
Transformation Action Plan (TAP)



TAP Section 2: Part 1A & 1B of MCD Simulation

- In order to ensure you have mastered the best practices covered in this workshop, you will work through the primary steps of the SHARE™ framework in order to forecast the future valuation multiple for a stock, specifically, McDonald's (MCD).
 - In this section of your TAP, you will:
 - Classify if MCD's historical relative valuation has been primarily moving cyclically or secularly
 - Identify the cause of the historical premium or discount in MCD's P/E ratio relative to peers and a broad index
 - Use the data below to answer the questions, as though it is currently late December 2011
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Part 1A of MCD Simulation: Cyclical, Secular or Both

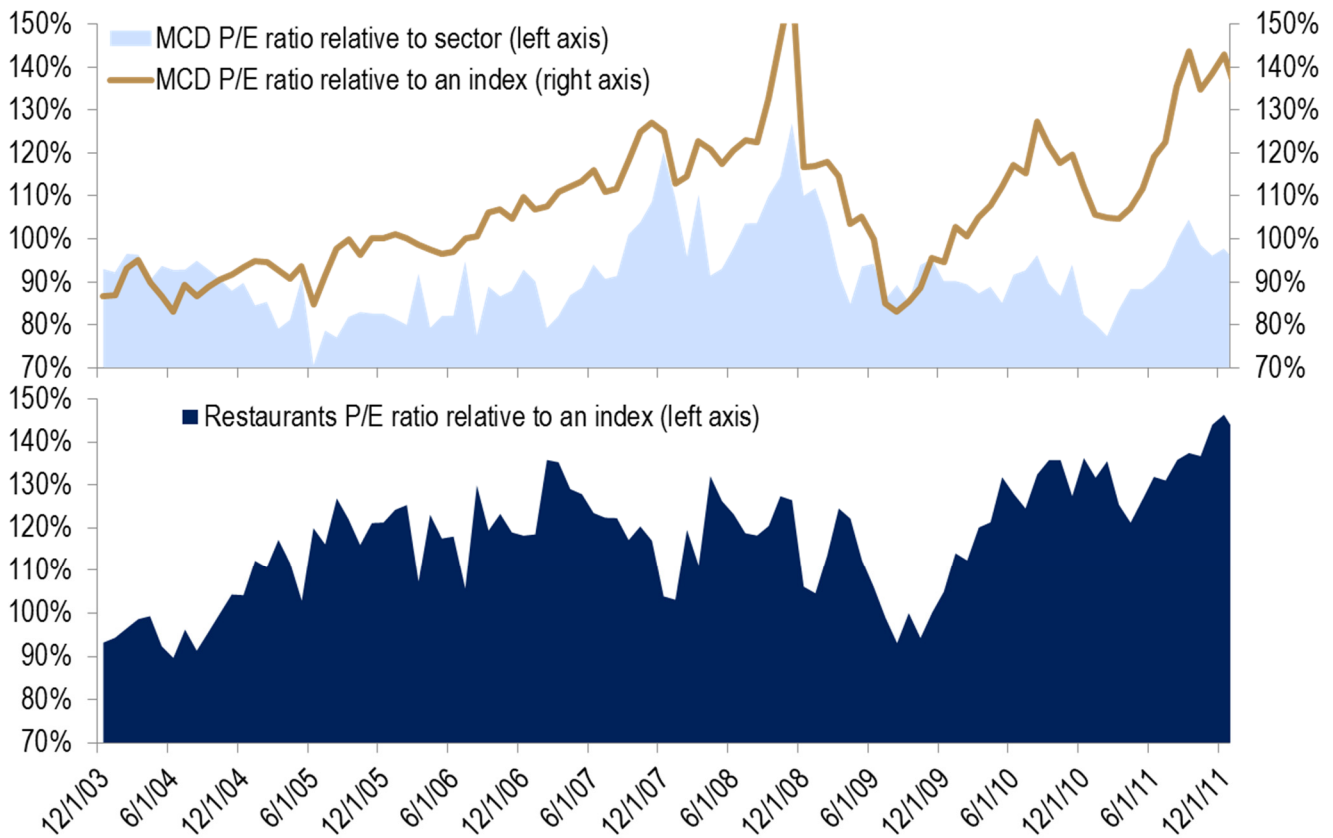
Reviewing the light blue area in the first chart below, determine if MCD's P/E ratio relative to the sector over this 8-year time period was primarily cyclically-moving or secularly-moving (ignore the tan line and dark blue area chart for this question):

