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McDonald's Faces Pressure From Ackman, Person Says (Update2)
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(Adds investor comment in 16th paragraph.)

By Chris Burritt and Josh Fineman

Sept. 27 (Bloomberg) -- McDonald's Corp. faces pressure again from investor Bill Ackman, who plans to buy more than \$2 billion of the company's stock and may wage a proxy fight to push the restaurant chain to increase its share price, a person familiar with the matter said.

Ackman's Pershing Square Capital Management LP, a New York-based hedge fund, is raising money to buy even more McDonald's stock, the person said. At yesterday's closing price, a \$2 billion purchase would give Pershing Square about 51 million shares, or a 4.2 percent stake, making it McDonald's third-biggest shareholder, according to data compiled by Bloomberg.

McDonald's, the world's largest restaurant company, has increased profits for three straight years and the shares have gained 19 percent since Ackman first disclosed an investment last year. He says that isn't enough and the stock should be as high as \$61. Ackman, who holds an MBA from Harvard Business School, formed Pershing Square in 2004 with \$54 million raised from three investors.

"The more stock we own, the greater influence we can have," Ackman, 40, wrote in a five-page letter to investors. "We need to be a large shareholder with the associated voting power to lead a credible proxy contest so that our ideas are considered more seriously by all stakeholders."

Bloomberg News obtained an undated copy of the letter, which a person familiar with the matter said was sent to potential investors in the past week. Ackman declined to comment.

Tripling Share Price

McDonald's spokeswoman Mary Kay Shaw said the more than tripling of the company's share price since early 2003 is "a clear indication of the confidence investors continue to have in McDonald's business strategies." The company today raised its annual dividend to \$1 a share from 67 cents.

McDonald's declined to comment on Pershing Square's letter, Shaw said.

The \$2 billion or more in planned purchases includes the more than \$793.8 million in stock McDonald's said Ackman planned to buy in a Sept. 1 regulatory filing. Pershing Square received U.S. antitrust approval to purchase that amount on Sept. 12.

Ackman sold a previous stake in McDonald's and owned no shares as of June 30, according to a Pershing Square regulatory filing last month.

Shares of Oak Brook, Illinois-based McDonald's rose 78 cents, or 2 percent, to a six-year high of \$39.84 at 12:51 p.m. in New York Stock Exchange composite trading. They are down 18 percent from their record of \$48.38 in November 1999.

Stock Climbs

The stock has climbed 18 percent this year, with more than half of the gain since Aug. 31, the day before McDonald's disclosed Ackman's plans to buy stock.

Ackman's letter doesn't spell out new steps he thinks McDonald's should take other than those he proposed last year,

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when he urged management to sell a 65 percent stake in McDonald's company-owned restaurants in an initial public offering and borrow \$14.7 billion for a stock buyback.

He said in the letter McDonald's own plan to divest restaurants, repurchase stock and increase its dividend "has not gone far enough."

"As far as our business strategy is concerned, McDonald's performance speaks for itself," Shaw said in an e-mailed statement, citing 40 straight months of higher global comparable-store sales and double-digit gains in per-share earnings the past three years.

Credits McDonald's

In his letter, Ackman did credit McDonald's with introducing new products, restaurant renovations and new advertising that led to sales gains.

"His contention isn't that the company isn't doing well," said Jeffrey Malcom, who helps manage 210,000 McDonald's shares among \$220 million in assets at Horan Capital Management in Towson, Maryland. "He just thinks there are financial ways to structure the business that can result in a higher stock price."

McDonald's posted its biggest profit increase in more than a year in the second quarter on revenue gains in Europe and sales of better-tasting coffee in the U.S. The company bought back \$1.8 billion of its shares in the first half of the year, part of a plan to return as much as \$10 billion to shareholders in dividends and stock repurchases through 2008.

The letter said Pershing Square is seeking indications of interest from investors by this week and that it will require the funding by Oct. 3.

'Financial Engineering'

McDonald's shares would be worth \$45 to \$50 if it adopted his proposals, Ackman told analysts Nov. 14, when the shares closed at \$33.93, 13 percent lower than yesterday's close.

McDonald's Chief Financial Officer Matthew Paull that same day called Ackman's proposal "an exercise in financial engineering" that would risk the company's relations with franchisees and suppliers.

Ackman subsequently said on Jan. 18 that McDonald's might be worth as much as \$61 after taking into account cost reductions.

Pershing Square helped push hamburger chain Wendy's International Inc. to spin off its Tim Hortons Inc. doughnut restaurants last year, boosting Wendy's shares 38 percent. Ackman has also invested in real-estate related companies including First Union Real Estate Equity and Mortgage Investments.

In his letter, Ackman said investor reaction to McDonald's steps "was somewhere between a yawn and a Bronx cheer."

"The company's plan is a step in the right direction, but it has not gone far enough," Ackman said. "If we can convince the company to make additional changes in its structure and approach to capital allocation, or simply if our presence motivates management to do the same, we will have a higher probability of making an even more material profit over the course of the investment."

--with reporting by Charlie Stein in Boston and Karen Moskow, Bernardo Soriano and Vonnie Quinn in New York. Editor: Zahradnik

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