

18 October 2006

Restaurants: New Coverage

The chains have been cooking, still some value left

Initiation of Coverage

Initiating coverage on the restaurant group and four stocks

Our universe includes two Buys and two Holds. YUM! Brands (target price \$66) is our favored large-cap stock and Panera Bread Company (\$81 target) is our growth pick. We think recovery is priced in at McDonald's, while Chipotle Mexican Grill is a great story that also looks fairly valued at current levels.



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DISCLOSURES AND ANALYST CERTIFICATIONS ARE LOCATED IN APPENDIX 1

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The industry has strong fundamentals...

Disposable income is a key driver of restaurant sales growth. Restaurant shares closely track discretionary spending, and valuation also appears well correlated with consumer confidence. The fundamental story: a bigger slice of a bigger pie – i.e., rising disposable income and more away-from-home consumption – goes to convenience and innovative, health-oriented concepts.

...but they're largely priced in

Restaurant stocks have performed well both on a long- and short-term basis, coming off lows reached during the last recession as consumer confidence has recovered. This year, the stocks took a breather over the summer on a sharp decline in confidence, but the S&P Super Restaurants index is up 15% since the end of June as the decline looks to be more short-term in nature than originally feared by the market.

Growth mix: comps (same-store sales) are the key

The market likes data-points and comparable store sales are a key data point historically reported on a monthly basis. While this measure will surely drive sentiment on a longer-term basis as it is a key indicator of restaurant efficiency and brand equity health, we expect monthly comps to go by the wayside. Recent elimination of monthly comp sales reports by SBUX and YUM are just the beginning. A shift to quarterly reporting could shift the trading pattern of the sector to a more long-term focus, thereby reducing volatility.

Bakery Café and Mexican to drive 4%-5% restaurant industry sales growth

By segment, Bakery Café and Mexican are the fastest-growing pieces of the restaurant industry, with 5-year average annual sales growth of 7% and 4.5%, respectively. We expect mid- to high-single-digit growth in Bakery Café, driven by high-end concepts like Panera Bread, and mid-single-digit growth in Mexican on a growing interest in variety and a growing Hispanic demographic. We expect Hamburger and Pizza to grow at rates below industry average and Chicken to grow with or slightly ahead of the industry.

Key valuation methods: P/E, EBITDA, PEG; key risk – discretionary spending

We select what we deem to be an appropriate multiple on our forward EPS and EBITDA estimates based on our assessment of relative growth rates and competitive position. In support, we also employ ROIC and DCF valuations. We regard a slowing economy, characterized by higher fuel expense and declining home values, as a principal risk to continued strong restaurant industry growth. We also cite consumer health and contamination/disease issues, along with commodity input prices.

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Top picks	
Panera Bread Co (PNRA.OQ),USD66.80	Buy
YUM Brands, Inc. (YUM.N),USD58.03	Buy

Companies featured			
Chipotle Mexican Grill, Inc (CMG.N),USD56.80 Hold			
	2005A	2006E	2007E
EPS (USD)	1.43	1.06	1.33
P/E (x)	-	53.6	42.8
EV/EBITDA (x)	-	19.4	15.0
McDonald's (MCD.N),USD42.11 Hold			
	2005A	2006E	2007E
EPS (USD)	2.04	2.41	2.55
P/E (x)	15.6	17.5	16.5
EV/EBITDA (x)	8.5	10.0	9.4
Panera Bread Co (PNRA.OQ),USD66.80 Buy			
	2005A	2006E	2007E
EPS (USD)	1.65	1.96	2.41
P/E (x)	34.8	34.1	27.7
EV/EBITDA (x)	15.0	14.4	11.3
YUM Brands, Inc. (YUM.N),USD58.03 Buy			
	2005A	2006E	2007E
EPS (USD)	2.55	2.93	3.32
P/E (x)	19.4	19.8	17.5
EV/EBITDA (x)	9.7	9.7	8.7
Starbucks Corporation (SBUX.OQ),USD37.93 Hold			
	2005A	2006E	2007E
EPS (USD)	0.61	0.73	0.90
P/E (x)	43.4	52.2	42.1
EV/EBITDA (x)	18.3	21.9	17.7

Table of Contents

Executive summary	3
A growing business.....	5
Growth mix	8
Trends within key segments	10
Making the stocks cook	15
Other key industry risks.....	17
YUM Brands, Inc.	20
Panera Bread Co	42
McDonald's	62
Chipotle Mexican Grill.....	84

Executive summary

Outlook: a great story...

