,000)	($62,900,000)	($38,100,000)	($30,200,000)	($14,900,000)
Accounts payable	$89,700,000	$10,200,000	($11,200,000)	($77,600,000)	$86,700,000
Income taxes	($45,800,000)	$270,400,000	$139,000,000	$23,500,000	$84,200,000
Other accrued liabilities	($244,100,000)	($60,000,000)	$309,000,000	($170,700,000)	$70,200,000
Other (including noncash portion of impairment and other charges)			$491,500,000	$622,000,000	$405,700,000
Cash provided by operations	$2,751,500,000	$2,688,300,000	$2,890,100,000	$3,268,800,000	$3,903,600,000
Investing activities					
Property and equipment expenditures	($1,945,100,000)	($1,906,200,000)	($2,003,800,000)	($1,307,400,000)	($1,419,300,000)
Purchases of restaurant businesses	($425,500,000)	($331,600,000)	($548,400,000)	($375,800,000)	($149,700,000)
Sales of restaurant businesses and property	$302,800,000	$375,900,000	$369,500,000	$390,600,000	$306,300,000
Other	($144,800,000)	($206,300,000)	($283,900,000)	($77,000,000)	($120,400,000)
Cash used for investing activities	($2,212,600,000)	($2,068,200,000)	($2,466,600,000)	($1,369,600,000)	($1,383,100,000)
Financing activities					
Net short-term borrowings (repayments)	$59,100,000	($248,000,000)	($606,800,000)	($533,500,000)	$35,900,000
Long-term financing issuances	$2,381,300,000	$1,694,700,000	$1,502,600,000	$398,100,000	$225,600,000
Long-term financing repayments	($761,900,000)	($919,400,000)	($750,300,000)	($756,200,000)	($1,077,000,000)
Treasury stock purchases	($2,023,400,000)	($1,068,100,000)	($670,200,000)	($391,000,000)	($621,000,000)
Common stock dividends	($280,700,000)	($287,700,000)	($297,400,000)	($503,500,000)	($695,000,000)
Proceeds from stock option exercises			$195,000,000	$171,200,000	$580,500,000
Other	$88,900,000	$204,800,000	$115,900,000	($121,900,000)	($82,500,000)
Cash used for financing activities	($536,700,000)	($623,700,000)	($511,200,000)	($1,736,800,000)	($1,633,500,000)
Cash and equivalents increase (decrease)	$2,200,000	($3,600,000)	($87,700,000)	$162,400,000	$887,000,000
Cash and equivalents at beginning of year	$419,500,000	$421,700,000	$418,100,000	$330,400,000	$492,800,000
Cash and equivalents at end of year	$421,700,000	$418,100,000	$330,400,000	$492,800,000	$1,379,800,000
Supplemental cash flow disclosures					
Interest paid	$469,700,000	$446,900,000	$359,700,000	$426,900,000	$370,200,000
Income taxes paid	$854,200,000	$773,800,000	$572,200,000	$608,500,000	$1,017,600,000

