GROUP WORK ASSIGNMENT

GESTÃO FINANCEIRA II

UNDERGRADUATE PROGRAMS

1st SEMESTER 2012-2013

The Group Work Assignment of Gestão Financeira II involves solving a practical corporate investment project case. This requires a sound knowledge of cash flow forecasting, determining cost of debt and cost of equity in different industries, making credible assumptions about different scenarios, and decision-making.
The case-study is briefly summarized in the next page, but please read first the rules of the game.

Rules of the Game:

1. **Important Dates:**
   Group Composition by November 9th, 2012: Each group must give to one of the course instructors a sheet of paper containing – for each member of the group: name, student number, photograph, and class (turma) attended.
   Final Due Date is December 10th, 2012: you can hand in your assignments to your class instructor (during any class before the deadline) or address it to Professor Clara Raposo (Gabinete 616) – at the reception of the ISEG building in Rua Miguel Lupi, No. 20;

2. **Each group must be of 4 to 5 students**. If any of you has a problem in finding partners, let your class instructor know as soon as possible, and a solution will be found.

3. **The assignment involves producing three elements:**
   A Report written in Microsoft Office **word**, discussing your choice of methodology, assumptions, computations, tables, and conclusions (MAXIMUM 10 pages A4);
   A Spreadsheet in Microsoft Office **excel** in a cd-rom, supporting your written report with calculations;
   A Presentation in Microsoft Office **powerpoint** included in the cd-room.

4. Any group and group member may be asked by the course instructors to **present** their assignment.

CASE DESCRIPTION:
INTRODUCING McDONALD'S NEW MENU

McNAIL in granny's Bread with portuguese fries

DISCLAIMER: Most numbers provided regarding investment and quantities are totally fictional!!!

From McDonald's Corporation's website:
"Can you imagine a world without the Big Mac? Or Chicken McNuggets? Or Happy Meals? Luckily, back in 1954, a man named Ray Kroc discovered a small burger restaurant in California, and wrote the first page of our history. From that humble start as a small restaurant, we're proud to have become one of the world's leading food service retailers, with more than 33,000 restaurants serving nearly 68 million people in more than 119 countries every day.
Since 1955, we've been proud to serve the world some of its favorite food. And along the way, we've managed not just to live history, but create it: from drive-thru restaurants to Chicken McNuggets to college credits from Hamburger U and much more. It's been quite the journey, and we promise this is just the beginning - we've got our hearts set on making more history."

The fictional component of the assignment comes next.

With the aim of making more history McDonald's Corporation is developing a new product, which will be introduced in the US market in 2013.

Inspired by the traditional Portuguese "prego no pão", and after the success of the McBifana menu in Portugal, the company is conceiving the new menu **"McNail in granny's bread with Portuguese fries"**. This new menu consists of a tender steak served in the traditional Portuguese granny's bread, together with Portuguese fries, which are deep fried round slices of potato, and a soft drink. For those who wish to add in a dessert there is a choice between the healthy sliced "Portuguese Rocky Pear" and the sweeter pastry "Portuguese Nata".

The US market represents 32% of the total revenues of McDonald's corporation in 2011. We consider that the new menu will be introduced only in those restaurants that are directly operated by McDonald's, but not by its franchisees. In 2011 the total revenues of McDonald's own-operated restaurants in the US were $4,433 million. The operating margin was approximately 20% of the revenues.

To introduce the new project, the company will have to make immediately some investment in fixed assets – some restaurants require modernization and new equipment needs to be acquired in order to bake the new bread and slice the new potatoes. The estimated capital expenditure is around $30 million. The new assets have a life of 15 years.

The price of each meal (with the option of dessert or not) is… your choice! Be creative and give us your personal estimate, explaining your choice.

The number of "McNail menus" sold is also going to be estimated by… you! (Remember that you know the total revenues of the company in the US restaurants; given some average menu price you can try to "guess" what's the number of menus per year that McDonald's sells in the US. You then need to assume that the McNail menu will attract some reasonable % of new customers, and old customers too).

Don't forget also to consider possible side effects, such as the potential of the McMail Menu to cannibalize other menus, or the potential of increasing sales in the McCafe because of the "Portuguese Nata".

Selling, general and administrative expenses are 9% of the annual revenues of the new project. Annual Net working capital will be about 10% of the revenues of the following year.

As a newly hired expert in the capital budgeting division you have been asked to evaluate the new project. You will compute the appropriate cash flows, costs of capital and the net present value. You must seek out the information necessary to value the free cash flows. But you'll be given some directions to follow!

Additional Help on How to Get More Information:

Data on McDonald's Corporation (quote MCD) is available at Yahoo Finance (http://finance.yahoo.com):

- *Go to Yahoo Finance (http://finance.yahoo.com) and get the quote for McDonald's Corp (symbol: MCD). If you click "Key Statistics", in the bottom of the page you will find "View Financials". You can then choose to view "Income Statements", "Balance Sheet" or "Cash Flow", for the last 3 years (select Annual Data).*

- *For the cost of debt (r_D) you can go to NasdBondInfo.com, (http://cxa.marketwatch.com/finra/BondCenter/Default.aspx), and click to search by symbol. Enter the symbol MCD, which is the ticker for McDonald's Corporation. After entering McDonald's symbol, you select the "Corporate" toggle, and press "Enter." You should have access to McDonald's average **credit rating** for long-term bonds.*

- *For the cost of equity (r_E) you can get **the yield on U.S. Treasury Bonds** from Yahoo! Finance (http://finance.yahoo.com). If you scroll down to the Market Data, on the right hand side, you select "Bonds" and then you have information on the Yield to maturity. Enter that yield as the risk-free rate. To find the **beta** for McDonald's Corporation use (http://www.nasdaq.com/symbol/mcd), where MCD is the ticker for McDonald's Corp. (Sometimes you must be patient.)*

- *Use a **market risk premium** of 4.00%.*

- *To compute the **net debt** for McDonald's, add the long-term debt and the short-term debt and subtract cash and cash equivalents for each year on the balance sheet.*

- *To compute McDonald's **market capitalization** at the end of each fiscal year multiply the historical stock prices by the "Basic Weighted Shares Outstanding" data at the end of the income statement that you can find in http://www.marketwatch.com/investing/stock/mcd/financials.*

- *You may also get information on **industry** betas from http://pages.stern.nyu.edu/~adamodar/ by selecting Updated Data/ Levered and Unlevered Betas by Industry.*

- *You are also advised to visit McDonald's Corporation's site and its annual reports.*

QUESTIONS

1. Estimate the FCFs of the new project “McNail”. Explain your assumptions.

2. Assume that the project is financed exclusively with equity (unlevered). Is this new investment valuable? Explain your answer.

3. Perform reasonable sensitivity and /or scenario analysis on your main assumptions. Explain.

4. Now assume that the project uses a target capital structure, which is equal to the firm’s average capital structure of the last 3 years. Compute the WACC rate, and re-evaluate the project. Comment.

5. Now imagine that the cash flows of this project were actually related to another project that the company wants to start in a totally different industry – the tobacco industry – to be financed with a target debt-to-equity ratio of 1.25. What would the NPV be in this case?