Broadly speaking, the restaurant industry tends to outpace real economic growth by 1 to 2 percentage points, as consumers spend an increasing amount of money on food outside the home.

Drivers: disposable income, convenience, healthy choices

- **A bigger slice:** 'Away from home' consumption has increased from 38% to 47.5% of food expenditure in the last 10 years.
- **Of a bigger pie:** Rising disposable income (10-year real CAGR 2.1%) to \$30.5k/per capita underpins favorable dining out trends.
- **Goes to convenience:** Successful concepts gear to speed, for on-the-go lifestyles, such as snack-type meals and drive-through operations (Starbucks expects more than one-third of its outlets to offer drive-through within five years).
- **Goes to innovative, health-oriented concepts:** Chains are moving to provide healthier offerings to win over boomers battling the bulge. They position well against childhood obesity concerns (salads, smaller portions, lower trans fats).

By 2010, we expect US restaurant sales to exceed \$500bn, capping a 10-year growth rate of 5.1%. In 2006, we expect 4-5% industry growth, ahead of DB real GDP forecast of approximately 3%, to industry sales of well over \$400bn, just under 5% of the \$9.5 trillion in estimated disposable income.

Valuation: ...but largely priced in

At current levels, we like YUM and PNRA

Here are our four new recommendations in brief:

- **YUM! Brands (Buy, price target \$66):** We think YUM presents better value than McDonald's in the mature category. We believe its ROIC spread and international positioning warrant multiple expansion to 18-19x P/E and 10x TEV/EBITDA.
- **Panera Bread Company (Buy, price target \$81):** We view PNRA as relatively "cheap" at 28x our 2007E EPS. Our target P/E of 33x implies a 1.5 PEG ratio. A target TEV/EBITDA ratio of 15x also supports a price in the low \$80s.
- **McDonald's (Hold, price target \$43):** Recovery has already been rewarded. We believe a historical average 16-17x P/E is appropriate based on forward EPS growth forecasts of 8-9% (just above 7-8% 5-year average). A 17x multiple on our 2007 EPS estimate suggests a low \$40s share price.
- **Chipotle Mexican Grill (Hold, price target \$57):** Here too we think the story has been priced in. Chipotle is the fastest-growth concept in the group, and we like its value proposition: freshness, quality, and simplicity. However, the current 43x P/E represents the highest PEG ratio in the group; we think a PEG of 1.75 is appropriate, equating to 42x P/E or \$56-57 per share on 2007E EPS.

Starbucks (lead analyst Marc Greenberg) remains rated Hold at \$37.93 vs. a price target of \$37.

Risks

We cite four key factors for the restaurant group in general (see page 17 for more detail):

- **Consumer slowdown** – The restaurant industry is clearly a consumer discretionary spending play, and based on our valuation work, very much trades in line with consumer confidence. We view a slowing economy, characterized by higher fuel expense and declining home values, as a principal risk to continued strong restaurant industry growth. Any further slowdown in consumer confidence and spending could pressure restaurant industry sales and stock prices.
- **Consumer health issues** – Obesity, heart disease, and diabetes are major public health concerns, and major fast food chains are most at risk of litigation.
- **Contamination/disease issues** – Risks related to E. Coli, mad cow disease, avian flu, etc. represent tangible operational risk and can lead to short-term pullbacks.
- **Commodity inputs** – Restaurants are exposed to increases in commodity and input costs, for both ingredients and packaging materials, as well as shortages and product safety issues.