	2005	2006	2007	2008	2009
Operating activities					
Net income	$2,167,995,029.91	$2,406,474,483.20	$2,671,186,676.35	$2,911,593,477.22	$3,173,636,890.17
Adjustments to reconcile to cash provided by operations					
Cumulative effect of accounting changes	$146,732,874.36	$162,873,490.54	$180,789,574.50	$197,060,636.21	$214,796,093.47
Depreciation and amortization	$1,586,279,189.60	$1,760,769,900.45	$1,954,454,589.50	$2,130,355,502.56	$2,322,087,497.79
Deferred income taxes	($10,842,059.55)	($12,034,686.10)	($13,358,501.57)	($14,560,766.72)	($15,871,235.72)
Changes in working capital items					
Accounts receivable	($29,670,793.93)	($32,934,581.27)	($36,557,385.20)	($39,847,549.87)	($43,433,829.36)
Inventories, prepaid expenses and other current assets	($53,379,768.52)	($59,251,543.06)	($65,769,212.80)	($71,688,441.95)	($78,140,401.73)
Accounts payable	$10,568,893.92	$11,731,472.25	$13,021,934.20	$14,193,908.28	$15,471,360.02
Income taxes	$151,998,561.59	$168,718,403.36	$187,277,427.73	$204,132,396.23	$222,504,311.89
Other accrued liabilities	$43,583,742.45	$48,377,954.12	$53,699,529.07	$58,532,486.69	$63,800,410.49
Other (including noncash portion of impairment and other charges)	$831,690,829.92	$923,176,821.21	$1,024,726,271.55	$1,116,951,635.98	$1,217,477,283.22
Cash provided by operations	$4,424,240,443.15	$4,910,906,891.90	$5,451,106,650.01	$5,941,706,248.51	$6,476,459,810.87
Investing activities					
Property and equipment expenditures	($2,559,335,286.22)	($2,840,862,167.70)	($3,153,357,006.15)	($3,437,159,136.71)	($3,746,503,459.01)
Purchases of restaurant businesses	($586,519,765.56)	($651,036,939.77)	($722,651,003.14)	($787,689,593.42)	($858,581,656.83)
Sales of restaurant businesses and property	$518,695,355.72	$575,751,844.85	$639,084,547.79	$696,602,157.09	$759,296,351.23
Other	($269,784,135.62)	($299,460,390.53)	($332,401,033.49)	($362,317,126.51)	($394,925,667.89)
Cash used for investing activities	($2,896,943,831.67)	($3,215,607,653.15)	($3,569,324,495.00)	($3,890,563,699.55)	($4,240,714,432.51)
Financing activities					
Net short-term borrowings (repayments)	($497,596,193.97)	($552,331,775.30)	($613,088,270.59)	($668,266,214.94)	($728,410,174.28)
Long-term financing issuances	$1,860,613,131.95	$2,065,280,576.47	$2,292,461,439.88	$2,498,782,969.47	$2,723,673,436.72
Long-term financing repayments	($1,202,561,229.66)	($1,334,842,964.92)	($1,481,675,691.06)	($1,615,026,503.25)	($1,760,378,888.55)
Treasury stock purchases	($1,285,323,219.21)	($1,426,708,773.32)	($1,583,646,738.39)	($1,726,174,944.84)	($1,881,530,689.88)
Common stock dividends	($562,732,261.09)	($624,632,809.81)	($693,342,418.89)	($755,743,236.59)	($823,760,127.88)
Proceeds from stock option exercises	$425,915,281.72	$472,765,962.71	$524,770,218.60	$571,999,538.28	$623,479,496.72
Other	$78,376,525.79	$86,997,943.63	$96,567,717.43	$105,258,811.99	$114,732,105.07
Cash used for financing activities	($1,353,674,077.15)	($1,502,578,225.63)	($1,667,861,830.45)	($1,817,969,395.20)	($1,981,586,640.76)
Cash and equivalents increase (decrease)	$173,622,534.34	$192,721,013.11	$213,920,324.55	$233,173,153.76	$254,158,737.60
Cash and equivalents at beginning of year	$597,756,167.82	$663,509,346.28	$736,495,374.37	$802,779,958.07	$875,030,154.29
Cash and equivalents at end of year	$771,378,702.16	$856,230,359.40	$950,415,698.93	$1,035,953,111.83	$1,129,188,891.90
Supplemental cash flow disclosures					
Interest paid	$592,206,733.46	$657,349,474.14	$729,657,916.30	$795,327,128.77	$866,906,570.35
Income taxes paid	$1,042,969,059.19	$1,157,695,655.71	$1,285,042,177.83	$1,400,695,973.84	$1,526,758,611.48

