

# Compare the financial situations of two companies essay sample

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This report is to compare the financial situations of two companies in the restaurant industry, Darden Restaurants Inc. of Florida and Brinker International Inc. of Texas. The report will provide a detailed analysis and summary of several things including financial analysis, industry history and analysis, both companies history and analysis, vertical and horizontal analysis, and the creditworthiness of each company.

These analysis' that we are going to conduct will provide us with a myriad of information about the two companies and how they compare to each other.

In comparing the companies to each other it is important to take into account the liquidity or ability of a firm to meet its current obligations, and solvency analysis, which is a firm's ability to meet interest payments and other financial long term obligations. Profitability is also very important to gauge along with the activity ratio's which give us insight into how a company is managing its assets and running its business in general.

(Accounting Text and Cases, 10th Edition, By Anthony, Hawkins

and Merchant. New York: Irwin/McGraw-Hill, Inc., 1999. This report will give us in depth analysis on the two companies financial position and will help in determining which company is healthier financially.

## History and Development

### Restaurant Industry History

The restaurant industry historically has been an increasingly competitive industry and a widespread industry as well. Companies in this industry can

compete on a variety of different things including taste of food, quality, service, timeliness of food, atmosphere or different food products.

Darden Restaurants Inc.

Darden Restaurants is the world's biggest restaurant operator. The company is in the business of restaurant dining for customers who enjoy somewhat "relaxed" dining, and eating Italian and seafood in the United States and Canada. (99 Darden Restaurants 1999 Annual Report.) This is evident because as far as customers are concerned they generally dress down when they go out to restaurants such as the Olive Garden or Red Lobster. It is the kind of atmosphere in those Darden restaurants that is not very upscale but you couldn't go in there with a bathing suit on either. It is sort of in between.

As far as product is concerned it is seafood because that is generally what red lobster serves and Italian because that is what Olive Garden serves.

Geographic area is considered the United States because these restaurants are all over the states with 1094 total between Red Lobster and Olive Garden. They also have

a Bahama Breeze restaurant in six locations throughout the United States.

Darden is also present in Canada with 39 restaurants. (99 Darden Restaurants 1999 Annual Report.

Brinker International Inc.

Brinker has a similar market to Darden in that it competes in the Italian foods industry with their Macaroni Grill restaurant and Maggiano's Little Italy Italian

Restaurant. (Brinker International Annual Report) These two restaurants are direct competitors of Darden's Olive Garden. The markets are similar and also the atmosphere for each is casual much in the same way that Olive Garden's atmosphere is.

As far as Brinker their market is very close to that of Darden because they compete with Olive Garden with their own Italian restaurants. As far as Italian food goes, these two companies compete not only in the same product but the same type of atmosphere for customers who are looking for the same thing. Brinker also offers customers a choice of Mexican food with their Chili's restaurants in certain markets this product offering is different from Darden because Darden does not offer Mexican.

## Financial Analysis

### Liquidity

Liquidity is the measure of a company's ability to meet its current obligations. It is normally measured using the company's current and quick ratio's. The current ratio is measured in terms of current assets/current liabilities while the quick ratio is measured in terms of monetary current assets/current liabilities. (Accounting Text and Cases, 10th Edition, By Anthony, Hawkins and Merchant. New York: Irwin/McGraw-Hill, Inc., 1999.)

### Liquidity Analysis of Darden Restaurants Inc.

Current Ratio = 0.48

In the year 2000 the current assets of Darden equaled \$290,500,000 while the current liabilities equaled \$606,900,000.

Quick Ratio = 0.1

In the year 2000 Darden had monetary current assets of \$60,000,000 while current liabilities was \$606,900,000.

### Liquidity Analysis of Brinker International Inc.

Current Ratio = 0.57

In the year 2000 the current assets of Brinker International equaled \$131,700,000 while current liabilities equaled \$231,000,000.

Quick Ratio = 0.20

In the year 2000 Brinker International had monetary current assets of \$46,700,000 while current liabilities equaled \$231,000,000.