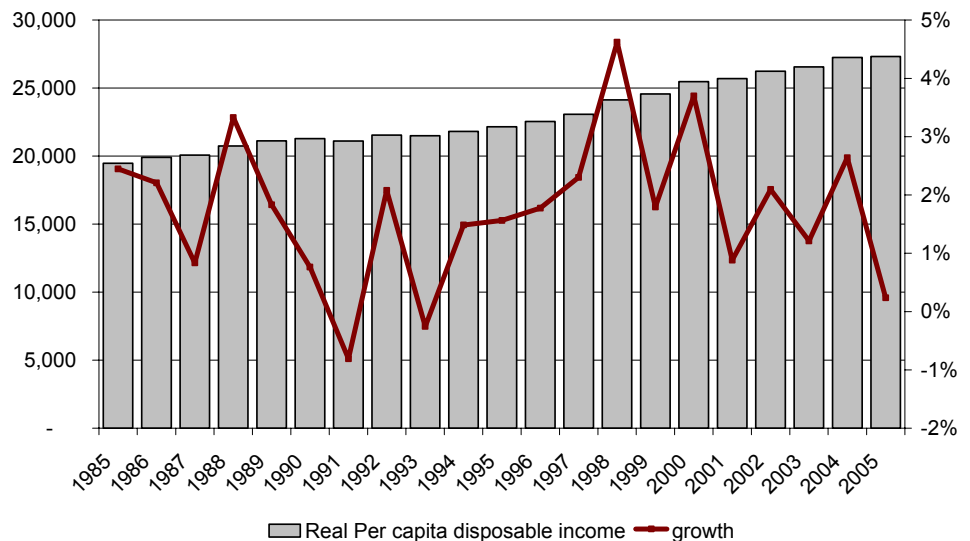
At the company level, although we believe the focus on monthly comp sales trends is waning, this factor can still have a meaningful impact – often asymmetric to the downside. We discuss other company-specific risks in our individual company reports, which we have also included in this volume.

A growing business

Disposable income: a risk, but more is flowing to restaurants

Disposable income, a component of what drives consumer confidence, is clearly a key driver of restaurant sales growth. Disposable real income per capita grew at a five-year CAGR of 2.8% between 1995 and 2000, but has slowed to 1.4% annualized from 2000-2005.

Figure 1: Disposable income growth history



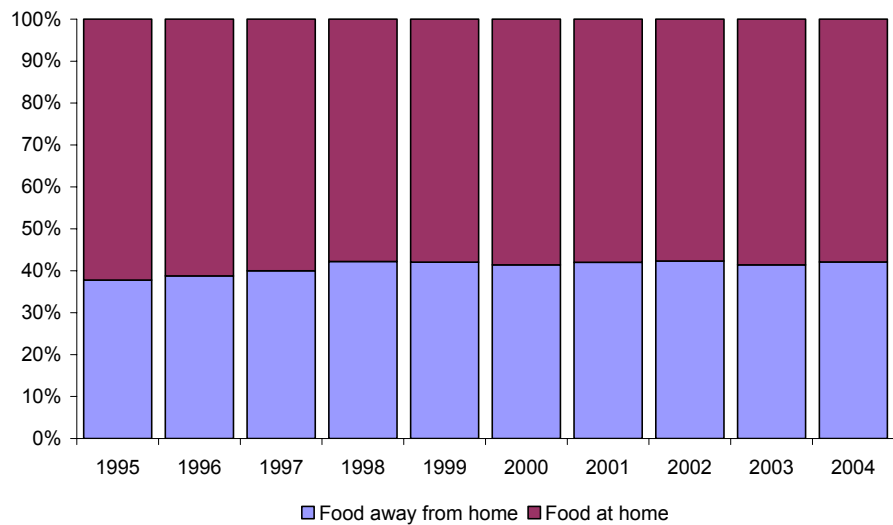
Source: Deutsche Bank, Census Bureau

We thus regard a slowing economy, characterized by higher fuel expense and declining home values, as a principal risk to continued strong restaurant industry growth.

Greater percentage of food spending goes to eating out every year

That said, ever-higher spending devoted to food away from home is a strong secular underpinning for industry growth. Share of food expenditure toward food away from home has increased from 38% in 1995 to an estimated 47.5% in 2006. Annualized growth of 3.7% has outpaced the 2.7% growth in total expenditure on food.