	2010	2011	2012	2013	2014
Operating activities					
Net income	$3,459,264,210.29	$3,701,412,705.01	$3,960,511,594.36	$4,237,747,405.96	$4,534,389,724.38
Adjustments to reconcile to cash provided by operations					
Cumulative effect of accounting changes	$234,127,741.88	$250,516,683.81	$268,052,851.68	$286,816,551.29	$306,893,709.88
Depreciation and amortization	$2,531,075,372.59	$2,708,250,648.67	$2,897,828,194.08	$3,100,676,167.66	$3,317,723,499.40
Deferred income taxes	($17,299,646.93)	($18,510,622.22)	($19,806,365.78)	($21,192,811.38)	($22,676,308.18)
Changes in working capital items					
Accounts receivable	($47,342,874.00)	($50,656,875.18)	($54,202,856.45)	($57,997,056.40)	($62,056,850.35)
Inventories, prepaid expenses and other current assets	($85,173,037.88)	($91,135,150.53)	($97,514,611.07)	($104,340,633.84)	($111,644,478.21)
Accounts payable	$16,863,782.43	$18,044,247.20	$19,307,344.50	$20,658,858.61	$22,104,978.72
Income taxes	$242,529,699.96	$259,506,778.96	$277,672,253.48	$297,109,311.23	$317,906,963.01
Other accrued liabilities	$69,542,447.43	$74,410,418.75	$79,619,148.06	$85,192,488.43	$91,155,962.62
Other (including noncash portion of impairment and other charges)	$1,327,050,238.71	$1,419,943,755.42	$1,519,339,818.30	$1,625,693,605.58	$1,739,492,157.97
Cash provided by operations	$7,059,341,193.85	$7,553,495,077.42	$8,082,239,732.84	$8,647,996,514.14	$9,253,356,270.13
Investing activities					
Property and equipment expenditures	($4,083,688,770.32)	($4,369,546,984.24)	($4,675,415,273.14)	($5,002,694,342.26)	($5,352,882,946.22)
Purchases of restaurant businesses	($935,854,005.95)	($1,001,363,786.36)	($1,071,459,251.41)	($1,146,461,399.01)	($1,226,713,696.94)
Sales of restaurant businesses and property	$827,633,022.84	$885,567,334.44	$947,557,047.85	$1,013,886,041.20	$1,084,858,064.08
Other	($430,468,978.00)	($460,601,806.46)	($492,843,932.92)	($527,343,008.22)	($564,257,018.80)
Cash used for investing activities	($4,622,378,731.43)	($4,945,945,242.63)	($5,292,161,409.62)	($5,662,612,708.29)	($6,058,995,597.87)
Financing activities					
Net short-term borrowings (repayments)	($793,967,089.97)	($849,544,786.27)	($909,012,921.31)	($972,643,825.80)	($1,040,728,893.60)
Long-term financing issuances	$2,968,804,046.02	$3,176,620,329.24	$3,398,983,752.29	$3,636,912,614.95	$3,891,496,498.00
Long-term financing repayments	($1,918,812,988.52)	($2,053,129,897.71)	($2,196,848,990.55)	($2,350,628,419.89)	($2,515,172,409.28)
Treasury stock purchases	($2,050,868,451.97)	($2,194,429,243.60)	($2,348,039,290.66)	($2,512,402,041.00)	($2,688,270,183.87)
Common stock dividends	($897,898,539.39)	($960,751,437.15)	($1,028,004,037.75)	($1,099,964,320.39)	($1,176,961,822.82)
Proceeds from stock option exercises	$679,592,651.43	$727,164,137.03	$778,065,626.62	$832,530,220.49	$890,807,335.92
Other	$125,057,994.53	$133,812,054.15	$143,178,897.94	$153,201,420.79	$163,925,520.25
Cash used for financing activities	($2,159,929,438.43)	($2,311,124,499.12)	($2,472,903,214.06)	($2,646,006,439.05)	($2,831,226,889.78)
Cash and equivalents increase (decrease)	$277,033,023.99	$296,425,335.67	$317,175,109.16	$339,377,366.80	$363,133,782.48
Cash and equivalents at beginning of year	$953,782,868.18	$1,020,547,668.95	$1,091,986,005.78	$1,168,425,026.19	$1,250,214,778.02
Cash and equivalents at end of year	$1,230,815,892.17	$1,316,973,004.62	$1,409,161,114.94	$1,507,802,392.99	$1,613,348,560.50
Supplemental cash flow disclosures					
Interest paid	$944,928,161.69	$1,011,073,133.00	$1,081,848,252.31	$1,157,577,629.98	$1,238,608,064.08
Income taxes paid	$1,664,166,886.52	$1,780,658,568.57	$1,905,304,668.37	$2,038,675,995.16	$2,181,383,314.82