### Liquidity Analysis of the Restaurant Industry

The industry average current ratio for the year 2000 was 0.6, while for the quick ratio it equaled 0.3.

These numbers come out to be lower than what is considered average for a normal manufacturing company in which a satisfactory current ratio is 2.0

while a good quick ratio is considered 1.5. However according to my research on the industry those numbers seem to be the norm.

We can see that Brinker has the better ratios as far as liquidity is concerned with a slightly better ratio in both the current ratio and quick ratio than Darden. Brinker is also more in line with the industry standard than Darden is, with Darden's liquidity slightly below the norm for restaurants of its type. This indicates to us that Brinker would be better able to meet its current financial obligations as opposed to Darden.

### Activity Analysis

Activity analysis is done to determine a company's use of assets and how effectively managed the company is overall. In determining this we use several different ratios including the P/E ratio, return of assets, return of equity, and return on invested capital.

P/E is determined by price per share/net income per share. Return on assets is determined by Net income/total assets. Return on equity is determined by net income/stockholders equity. Finally, invested capital is determined by net income/long term liabilities + stockholders equity.

### Activity Analysis for Darden Restaurants Inc.

Current P/E ratio = 15.4

This is an up to date ratio using today's numbers.

Return on Equity (year 2000) = 19.2

Return of Equity (3-year average) = 07. 7

Return on Assets (year 2000) = 09. 1

Return on Assets (3-year average) = 04. 1

Return on Capital (year 2000) = 13. 2

Return on Capital (3-year average) = 5. 90

Activity Analysis for Brinker International Inc.

Current P/E ratio = 22. 1

This is an up to date ratio using today's numbers.

Return on Equity (year 2000) = 16. 20

Return of Equity (3-year average) = 11. 70

Return on Assets (year 2000) = 10. 50

Return on Assets (3-year average) = 07. 20

Return on Capital (year 2000) = 14. 00

Return on Capital (3-year average) = 09. 20

Activity Analysis For the Restaurant Industry

P/E ratio for the year 2000 was 18. 20

Return on Equity (year 2000) = 20. 00

Return on Assets (year 2000) = 08. 20

Return on Capital (year 2000) = 11. 70

We can see that Brinker has a higher P/E ratio currently than does Darden Inc. This indicates to us that they are getting a better price per share for the income they are earning than Darden is.

As far as return on equity over a three year period Brinker is earning more income per stockholders equity than Darden did but in the year 2000 alone Darden had a better ratio than Brinker.

When considering return on assets, we can see that Brinker has consistently been earning a better return on their assets than Darden has, year 2000 included.

In our analysis of return on capital the same scenario is true in that Brinker is getting better returns on their capital more consistently than that of Darden.

When considering these companies with the industry average we can see that both companies are above average in the industry in almost every category with Brinker being just slightly more above average than Darden. The only exception to this statement is where Brinker is lower than industry average in return on equity in the year 2000, the same year that Darden had a better ROE than them.

Solvency Analysis



Solvency is the term used when discussing a companies ability to cover interest and payments on long term liabilities. (Accounting Text and Cases, 10th Edition, By Anthony, Hawkins and Merchant. New York: Irwin/McGraw-Hill, Inc., 1999.)

In analyzing this aspect of a firm's financial strength we use the debt/equity ratio, the timed interest earned ratio, and the financial leverage ratio.

The debt/equity ratio is expressed as long term liabilities/shareholders equity. The times interest earned ratio is pretax operating profit + interest/interest, while the financial leverage ratio is assets/shareholders equity. (Accounting Text and Cases, 10th Edition, By Anthony, Hawkins and Merchant. New York: Irwin/McGraw-Hill, Inc., 1999.)

Solvency Analysis for Darden Restaurants Inc.

Debt/Equity Ratio = 00. 45

Times Interest Earned Ratio = 12. 10

Financial Leverage Ratio = 2. 10

Solvency Analysis for Brinker International Inc.