Figure 2: Food spending – away from home vs. at home

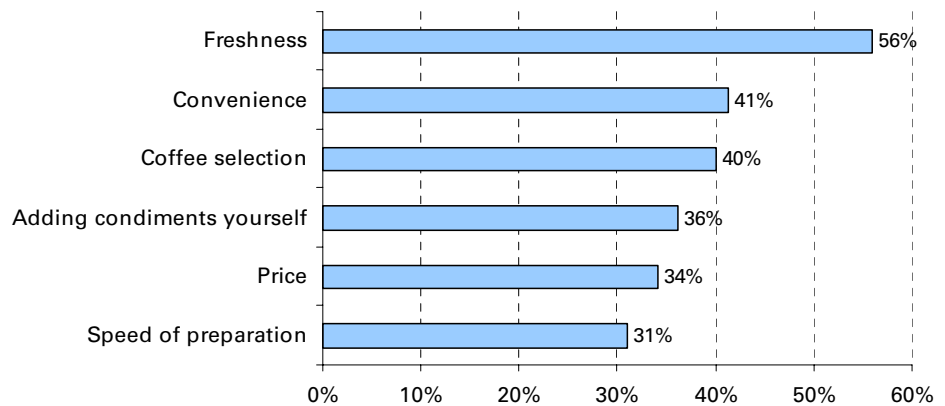


Source: Deutsche Bank, Census Bureau

Convenience counts

We believe this reflects a secular trend affecting most consumer businesses – the need for convenience. People are working more, doing more, commuting longer distances, and spending less time at home, particularly as women take on more responsibility in the workforce. Many are looking for ways to take back time in their day, and eating a prepared meal from a restaurant is an easy and often affordable way to do this given the many choices now available. At its recent Oct. 2006 analyst day, Starbucks mentioned that drive-through concepts will dominate new store openings, comprising as much as 1/3 of total stores within 5 years.

Figure 3: What matters most on-the-go (coffee)



Source: Deutsche Bank proprietary survey

For example, more than 41% of the 1,400-plus survey respondents in our 2006 coffee industry survey cited convenience as a leading factor in choosing coffee, 7% more than price. It is not surprising therefore that the percentage of disposable income going to restaurants has moved up – consumers continue to shift toward luxury choices in their leisure time, spending more for quality. This also underpins higher growth in more expensive segments of the restaurant industry.

Healthy choices

Healthier lifestyles

Consumers are more concerned than ever about what they put in their bodies. Diets have come and gone in recent years, not to mention the move towards more organic foods and naturally raised meats. Restaurants have capitalized on this trend by innovating and developing more health-conscious menu options. Fast-food chains, which have received criticism for unhealthy menus, have begun offering things like baked or grilled products as alternatives to fried foods, as well as salad offerings and food without trans fat.

- **Chipotle Mexican Grill (CMG)** is a concept that is increasingly tying itself to the health movement by switching to natural ingredients, not to mention that the company has always prided itself on the use of fresh ingredients instead of processed foods.
- **Panera Bread (PNRA)** offers many healthy options in the way of salads, sandwiches, and whole grain breads.

More choice

Not only do consumers want healthy foods, they want choice. We have seen this trend across the consumer spectrum, especially across the various beverage segments. While fast-food chains have traditionally been known for their standardized menus, which facilitate an efficient, high-volume business, competition has forced change. The name of the game for most quick service restaurants (QSR) is innovation—offering new and interesting items to complement the core menu. Consumers have come to expect it, and market share shifts often occur based on the success of a restaurant's innovation. On the other hand, some concepts are growing simply because they are new and different, not necessarily because they offer new menu items every so often. For instance, Chipotle continues to win new customers as they discover the unique aspects of the concept. Broadly speaking, innovation of new menu items is much more important for more mature chains like **McDonald's (MCD)**.

Multiple branding

The trend of multiple branding, wherein several restaurant chains operate at the same location, has started to catch on as a means to generate synergistic growth. Consumers like the variety such an operation offers. Not to mention that chains that engage in multiple-branding can better absorb fixed operating costs.

Technology innovation

Restaurants have turned to technological innovations as a strategy to attract new customers and improve efficiency. Offering wireless hotspot networks to customers with cell phones or laptop computers and using PDA's to speed up curbside ordering or table wait times are some of the things that restaurants have started doing to bring in new customers.

Yum Brands, the owner of Taco Bell, KFC and Pizza Hut, is the leader in multi-branding.

Growth mix

Comps (same store sales) are the key

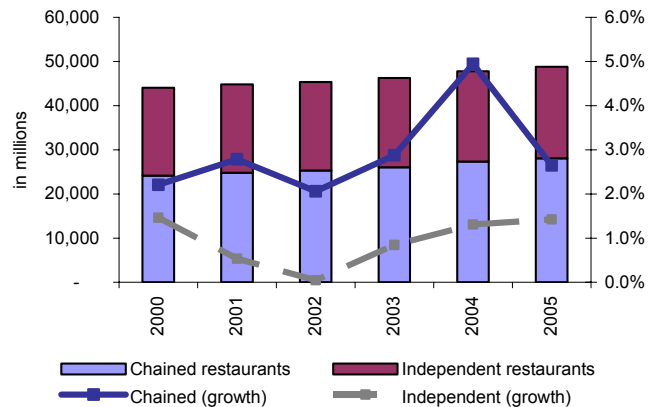
The mix of growth is an important topic and closely watched by the investment community. Unit growth and comparable sales growth are key focus items. All else being equal, slower growth in comparable sales vs. growth in restaurant units suggests cannibalization and, generally, a less efficient operation. The logic is this: why would one add stores if comparable store sales growth is waning? Once a chain is mature, efficiency becomes an important driver of profits. Many mature chains are shrinking their restaurant base while attempting to boost comparable store sales in order to achieve better returns on the existing asset base.