Table 1: Forward Price to Earnings Ratio

Forward Price to Earnings Ratio

	Price per share	Earnings per share	Forward Price/Earnings Ratio
YUM	51.81	2.9	17.87
Wendy's	39.04	2.52	15.49
Industry Average P/E Ratio			***16.68***
McDonald's	31.14	2.13	
Expected Share Price			**$35.53**

1. Price per share as reported by yahoo finance on 4/1/05
2. Earnings per share estimated for current year based on forward P/E
3. Calculated by (Price per share)/(Earnings per share)
4. Industry average found by averaging competitor's P/E excluding McDonald's
5. Industry average Price/Earnings ratios multiplied by McDonald's Earnings per share

Table 2: Trailing Price to Earnings Ratio

Trailing Price to Earnings Ratio			
	Price per share [1]	**Earnings per share** [2]	**Trailing Price/Earnings Ratio** [3]
YUM	$51.81	$2.42	20.88X
Wendy's	$39.04	$2.08	18.77X
Industry Average P/E Ratio [4]			***19.83X***
McDonald's	$31.00	$1.80	
Expected Share Price [5]			**$ 35.69**

1. Price per share as reported by Yahoo Finance on 4/1/05.
2. Trailing twelve month (TTM) earnings as reported per Yahoo Finance.
3. Calculated by (Price per share)/(Earnings per share).
4. Industry average found by averaging competitor's P/E ratios excluding McDonald's.
5. Industry average Price/Earnings ratios multiplied by McDonald's TTM earnings.

Table 3: Price/Book Ratio

Price/Book Ratio:

	Price Per Share [1]	Book Value per share [2]	Price/Book Ratio [3]
YUM	$ 51.81	$ 5.50	9.42X
Wendy's	$ 39.04	$ 15.26	2.56X
Industry Average			***5.99X***
McDonald's	$ 31.00	11.183	11.18X
Expected Share Price [5]			**$ 66.99**

1. Price per share as reported by Yahoo Finance on 4/1/05.
2. Book Value per share as reported and estimated by Yahoo Finance for the current year.
3. Calculated by (Price per share)/(Book Value per share).
4. Industry average found by averaging competitor's P/B excluding McDonald's.
5. Industry average Price/Book ratios multiplied by McDonald's Book Value per share.

Table 4: Dividends Yield Ratio Analysis

Dividend/Price Ratio:

	Price Per Share 1	Dividends per share 2	Dividends/Price Ratio 3
YUM	$ 51.81	$ 0.40	0.0077
Wendy's	$ 39.04	$ 0.54	0.0138
Industry Average of DPS/PPS 4			***0.01075***
McDonald's	$ 31.00	$ 0.55	0.0177
Expected Share Price 5			**$ 51.16**

1. Price per share as reported by yahoo finance on 4/1/05.
2. Dividends per share as calculated by current (Dividends Paid)/ (# of shares outstanding).
3. Calculated by (Dividends per share)/ (Price per share).
4. Industry average found by averaging competitor's Dividends/Price ratio excluding McDonald's.
5. Expected share price found by dividing McDonald's (Dividends per share)/ (Industry average Dividends yield ratio).

