

McDonald's Net Falls 10% on Profit Repatriation Costs (Update2)
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(Adds gross margin in the eighth paragraph. Updates shares.)

By Chris Burritt

July 21 (Bloomberg) -- McDonald's Corp., the world's largest restaurant chain, said second-quarter profit fell 10 percent because of costs to repatriate earnings. European sales slipped for the first time since 2003.

Net income fell to \$530.4 million, or 42 cents a share, from \$590.7 million, or 47 cents, a year earlier. Sales rose 7.8 percent to \$5.1 billion, Oak Brook, Illinois-based McDonald's said today in a statement.

Tax costs to bring home \$3.2 billion in foreign profits cut net income by 9 cents a share at McDonald's, which announced last week that it had earned about 42 cents in the quarter. Sales dropped 0.3 percent in Europe, where Chief Executive Jim Skinner last month named a new chief as Germany's near-record jobless rate halted a year and a half of gains.

``The question is, Can they sustain the growth domestically, and is Europe going to turn around?'' said Peter Goldman, who helps manage \$900 million including 306,000 McDonald's shares at Chicago-based Chicago Asset Management. ``A lot of the easy work has been done with the menu changes.''

The company, which has had more than two years of sales gain by expanding beyond burgers and fries, added \$2.99 fruit-and-walnut salads to spur U.S. sales and used \$1 coupons to prompt health-conscious consumers to give the new item a try. U.S. sales rose 4.8 percent, leading a 2.8 percent gain worldwide.

Shares of McDonald's fell 34 cents to \$30.56 at 10:04 a.m. in New York Stock Exchange composite trading. The shares jumped 4.7 percent, their biggest gain in nine months, on July 15 after the company's preliminary figure for second-quarter profit beat analysts' estimates by 3 cents a share.

Higher Costs

Higher employee stock compensation lowered profit by 2 cents, the company said. Higher costs for commodities, rent and employee pay in the U.S. and higher marketing expenses in Germany and the U.S. narrowed the operating margin of company-owned restaurants to 14.8 percent from 15.4 percent, according to a securities filing today.

Gross margin, or the portion of sales left after subtracting the cost of goods sold, narrowed to 31 percent from 31.7 percent.

McDonald's, which has more than 31,500 restaurants in 119 countries, has met or exceeded analysts' estimates in four of the past five quarters.

European Menu

``The street consensus is that if Europe does not turn around, it almost doesn't matter what the U.S. does,'' said Chandy Smith, an analyst at New York-based New Amsterdam Partners, which manages \$4.5 billion including almost 1.8 million McDonald's shares on March 31. ``The question is the European economy.''

A year earlier, McDonald's profit climbed 25 percent as the chain debuted salads in 15 European countries, trying to match the U.S. success of \$3.99 meal-sized salads rolled out in 2003.

``The push is still on healthier products'' in the U.K, A.G. Edwards & Sons Inc. analyst Jack Russo wrote July 15. ``McDonald's continues to attempt to change consumers' perceptions.''

The St. Louis-based analyst is one of 12 tracked by Bloomberg who rates McDonald's as ``buy.'' Eight others says ``hold.''

McDonald's U.S. comparable-store sales increased 9.6 percent in 2004, their biggest annual rise in 30 years.

Germany

McDonald's has expanded its discount menu in Germany to 11 items including a dark-meat chicken sandwich that sells for one euro. Its U.K. billboard campaign pushed fruit, bagels and salads as menu options. European sales rose 1.3 percent through June, slowing from 4 percent a year earlier.

McDonald's promoted Denis Hennequin to president of its 51-country European region in June as German consumer confidence fell a third straight month. Hennequin succeeded Russ Smyth, who left for personal reasons, McDonald's spokesman Walt Riker said.

Joblessness in Germany, Europe's largest economy, is hurting sales growth at the chain's 1,260 restaurants there, McDonald's President Mike Roberts said in April. The country's unemployment rate was 11.7 percent in June.

Skinner, 60, plans to debut three varieties of premium chicken sandwiches in the U.S. Aug. 2, widening McDonald's offerings to attract consumers who shun burgers and fries. The addition of sliced apples to Happy Meals and white-meat Chicken Selects strips has raised average prices and pushed U.S. comparable-store sales higher for 27 straight months.

``Products that are premium-priced expand the audience,'' said Jeffrey Malcom, who helps Towson, Maryland-based Horan Capital Management manage \$215 million including 192,160 McDonald's shares.

Wendy's

McDonald's has taken sales from No. 3 U.S. hamburger chain Wendy's International Inc., which said July 7 second-quarter sales at U.S. company-owned restaurants dropped 4.6 percent, its third consecutive quarterly decline.

McDonald's expects to shift about \$3.2 billion in cash from international operations to the U.S. in the coming year. Under a law enacted in October, U.S. companies have a year to repatriate profits at a tax rate of 5.25 percent rather than the usual 35 percent corporate rate. Many companies have kept earnings abroad to avoid paying taxes in two countries.

The company repurchased about \$600 million in shares last quarter. For the first six months, McDonald's net income rose 14 percent to \$1.26 billion, or 98 cents a share. Revenue climbed 8.4 percent to \$9.9 billion.

--Editor: Blooston

Story illustration: See {MCD US <Equity> DES7 <GO>} for McDonald's sales by geographic area. To compare the company's share performance against rivals, see {S5REST <Index> MRR <GO>}. For Chief Executive Jim Skinner's profile, see {BBDP 1453821 <GO>}. For top retail stories, see {RTOP <GO>}.

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