

Taking Stock: McDonald's arches are pure gold again

by *Malcolm_Berko*

Dear Mr. Berko: I own 100 shares of McDonald's, which I bought at \$38 even though you told me not to buy it last September and it's now \$51. Now I'm thinking of buying 150 shares of Burger King because my broker says it's going to be a better company than McDonald's and has more growth potential. Please give me your thoughts on this. I might even sell my McDonald's if you recommend it.

D.P.

Cleveland

Dear D.P.: I certainly gave you poor advice on McDonald's so perhaps I can redeem myself with the following response. But you know the old expression: "Fool me once ...!"

Hands down, hands up and in your pocket McDonald's Corp. (MCD-\$51) with \$18.40 in revenue per share is a far superior company in almost every way to Burger King Holdings Inc. (BKC-\$26) with \$16.60 in revenue per share.

While most burger aficionados would agree that BKC's Whoppers are juicier, tastier, more savorous and toothsome than MCD's burgers, most stock analysts would concur that MCD is, by orders of magnitude, a superior company to BKC. In fact, many analysts would suggest that BKC is egregiously overpriced compared to MCD.

The proof is in the numbers. BKC's net profit margins are a dinky 4.4 percent while MCD's net profit margins are a sweet 16.7 percent. In other words, MCD makes almost four times more money for every dollar of sales than BKC. BKC's return on assets is 6.3 percent versus MCD's is a lovely 11.4 percent. That's a heck of a significant difference, too. BKC's 6-cent dividend doesn't hold a candle to MCD's dividend of a \$1. BKC

has a niggardly \$142 million in cash, which computes to about \$1.05 per share while MCD has hefty \$2.5 billion, which computes to \$2.11 per share. Cash is king at MCD. BKC has about 98 cents in free cash flow per share while MCD has nearly \$2 in free cash flow per share.

But I'm concerned about BKC's cosmic price-earnings ratio of 35. I don't know of any restaurant stock that approaches this dangerously elevated number. Domino's Pizza Inc. trades at 17 times earnings, Jack in the Box Inc. trades at a 20 P/E, Papa John's International Inc. has an 18 P/E, Sonic trades at a 21 P/E, Steak n Shake Co.'s P/E is 17, YUM Brands Inc. (KFC, Taco Bell and Pizza Hut trades at 18 times earnings, Wendy's International Inc. P/E is 24, while McDonald's P/E is 17.4. And there's zero reason on this side of the sun for BKC to trade at twice the multiple of MCD - unless of course Paris Hilton decides to buy controlling interest.

Anyhow, with the exception of Taco Bell, I prefer a Triple Whopper with double cheese to any of the food items offered by the various above menus. And I think BKC's french fries are better, too. But the staff at BKC is, like, Stone Age! BKC service personnel's dark, grungy uniforms fit like spandex, servers look like they sleep in a swamp, refuse to smile and their sour attitudes don't encourage repeat business. Frankly, I get the impression that if BKC workers took longer than 30 minutes for lunch, management will have to retrain them - if they returned.

By comparison, MCD's employees are enthusiastic, wear bright uniforms; they smile, seem to enjoy their jobs and appear to have fun. They're for the most part clean and attractive employees, the service is good, the units and rest areas are clean and I'd rather take my grandchildren to a MCD than a BKC, even though the food is not as good. Besides MCD is child-friendly, the physical plants are bright and colorful and the energy level makes a MCD trip an event for the kids to anticipate.

MCD (\$22 billion in revenues) has 10 times the revenues of BKC and MCD's \$3.2 billion in net profits is 30 times the \$101 million earned by BKC. However, a significant difference between the two burger-makers is their clientele. The MCD customer is a bit more affluent, has a higher ticket total, is more likely to bring a child or family, is a loyal customer and less likely than a BKC consumer to visit another hamburger chain.

So no, don't buy BKC and don't sell your MCD. If you want to own another burger joint, consider 200 shares of Sonic Corp. (SONC-\$20.60). That's a real fun place to eat and visit especially on Friday and Saturday nights.

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