Table 5: Price/Sales Ratio Valuation

Price/Sales Ratio:

	Price Per Share 1	Sales per share 2	Price/Sales Ratio 3
YUM	$ 51.81	$ 30.93	1.68X
Wendy's	$ 39.04	$ 28.01	1.39X
***Industry Average of Price/Sales* 4**			***1.53X***
McDonald's	$ 31.00	$ 15.01	2.07X
Expected Share Price 5			**$ 23.03**

1. Price per share as reported by yahoo finance on 4/1/05.
2. Sales per share calculated by dividing (Total Revenue)/ (# of Shares Outstanding) for the year ended December 31, 2004.
3. Calculated by (Price per share)/ (Sales per share).
4. Industry average found by averaging competitor's Price/Sales ratios excluding McDonald's.
5. Calculated by multiplying McDonald's (Sales per share)*(Industry Average P/S ratio).

Table 6: Price Earnings Growth Valuation

P.E.G. (Price/Earnings)/(1-Year Forward Earnings Growth Rate)

	(Price/Earnings)[1]	Earnings Growth Rate [2]	PEG [3]
YUM	17.87X	10.30%	1.73X
Wendy's	15.49X	14.50%	1.07X
Industry Average of Price/Sales [4]			***1.40X***
McDonald's	16.79	9.23%	1.82

1. Price/Earnings as calculated using the forward year's consensus estimates.
2. Earnings Growth Rate as reported by Yahoo Finance forecasted for the year ahead.
3. Calculated by (Price/Earnings)/(Earnings Growth Rate)
4. Industry average found by averaging competitor's P.E.G. excluding McDonald's
5. McDonald's current year P/E is divided by the EGR to derive at McDonald's PEG.

Valuation Matrix

	Implied Value	Weight	Weighted Average
Forward Price Earning Ratio:	$ 35.53	25.00%	$ 8.88
Trailing Price to Earning Ratio:	$ 35.69	25.00%	$ 8.92
Price to Book Ratio:	$ 66.99	5.00%	$ 3.35
Dividend Yield Analysis	$ 51.16	10.00%	$ 5.12
Price/Sales Ratio	$ 23.03	10.00%	$ 2.30
Earnings Growth Valuation	$ 34.24	25.00%	$ 8.56
Weighted Avereage Implied Value		**100.00%**	**$ 37.13**

Discounted Dividends Model

Years from valuation date	0	1	2	3	4	5	6	7	8	9	10	Terminal
	2004	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	
Dividends per share		$0.45	$0.50	$0.56	$0.61	$0.67	$0.73	$0.78	$0.84	$0.90	$0.97	$1.00
Present Value Factor		0.94509	0.893196	0.84415	0.797798	0.7539915	0.71259	0.6734619	0.6364822	0.601533	0.568503	
Present Value of Future Dividends		$0.43	$0.45	$0.47	$0.49	$0.51	$0.52	$0.53	$0.53	$0.54	$0.55	
Total Present Value of Forecast Future Dividends	$5.01											
Continuing (Terminal) Value											17.2117	
Present Value of Continuing (Terminal) Value	$9.78											
Estimated Value per Share	$14.78											
Earnings Per Share		$1.73	$1.93	$2.15	$2.35	$2.57	$2.81	$3.02	$3.24	$3.48	$3.74	
Dividends per share		$0.45	$0.50	$0.56	$0.61	$0.67	$0.73	$0.78	$0.84	$0.90	$0.97	
Book Value Per Share	$22.00											
Actual Price per share	$31.00											
Cost of Equity	0.058											
Growth rate	0											

Sensitivity Analysis

		g			
		0	**0.01**	**0.02**	**0.03**
Ke	**0.038**	**$23.72**	**$30.20**	**$43.86**	**$91.69**
	0.048	**$18.33**	**$21.76**	**$27.64**	**$40.06**
	0.058	**$14.78**	**$16.87**	**$19.99**	**$25.34**
	0.068	**$12.37**	**$13.68**	**$15.54**	**$18.38**
	0.078	**$10.56**	**$11.45**	**$12.64**	**$14.34**