Answer:	
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Reviewing the dark blue area chart below, determine if the restaurant sector's valuation relative to the index (S&P 500) over this 8-year time period was primarily cyclically-moving or secularly-moving (ignore the tan line and light blue area chart for this question):

Answer:	
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After answering the questions above, continue to the next page to complete Part 1 of the MCD simulation



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Part 1B of MCD Simulation: Cause of the Premium or Discount

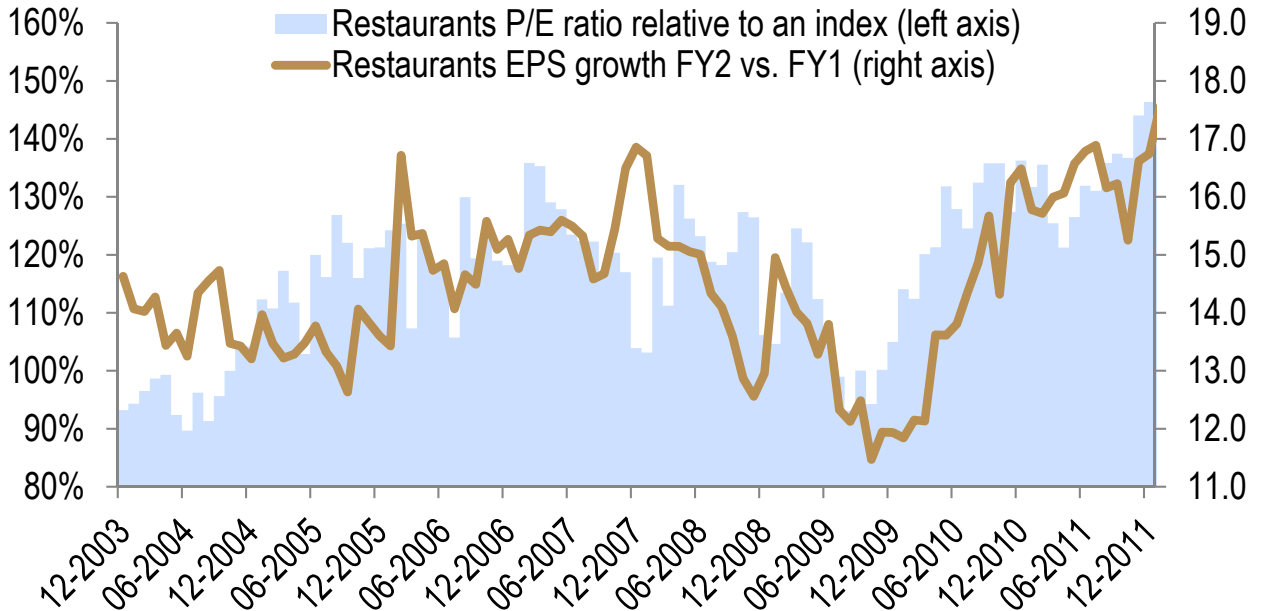
Review each of the charts below and evaluate the variable (tan line) in terms of being:

- Helpful in evaluating the level of the sector's or stock's relative P/E ratio
- Not helpful in evaluating the level of the sector's or stock's relative P/E ratio

Note the light blue bars are measuring one of these two elements in each chart:

- The restaurant sector's P/E ratio relative to a broad index (S&P 500); or
- MCD's P/E ratio relative to the restaurant sector