Figure 4: Chained vs. independent units



Source: Deutsche Bank

Figure 5: Chained vs. independent transactions



Source: Deutsche Bank

Chain outperformance driven by higher-end concepts

Over the last five years, the total number of restaurants in the U.S. has grown at a CAGR of 2% to 572,617 units in 2005. Expansion plans taken up by the restaurant chains have driven a chained unit CAGR of 2.8% vs. a 1.6% CAGR for independent restaurants. In 2005, chained restaurants accounted for 36.4% of total restaurant units and 57.5% of total restaurant transactions.

Chained restaurants are growing not only in units, but also transactions, at a faster pace than independents, with a 5-year CAGR in transactions of 3.1% vs. 0.8% for independents.

Transactions per chained restaurant have growth at a 0.3% CAGR vs. independents declining at a 0.8% CAGR. We believe the growth in higher-end, unique concepts like SBUX, PNRA, CMG, CAKE, and PFCB explains this differential, since most major fast food chains are rationalizing their store bases. This should continue on the heels of consumer trends discussed above, such as the need for convenience, variety, and interest in affordable luxuries. This is good news for the growth stocks in our universe, SBUX, PNRA, and CMG.

Revenues per restaurant and per transaction have also tracked ahead for chained vs. independent restaurants over the last five years

In particular, revenue per transaction has advanced at a healthy 2-3% for chained restaurants, implying modest pricing power above inflation. Independent restaurants have achieved revenue per transaction growth of 1-2%, possibly implying greater competition in this segment, which intuitively makes sense. Imagine the myriad independent restaurants in New York City and the intense competition therein. Net/net, we believe higher growth of chain store comps growth bodes well for our coverage group, particularly the less mature operators, and their ability to expand rationally.

Figure 6: Revenue metrics

Revenue / Restaurant	2000	2001	2002	2003	2004	2005
Chained restaurants	855,736	880,856	893,118	908,790	944,851	965,329
Independent restaurants	512,820	518,525	525,478	532,855	537,258	545,944
Growth						
Chained restaurants	4.0%	2.9%	1.4%	1.8%	4.0%	2.2%
Independent restaurants	1.5%	1.1%	1.3%	1.4%	0.8%	1.6%
Revenue / Transaction	2000	2001	2002	2003	2004	2005
Chained restaurants	6.45	6.60	6.70	6.85	6.97	7.17
Independent restaurants	8.65	8.85	9.09	9.27	9.39	9.58
Growth						
Chained restaurants	3.3%	2.3%	1.6%	2.2%	1.8%	2.8%
Independent restaurants	1.9%	2.3%	2.8%	1.9%	1.3%	2.1%