Discounted Free Cash Flows Model

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Cash Flow from Operations		4424.24	4910.91	5451.11	5941.71	6476.46	7059.34	7553.50	8082.24	8648.00	9253.36
Cash Provided (Used) by Investing Activities		(2896.94)	(3215.61)	(3569.32)	(3890.56)	(4240.71)	(4622.38)	(4945.95)	(5292.16)	(5662.61)	(6059.00)
Free Cash Flow (to firm)		1527.30	1695.30	1881.79	2051.15	2235.75	2436.96	2607.55	2790.08	2985.39	3194.36
discount rate (5% WACC)		0.951	0.904	0.860	0.817	0.777	0.739	0.703	0.668	0.635	0.604
Present Value of Free Cash Flows		1452.220	1532.720	1617.691	1676.602	1737.656	1800.931	1832.270	1864.153	1896.593285	1929.590355
Total Present Value of Annual Cash Flows	13,514.24										
Continuing (Terminal) Value (assume no growth)										57744.48743	
Present Value of Continuing (Terminal) Value	36684.59										
Value of the Firm (end of 2004)	50198.83										
Book Value of Debt and Preferred Stock	$13,636.00										
Value of Equity (end of 2004)	$36,562.83										
Shares outstanding	1270										
Estimated Value per Share	$28.79										

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Earnings Per Share		$1.73	$1.93	$2.15	$2.35	$2.57	$2.81	$3.02	$3.24	$3.48	$3.74
Dividends per share		$0.45	$0.50	$0.56	$0.61	$0.67	$0.73	$0.78	$0.84	$0.90	$0.97
Book Value Per Share	$22.00										

Actual Price per share	$31.00
Wacc	0.0517
Growth	0

Sensitivity Analysis

		g			
		0	0.01	0.02	0.03
Wacc	0.04	$41.77	$55.53	$83.06	$165.64
	0.05	$30.29	$37.87	$50.49	$75.75
	0.06	$22.71	$27.35	$34.31	$45.90
	0.07	$17.35	$20.40	$24.66	$31.05
	0.08	$13.38	$15.48	$18.28	$22.20

Discounted Residual Income Model

	0	1	2	3	4	5	6	7	8	9	10	Perp
		Forecast Years										
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	
Beginning BE (per share)		22	23.2845	24.7149	26.30776	28.04958	29.95432	32.0372	34.2732	36.6736	39.2504	
Earnings Per Share		$1.73	$1.93	$2.15	$2.35	$2.57	$2.81	$3.02	$3.24	$3.48	$3.74	
Dividends per share		$0.45	$0.50	$0.56	$0.61	$0.67	$0.73	$0.78	$0.84	$0.90	$0.97	
Ending BE (per share)	22	23.28	24.71	26.31	28.05	29.95	32.04	34.27	36.67	39.25	42.02	
Ke	5.800%											
"Normal" Income		1.28	1.35	1.43	1.53	1.63	1.74	1.86	1.99	2.13	2.28	
Residual Income (RI)		0.46	0.58	0.72	0.83	0.95	1.08	1.16	1.25	1.35	1.46	1.46
Present Value of RI		0.43	0.52	0.61	0.66	0.71	0.77	0.78	0.80	0.81	0.83	

BV Equity (per share) 2004	22	0.51
Total PV of RI (end 2004)	6.93	0.16
Continuation (Terminal) Value		
PV of Terminal Value (end 2004)	14.32	0.33
Estimated Value (2004)	**$43.24**	

Sensitivity Analysis

25.1635

		g			
		0	0.01	0.02	0.03
Ke	0.038	$75.22	$89.75	$120.42	227.76
	0.048	$55.73	$62.09	$72.98	95.97
	0.058	$43.24	$46.23	$50.78	58.59
	0.068	$34.64	$36.05	$38.03	$41.06
	0.078	$28.42	$19.02	$29.83	$30.97