Chart 1: Restaurant Sector

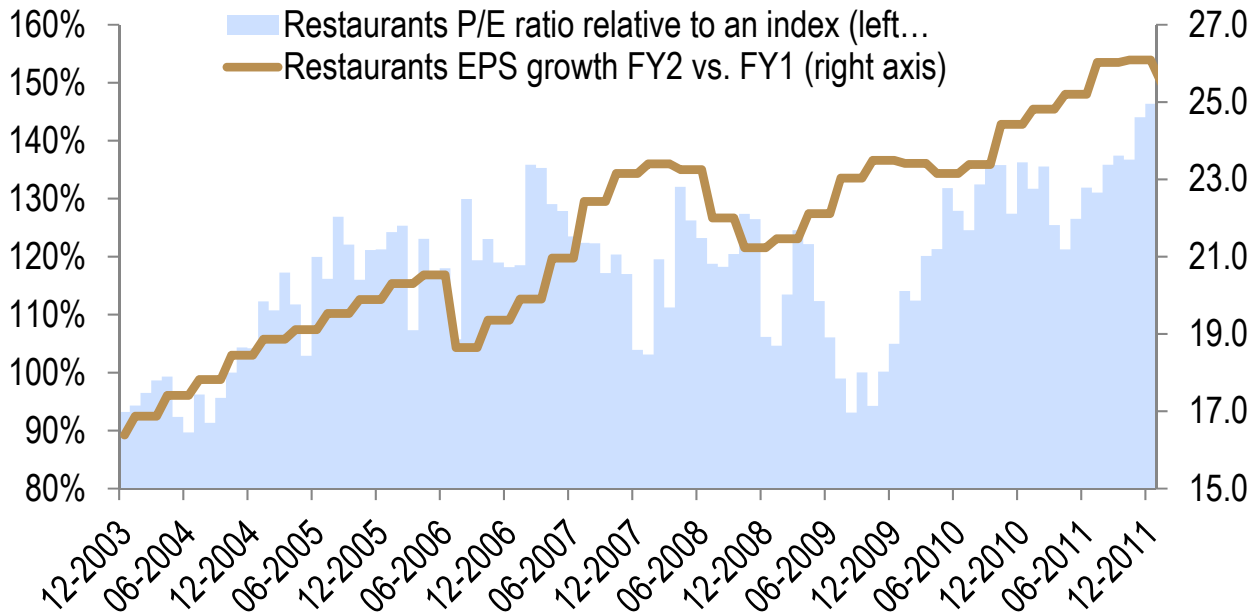


Circle or bold your answer below regarding the chart above:

Appears Helpful	Does Not Appear Helpful
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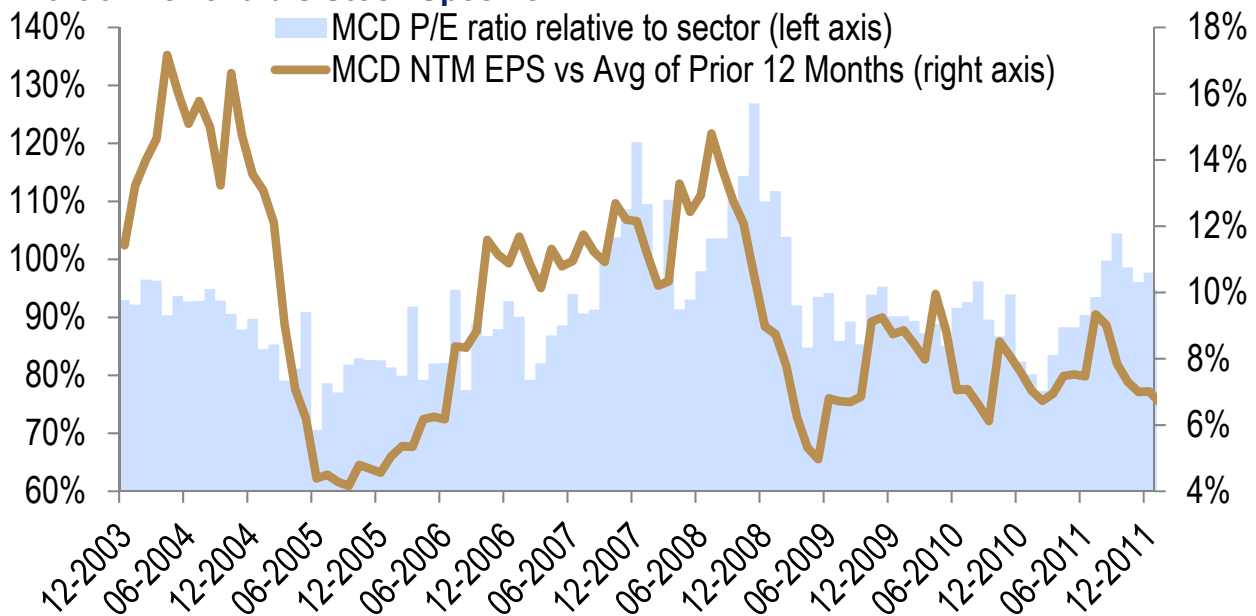
Chart 2: Restaurant Sector



Circle or bold your answer below regarding the chart above:

Appears Helpful	Does Not Appear Helpful
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Chart 3: McDonald's Stock Specific