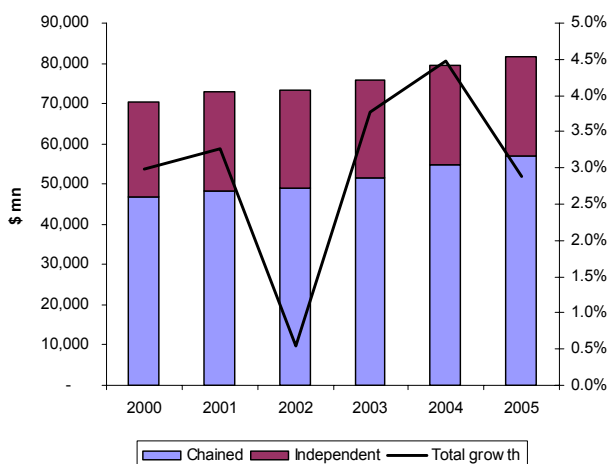
Source: Deutsche Bank, Euromonitor

Trends within key segments

Hamburgers

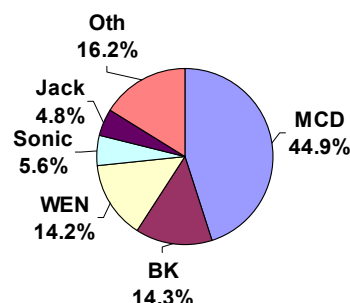
The sale of hamburgers has started picking up steam, with most players recently introducing bigger, beefier burgers to attract consumers. This rise in burger sales comes at a time when salad sales are slowing down after a three-year rise. In 2005, hamburgers contributed 20.5% of total industry revenues, 13.2% of total outlets and 33.8% of total transaction volume in the consumer foodservice industry.

Figure 7: Hamburger segment sales



Source: Deutsche Bank

Figure 8: Major players share



Source: Deutsche Bank

In the last five years, hamburger sales have grown at a CAGR 3%, with sales from chained restaurants growing at 4% and sales from independent restaurants growing at 0.8%

The main deterrent to hamburger chain growth has been a more health-conscious consumer. Big burger chains have recognized this and started offering healthier options like salads and pita sandwiches, a trend successfully started off by Wendy's and followed by McDonald's and other large chains. These chains have successfully used promotional pricing to get customers in the door, and then attempt to up-sell the customer away from promotional pricing menus. To succeed in this incremental selling effort, chains have experimented with software packages that allow servers to suggest items that round up purchases to the nearest whole dollar amount, thereby capturing spare change from each transaction.

McDonald's

McDonald's is by far the number-one chain in hamburger sales, accounting for 31.4% market share for hamburgers, up from 27.5% in 2001. McDonald's has grown hamburger revenues at a CAGR of 6.4% over the last four years, with estimated domestic 2005 retail sales exceeding \$25.6 billion

Burger King

Burger King has 10% market share of hamburger sales, down from 10.6% in 2002. The company has grown hamburger sales at a CAGR of 1.7%, with 2005 US sales of \$7.9bn.

Wendy's

Wendy's accounts for a 9.9% market share of hamburger sales, up from 8.6% in 2001. Wendy's hamburger sales have grown at a CAGR of 6.6% over the last four years.

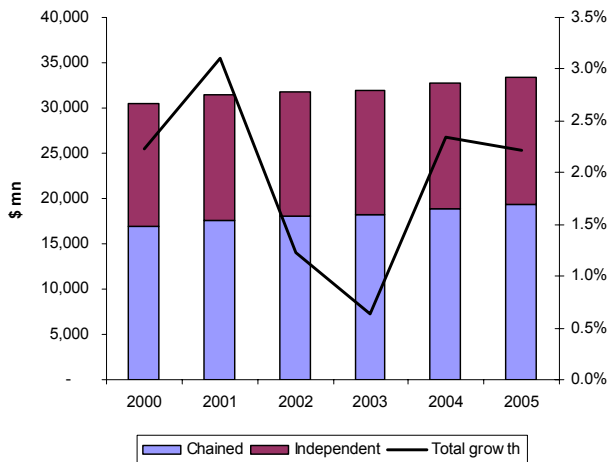
Looking forward, we expect the Burger segment to grow at a healthy clip, but it is still likely to remain below industry growth, in the 3-4% range.

Simply put, category dynamics are unattractive right now

Pizza

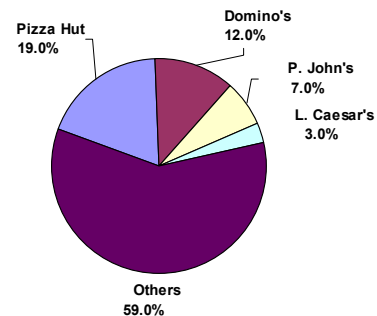
In 2005, the pizza industry registered growth of 2%, falling short of the 4.5% growth registered by the total restaurant industry. We believe this owes to an inability on the part of chains to increase their customer base by attracting the hamburger/chicken-eating customer. Further, price wars have only managed to pull customers from one chain to another, with the result that industry sales are stagnating and margins coming under pressure.

Figure 9: Pizza segment trends



Source: Deutsche Bank

Figure 10: Major players' share



Source: Deutsche Bank

Not surprisingly, pizza contributed only 8.4% of total foodservice revenues in spite of controlling 10.2% of total foodservice outlets. In the last five years, pizza sales have grown at a CAGR of 1.9%, with sales from restaurant chains growing at 2.6% and sales from independent restaurants growing at 1%. **Yum's Pizza Hut**, Domino's and Papa John's are the top three chains, accounting for 38% of total pizza sales in the US.