Actual Price per share $31.00

Growth 0

Abnormal Earnings Growth Model

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
			1	2	3	4	5	6	7	8	Perp
		Forecast Years									
EPS		$1.73	$1.93	$2.15	$2.35	$2.57	$2.81	$3.02	$3.24	$3.48	
DPS		$0.45	$0.50	$0.56	$0.61	$0.67	$0.73	$0.78	$0.84	$0.90	
DPS invested at 5.81%			$0.03	$0.03	$0.03	$0.04	$0.04	$0.04	$0.05	$0.05	
Cum-Dividend Earnings			$1.96	$2.18	$2.38	$2.61	$2.85	$3.06	$3.29	$3.53	
Normal Earnings			$1.83	$2.04	$2.27	$2.49	$2.72	$2.97	$3.20	$3.43	
Abnormal Earning Growth (AEG)			$0.13	$0.14	$0.11	$0.12	$0.13	$0.09	$0.09	$0.10	$0.00
PV Factor			0.945	0.893	0.844	0.798	0.754	0.712	0.673	0.636	
PV of AEG			$0.12	$0.12	$0.09	$0.09	$0.10	$0.06	$0.06	$0.06	
Core EPS		$1.73									
Total PV of AEG		$0.71									
Continuing (Terminal) Value										$0.00	
PV of Terminal Value		$0.00									
Total PV of AEG		$0.71									
Average Perpetuity		$2.44									
Capitalization Rate (perpetuity)		0.0581									

Value Per Share	pv	$42.04	Dec-04
	fv	$42.64	1-Apr
Ke	0.0581		
g	0		

Sensitivity Analysis

Ke \ g	0	0.01	0.02	0.03
0.0381	$64.11	$64.75	$65.39	66.02827
0.0481	$50.78	$51.29	$51.79	36.94092
0.0581	$42.04	$42.46	$42.88	43.29909
0.0681	$35.86	$36.22	$36.58	$36.94
0.0781	$31.27	$31.59	$31.90	$32.21

Actual Price per share $31.00

Long Run Average Residual Income Perpetuity based on the Price/Book Ratio

B-(Book Value of Equity per share)=	$11.18
ROE-(Return on Equity)=	17.75%
Ke-Cost of equity=	5.81%
g-(growth)=	0
Expected Market Price	**$34.28**

Sensitivity Analysis

		g			
		0	**0.01**	**0.02**	**0.03**
Ke	**0.0381**	**$52.09**	**$66.64**	**$97.28**	**203.59**
	0.0481	**$41.26**	**$49.15**	**$62.66**	**91.11**
	0.0581	**$34.16**	**$38.93**	**$46.22**	**58.69**
	0.0681	**$29.14**	**$32.23**	**$36.61**	**$43.28**
	0.0781	**$25.41**	**$27.50**	**$30.31**	**$34.28**

Implied Cost of Equity Using Discounted Dividends

Years from valuation date	0	1	2	3	4	5	6	7	8	9	10	11	Terminal
	2003	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	
Dividends per share		0.55	$0.45	$0.50	$0.56	$0.61	$0.67	$0.73	$0.78	$0.84	$0.90	$0.97	$1.00
Present Value Factor		1.041	0.922781	0.886437	0.851524	0.817987	0.78577	0.754823	0.725094	0.696536	0.669103	0.64275	
Present Value of Future Dividends		$0.57	$0.42	$0.44	$0.48	$0.50	$0.53	$0.55	$0.57	$0.59	$0.60	$0.62	
Total Present Value of Forecast Future Dividends	**$7.75**	$5.29											
Continuing (Terminal) Value												24.39024	
Present Value of Continuing (Terminal) Value	**$16.32**	$15.68											
Estimated Value per Share	**$24.07**	$20.96											
Earnings Per Share			$1.73	$1.93	$2.15	$2.35	$2.57	$2.81	$3.02	$3.24	$3.48	$3.74	
Dividends per share			$0.45	$0.50	$0.56	$0.61	$0.67	$0.73	$0.78	$0.84	$0.90	$0.97	
Book Value Per Share		$22.00											
Actual Price per share		31											
Cost of Equity		0.041											
Growth rate		0											
Actual end price	23.95												
Implied Ke	**4.10%**												