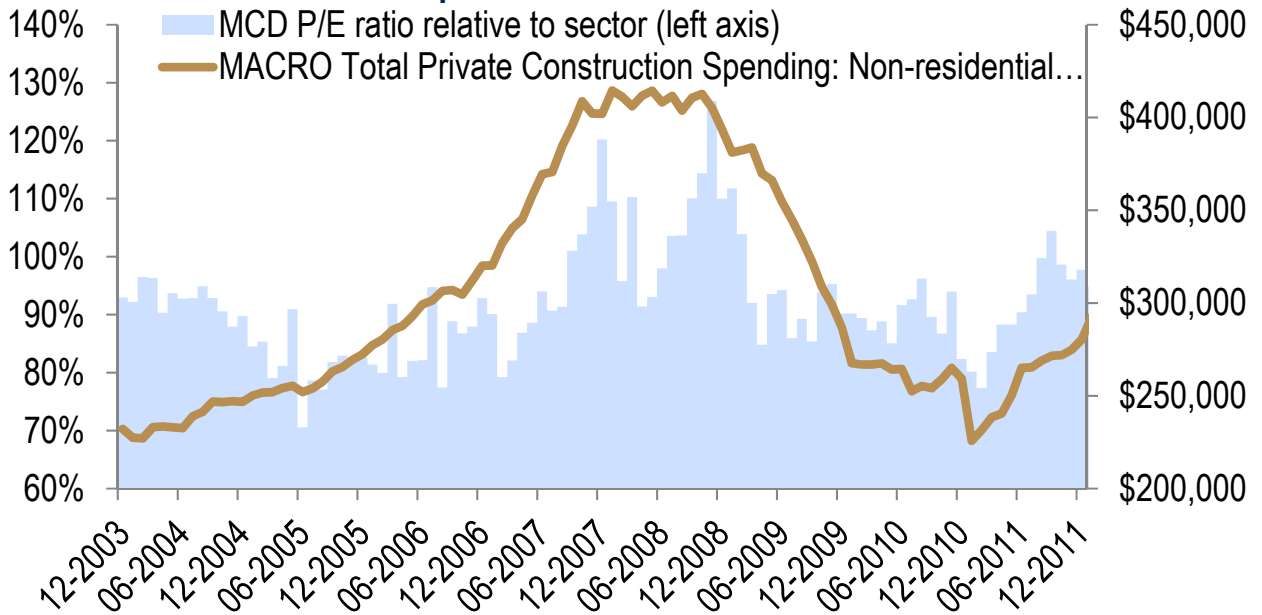


Circle or bold your answer below regarding the chart above:

Appears Helpful	Does Not Appear Helpful
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Chart 4: McDonald's Stock Specific



Circle or bold your answer below regarding the chart above:

Appears Helpful	Does Not Appear Helpful
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Answer Key for the MCD Simulation Part 1A: “Cyclical, Secular or Both”

- MCD’s P/E ratio relative to the restaurant sector appears to be cyclical because it’s not reaching new highs or new lows over more than one economic cycle
- The restaurant sector’s P/E ratio relative to the index appears to be predominantly cyclical, but given that it achieves an all-time high in late 2011, higher than any point of the prior economic cycle suggests there may be a slight secular element at work here as well

Answer Key for the MCD Simulation Part 1B: “Cause of the Premium or Discount”

The answer is all four charts help explain some of the fluctuation of MCD’s P/E relative to the index, explained in part by sector issues as well as stock-specific issues. In the table below, the right-most column shows the correlation coefficient between each of the two data series. The ones with the highest correlation presumably would be the most helpful.

Chart #	Variable Being Predicted	Variable explaining relative valuation	“Helpful”	Correlation Coefficient
1	Restaurant Sector P/E Relative to Index	Restaurant Sector’s Change in NTM EPS FY2 vs FY1	Yes, see correlation coefficient	(47%)
2	Restaurant Sector P/E Relative to Index	Restaurant Sector’s ROE	Yes, see correlation coefficient	(58%)
3	MCD’s P/E Relative to Restaurant Sector	MCD’s NTM EPS vs. 12 Month Average	Yes, see correlation coefficient	(40%)
4	MCD’s P/E Relative to Restaurant Sector	MCD’s NTM EPS vs. Private Construction Spending	Yes, see correlation coefficient	(56%)

Hopefully it’s becoming clear that there is value in finding a strong correlation between data and a sector’s or stock’s relative P/E ratio. Because:

- If the current figure is not on-trend, it forces the all-important research to better understand why, specifically why has the market psychology towards this stock changed from the past trends; and
- By accurately forecasting the company-specific data and having an understanding of the macro data trend, provides the foundation for a much more accurate future price target than simply using today’s valuation levels