

McDonald's Net Falls; New Coffee, Hours Boost Sales (Update4)
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(Adds executive comment in 17th paragraph.)

By Chris Burritt

April 21 (Bloomberg) -- McDonald's Corp., the world's largest restaurant company, said first-quarter profit fell 14 percent from a year earlier, when it had a tax gain. Sales rose 6.2 percent, spurred by the addition of a new blend of coffee and expanded store hours.

Net income dropped to \$625.3 million, or 49 cents a share, from \$727.9 million, or 56 cents, a year earlier. Sales increased to \$5.1 billion, Oak Brook, Illinois-based McDonald's said today in a statement.

Chief Executive Officer Jim Skinner boosted U.S. comparable sales 6.6 percent with the expansion of round-the-clock operation to more than a third of restaurants and the debut of coffee made from 100 percent Arabica beans. Revenue was also helped by demand for Dollar Menu items including double cheeseburgers and French fries. A tax benefit of 13 cents a share increased profit a year earlier.

"The U.S. was very robust," said Jeffrey Malcom, who helps manage \$200 million including 165,000 McDonald's shares at Towson, Maryland-based Horan Capital Management LLC. Europe is moving "in the right direction. They need to tinker with the stores to get the product right and drive people in."

Shares of McDonald's, which operates 31,900 restaurants, fell 19 cents to \$34.89 at 1 p.m. in New York Stock Exchange composite trading. Before today, the stock had increased 4 percent this year after a gain of 5.2 percent in 2005. The company reported preliminary per-share earnings of 49 cents on April 13.

Closes U.K. Restaurants

The stronger U.S. dollar reduced first-quarter profit by 1 cent a share, McDonald's said on April 13. Closing 25 U.K. restaurants, buying certain Brazilian franchisees and a loss on the anticipated sale of a small market in Europe led to costs of 4.5 cents.

The company recorded a gain of 3.5 cents from January's initial public offering of Chipotle Mexican Grill Inc.

In the year-earlier quarter, McDonald's net income climbed 42 percent on a tax gain of \$179 million after it settled a U.S.

Internal Revenue Service audit.

McDonald's said operating margins at its company-owned and franchisee units increased in all of its geographic regions last quarter. It bought back 29.5 million shares worth \$1 billion.

The company said in January it expected to repurchase shares and take steps to improve margins after facing pressure from activist investor and McDonald's shareholder William Ackman, who that same month dropped his campaign for a public offering of all company-owned restaurants.

Pershing Square

Ackman, whose hedge fund Pershing Square Capital Management LP owns McDonald's shares, backed off after the company also ceded to his demand to provide more information about the margins of company-owned stores, which lag franchisees in profitability.

First-quarter operating margin for company-owned restaurants increased 0.7 percentage point to 14.7 percent as higher comparable-store sales muted rising utility, labor and promotional costs, McDonald's said today in a regulatory filing.

The franchisee margin increased 0.1 percentage point to 79.7 percent, with lower profit in the U.K. and higher rent in many European markets limiting the gains from increased U.S. comparable-store sales.

CIBC World Markets Inc. analyst John Glass in Boston increased his per-share earnings estimate by 2 cents to 49 cents a share after McDonald's announced preliminary results. Glass is among analysts top ranked for accuracy by StarMine Corp.

Same-Store Sales

Sixteen analysts surveyed by Thomson Financial also estimated the company earned 49 cents. Thomson didn't return a telephone call seeking the parameters for the estimates in its survey.

The gain in U.S. sales at restaurants open at least 13 months spurred a 5.2 percent increase in worldwide same-store sales, the biggest rise in six quarters. Europe's same-store sales grew 2 percent, while sales in Asia/Pacific, Middle East and Africa rose 4.1 percent.

Selling the new coffee, which debuted in late February, could boost U.S. comparable-store sales by 1 percentage point while food purchases by coffee drinkers could add another 1 percentage point, A.G. Edwards & Sons Inc. analyst Jack Russo in St. Louis wrote on April 4.

``We had some breakfast rejectors, if you will, who didn't

think our coffee was as good as it could be," Chief Operating Officer Mike Roberts told analysts on a conference call. "Now that they know it is better, they are coming to McDonald's."

Starbucks

McDonald's operators charged less for coffee than rival chains Starbucks Corp. and Dunkin Donuts, prompting both to offer free coffee last month, according to Russo, who's among 12 analysts tracked by Bloomberg rating the shares a "buy." Six others say "hold."

Burger King Holdings Inc., the second-largest U.S. hamburger chain, started mimicking McDonald's Dollar Menu in February when it cut the price of the Whopper Jr. sandwich to \$1 and added four-piece Chicken Tenders and a 16-ounce soft drink to a new discount menu. McDonald's launched its national Dollar Menu in 2000 and it has contributed to three straight years of increased U.S. comparable-store sales.

The chain is driving sales with a combination of less-expensive traditional items and new healthier salads and premium-chicken sandwiches, said Peter Jankovskis, research director at Lisle, Illinois-based Oakbrook Investments LLC, which manages \$1 billion including 1 million McDonald's shares.

"They are making the stores attractive again to families as a whole," Jankovskis said. "Typically mothers want to have a salad and now they're more willing to go to McDonald's and the kids get their burgers, too."

Skinner, 61, added a spicy-chicken sandwich in January after debuting three varieties of premium-chicken sandwiches in August and \$2.99 fruit-and-walnut salads in May. McDonald's plans to add an Asian-chicken salad later this month.

--With reporting by Charlie Stein, Howard Liberman and Tony Kono in New York. Editor: Zahradnik.

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