Implied WACC Using Discounted Free Cash Flows

(Amounts in millions of dollars except per share data)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Cash Flow from Operations		3903.60	4424.24	4910.91	5451.11	5941.71	6476.46	7059.34	7553.50	8082.24	8648.00	9253.36
Cash Provided (Used) by Investing Activities		(1383.10)	(2896.94)	(3215.61)	(3569.32)	(3890.56)	(4240.71)	(4622.38)	(4945.95)	(5292.16)	(5662.61)	(6059.00)
Free Cash Flow (to firm)		2520.50	1527.30	1695.30	1881.79	2051.15	2235.75	2436.96	2607.55	2790.08	2985.39	3194.36
discount rate (5% WACC)		1	0.894	0.846	0.800	0.756	0.715	0.676	0.639	0.605	0.572	0.541
Present Value of Free Cash Flows			1365.726	1433.526	1504.699	1550.942	1598.604	1647.729	1667.207	1686.915	1706.857691	1727.029367
Total Present Value of Annual Cash Flows	15889.24	12,455.35										
Continuing (Terminal) Value (assume no growth)											51919.82609	
Present Value of Continuing (Terminal) Value	28070.43	29684.48										
Value of the Firm	43959.67	42139.83										
Book Value of Debt and Preferred Stock	$13,543.20	$13,636.00										
Value of Equity	30416.47	28503.83										
Shares outstanding	1270	1270										
Estimated Value Per Share	$23.95	$22.44										
Earnings Per Share			$1.73	$1.93	$2.15	$2.35	$2.57	$2.81	$3.02	$3.24	$3.48	$3.74
			$0.45	$0.50	$0.56	$0.61	$0.67	$0.73	$0.78	$0.84	$0.90	$0.97
Book Value Per Share		$22.00										
Actual Price per share		$31.00										
Implied Wacc		**0.0575**										
Growth rate		0										
End Price	23.95											

Weighted Average Cost of Debt

LIABILITIES AND SHAREHOLDERS EQUITY	2004	Percent of Total Liabilites	Computed Interest Rate	Value Weighted Rate
Current liabilities				
Accounts payable	$714,300,000	5.24%	0.0%	0.00%
Income taxes	$331,300,000	2.43%	0.0%	0.00%
Other taxes	$245,100,000	1.80%	0.0%	0.00%
Accrued interest	$179,400,000	1.32%	4.4%	0.06%
Accrued restructuring and restaurant closing costs	$71,500,000	0.52%	0.0%	0.00%
Accrued payroll and other liabilities	$1,116,700,000	8.19%	4.4%	0.36%
Current maturities of long-term debt	$862,200,000	6.32%	3.9%	0.25%
Total current liabilities	$3,520,500,000	25.82%		
Long-term debt	$8,357,300,000	61.29%	3.9%	2.39%
Other long-term liabilities	$976,700,000	7.16%	3.9%	0.28%
Deferred income taxes	$781,500,000	5.73%	0.0%	0.00%
Total non-current liabilites	$10,115,500,000	74.18%		
Total Liabilites	$13,636,000,000		**Weighted Average Cost of Debt**	**3.33%**

Sources

1. www.Yahoo.finance.com

2. www.McDonald’s.com

3. http://www.wendys-invest.com

4. www.Yum.com

5. www.morningstar.com

6. www.edgarscan.com

7. Business Analysis and Valuation Using Financial Statements. Palepu, Healy, Bernard.