Debt/Equity Ratio = 00. 16

Times Interest Earned Ratio = 24. 00

Financial Leverage Ratio = 01. 60

Industry Solvency Analysis

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Debt/Equity Ratio = 00. 70

Times Interest Earned Ratio = 06. 40

Financial Leverage = 02. 40

In analyzing both of these company's debt to equity ratio we must realize that the lower this ratio gets the better it is for the company. Understanding this enables us to see that compared to the industry both companies are above average with Brinker's debt to equity ratio being better than Darden's.

In analyzing the times interest earned ratio we see how much pretax profit per interest payments owned the company has. In this analysis both companies are well above average in their ability to cover their interest with Brinker being well above Darden in their ability to pay off interest owed.

In looking at the financial leverage ratio we see how many assets a company has per equity. In this instance both companies have ratio's below the average for the industry. (Darden Restaurants Inc. Annual Report for year ending 2000) and (Brinker International Inc. Annual report for year ending 2000)

### Profitability Analysis

Profitability ratio's are used in measuring a firms profit. In measuring a firms profit in general, revenue is analyzed in relation to a firms expenses. The ratio's we use in this analysis are gross margin percentage, net profit margin, and eps (earnings per share). Gross margin percentage is measured by gross margin/net sales revenues. Profit margin is measured by net

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income/net sales revenues, and earnings per share is calculated by doing net income/number of shares outstanding. EPS is generally expressed in dollars while the other two ratio's are generally said in percentages. (Accounting Text and Cases, 10th Edition, By Anthony, Hawkins and Merchant. New York: Irwin/McGraw-Hill, Inc., 1999.)

Profitability Analysis for Darden Restaurants Inc.

EPS = \$32. 10

EPS (3-year average) = \$32. 98

Gross Margin Percentage = 22. 20%

Gross Margin Percentage (3 year average) = 20. 9%

Net Profit Margin = 04. 90%

Net Profit Margin (3-year average) = 02. 40%

Profitability Analysis for Brinker International Inc.

EPS = \$26. 90

EPS (3-year average) = \$30. 97

Gross Margin Percentage = -8. 0%

Gross Margin Percentage (3 year average) = 17. 90%

Net Profit Margin = 05. 80%

Net Profit Margin (3-year average) = 04.50%

### Industry Profitability Analysis

EPS = 0.80

Gross Margin = 41.9

Net Profit Margin = 6.9

We can tell from doing this analysis that Darden has a better EPS than Brinker meaning that if we were considering this rate in a vacuum Darden would be the more profitable company based on only that. If we look at gross margins Darden again is more profitable than Brinker, with Brinker lingering even below what is average for the industry in this ratio. If we look at net profit margin which measure net income to sales revenue we can see that both companies are below the average for the industry with Brinker earning slightly better margins than Darden. This may suggest to us that because of both these companies enormous size compared to the average competitor in the industry they are benefiting from economies of scale despite their low margins. This is confirmed if we look at both sales and income for both the companies which is much higher than industry average in both cases.

### Verticle Analysis

Verticle Analysis is done by dividing every number on the income statement by the sales figure thus giving us a percentage to sales for every expense.

Attached

Horizontal Analysis

Darden Brinker Industry

Current Ratio. 48 . 57 0. 6

Quick Ratio. 10 . 20 0. 3

P/E 15. 4 22. 1 18. 2

Return on Assets 9. 1 10. 5 8. 2

Return on Equity 19. 2 16. 2 20. 0

Return on Capital 13. 2 14. 0 11. 70

Debt/Equity . 45 . 16 . 70

Times Int Earned 12. 10 24. 0 6. 40

Financial Leverage 2. 10 1. 60 2. 40

EPS \$32. 10 \$26. 90 \$0. 80

Gross Margin 22. 20 -8. 0 41. 9

Net Profit Margin 4. 9 5. 80 6. 90

Creditworthiness

In order to judge the credit worthiness of these companies we need to look at several factors including how much each of these companies earn in comparison to industry average and each other, how fast a company is growing and how these companies are financing that growth, how profitable the company is along with looking at the management that is in place and the strategies they are implementing to make the company go. (Accounting Text and Cases, 10th Edition, By Anthony, Hawkins and Merchant. New York: Irwin/McGraw-Hill, Inc., 1999.)