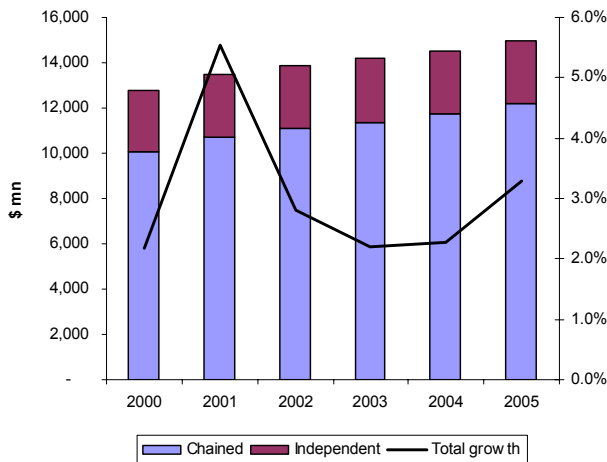
According to Technomic, both Domino's and Little Caesar's substantially outperformed Pizza Hut last year. **Pizza Hut sales rose just 1.2%, with 0.9% owing to an increase in units – implying essentially flat comparable sales.** Domino's sales rose 4.5% on 1.7% unit growth, while Papa John's 6.0% sales growth bested the others on 1.3% unit growth suggesting the best comparable sales performance in the group.

Looking ahead, the pizza category shows little sign of a pick-up and we would expect this to remain the slowest growing category in the industry, up approximately 2% to 3%.

Chicken

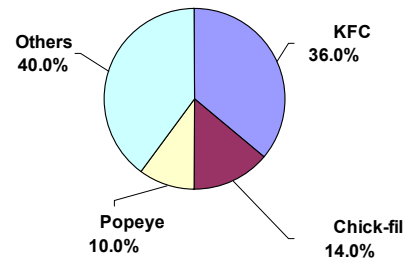
We estimate chicken segment sales rose 7% in 2005, outperforming overall category sales. In part, we believe this owes to a consumer migration to healthier concepts like grilled chicken, chicken sandwiches, wraps and chicken salads. These recent gains have countered a lower five-year trend, wherein chicken sales have grown at a CAGR of 3.2%, slower than the 4.1% growth of the total foodservice industry.

Figure 11: Chicken segment sales



Source: Deutsche Bank

Figure 12: Major players' share



Source: Deutsche Bank

We estimate the top three players – YUM's KFC, Chick-fil-A and Popeye's account for 50% of segment sales domestically

YUM (KFC)

KFC, the chicken chain of Yum! Brands, is the chicken market leader with a 35% share of total chicken revenues in the US. **Last year's retail sales grew 5.8% to \$5.2 billion as units declined 1.5%.** This performance is ahead of the 3.6% annualized rate over the last four years.

Chick-fil-A

We estimate Chick-fil-A (CFA properties) chicken share to be 14% domestically. Its strong growth (+13% in 2005) represents the best capture of the trend to health and wellness – led by grilled chicken sandwiches and wraps. Last year, the company store base grew by 4%.

Popeye's

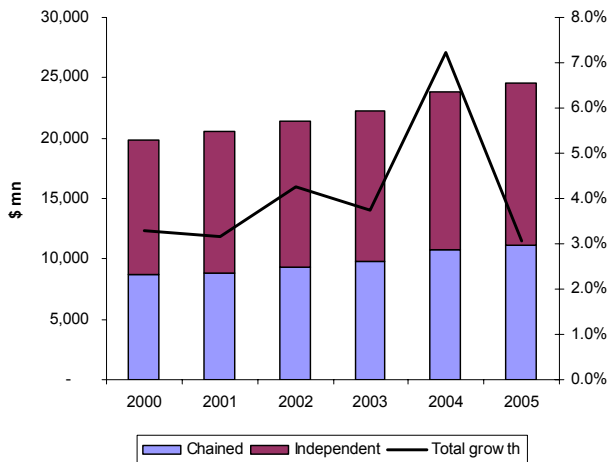
In 2005, Popeye's Chicken & Biscuits (AFC Enterprises) accounted for 9.4% of chicken sales in the US, down from 14.1% in 2001.