We can break this creditworthiness down into two categories, long and short term. The following is an analysis of the creditworthiness of each of these companies.

#### Short Term Creditworthiness

The short-term credit worthiness of a company is gauged by several factors. Including the ability of a company to pay its interest and principal on short term debts. This can be assessed by looking at the liquidity of a company, along with the consistency of the revenue stream they bring in and the percent of the market they currently hold.

For Darden, there liquidity is somewhat below the industry average but the fact that they are the largest restaurant of its kind for casual dining in the United States and there sales are substantial. They are a good short-term risk.

Brinker is a good short-term credit risk as well because their liquidity is even better than Darden's is. Brinker also is a top market share-holder in the

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industry with sales well above average. They also have strong management in place and in the short term they are a good credit risk.

### Long Term Creditworthiness

The long-term creditworthiness of a company is more dependent on solvency issues. This is whether a company has the ability to pay its interest and principal on long term loans as well as the overall financial strength of a company. The people who lend a money or give credit to a company on a long-term basis want to know that they are going to be paid back, and assured that the company's financial health is strong enough to withstand any tough times. The company must have enough money and clout for a lender to give money long-term. This is determined by looking at ratio's for solvency, the overall management, market position, and strategy of a company.

For Darden, they are the number one market share holder in the industry with more sales than anyone else. (Darden Restaurant Inc. Consolidated Annual Report for year ending 2000) They also have strong management in place. Their solvency ratio's are above or around industry average and they have a strong following in terms of customers. They are very creditworthy long term.

When speaking about Brinker's solvency ratio's they are well above industry average and also even above Darden's ratios. This company has a very strong following in terms of customers, and strong management in place. The company also has a very strong market share despite it not being the leader

in the industry. (Brinker International Consolidated Annual Report for year ending 2000)

### Investment Attractiveness

The investment attractiveness of these companies depends on many things including the financial health of the company and how the public perceives the company. In the real world, and on wall street companies are generally judged a lot on their sales and growth rates. Generally investors look for companies that are outgrowing their peers and have a financially stable base. Investors also look for companies that are under valued as far as price per share. Earnings are looked at in terms of what analysts predict and if the company matched the expectations of the experts or not. Expert investors look for companies that sell and earn consistently more than their peers and have stronger ratio's. Investment attractiveness is also determined by how strong a companies financial margins are compared to their competitors, especially in terms of profit margins. (Accounting Text and Cases, 10th Edition, By Anthony, Hawkins and Merchant. New York: Irwin/McGraw-Hill, Inc., 1999.)

When analyzing the attractiveness of Darden and Brinker as investments I would say that both of these companies are the big earners of their industry.

Darden is a company that has more sales than their competitors, they consistently grow more than their competitors too. Darden's profit margins are not as strong as the industry average but the fact that they make up for that in terms of economies of scale and market share makes them a good



investment. (Darden Restaurants Inc. Consolidated Annual Report for year ending 2000.)

Brinker also is a good investment because its sales and income growth according to their annual report is much higher than the industry average. Brinkers net profit margin is not as high as the industry average but they are in the same situation as Darden in that they utilize economies of scale. (Brinker International Inc. Consolidated Annual Report for year ending 2000.)

### Conclusion

In conclusion to this report about Darden Restaurants Inc. and Brinker International Inc. we found out the financial strength and abilities of the two companies. We looked at the two companies in comparison to each other and also compared to industry average.

We found out that in terms of sales and market share Darden is the strongest company in the industry and is a very good investment and credit risk. They utilize economies of scale. They have better debt/equities ratio's than the industry average which makes them a better long term risk. Darden is an industry leader in all aspects of their financial well being and should be a force in the casual restaurant industry for some time.

Brinker is also a leader in the industry with over \$2 million in sales. This company is a good credit risk and a good investment as well because it out performs its competitors in the industry on all the fundamental ratio's that determine a companies financial well being.

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