Looking ahead, chicken continues to grow in popularity as a healthier option to beef. We therefore expect in-line to better than industry growth of approximately 5%.

Mexican

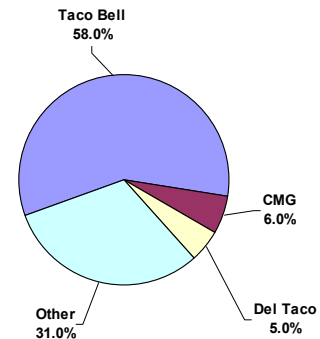
In 2005, Mexican food accounted for 6.1% of total industry sales and 5.6% of total units in the US foodservice industry. Independent restaurants account for 67% of the total Mexican food outlets, and 55% of total Mexican food sales. Mexican outlets are capable of generating high levels of takeaway sales, and hence small independent takeaway outlets have mushroomed over the years.

Figure 13: Mexican segment sales



Source: Deutsche Bank

Figure 14: Major players



Source: Deutsche Bank

The top three Mexican chains account for 69% of total Mexican food revenues, with Taco Bell, the Mexican food outlet of Yum! Brands, accounting for more than 58% of the total spend on Mexican food

YUM (Taco Bell)

YUM (Taco Bell) sales rose by 8.4% last year to \$6.1 billion as units declined 0.9%, suggesting the strongest underlying trends among YUM's big three – Taco Bell, KFC, and Pizza Hut. Taco Bell has successfully moved away from value offerings with items such as the Grilled Stuffed Burrito, which has driven recent sales acceleration from a low-single-digit growth base.

CMG

Chipotle Mexican Grill's strong underlying growth - 39% annually over the last four years - has enabled healthy market share growth, despite outlets numbering a still relatively small 600+. With 2005 growth of 275 stores driving sales of \$635 million, further share gains are likely for 2005 as fresh, healthy, and high quality converge within one concept.

Mexican food continues to grow in popularity along with consumer interest in new food choices and the growing Hispanic population. We therefore expect above-industry growth of 5-6% over the next couple of years.

Bakery café

In 2005, bakery café segment revenues accounted for 8% of total foodservice revenues, up from 7% in 2000. Bakery café revenues have grown at a CAGR of 6.7% over the last five years. Using a broad definition, this category includes Subway, Quiznos, and Dunkin' Donuts as well as Panera Bread.

Panera Bread

Panera Bread sales rose 28% to \$1.6 billion last year as units rose 19% to 877. Over the last five years, as with Chipotle, PNRA's combination of freshness, healthy offerings and high quality food are well-positioned to drive stronger-than-industry growth.

Bakery Café remains the fastest growing category in the industry and given consumer interest in healthier, high-end concepts like Panera Bread, we expect segment growth to remain well above the industry for the next couple years at 6-7%.

Making the stocks cook

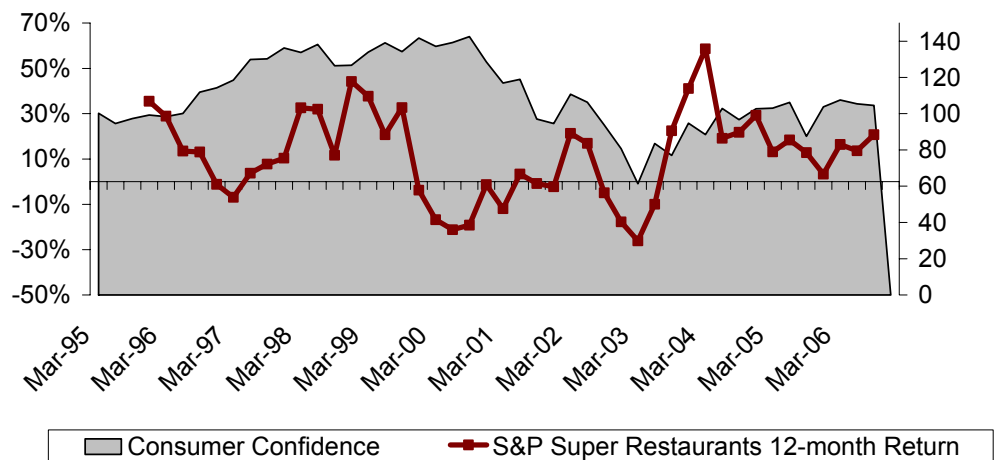
Restaurant shares closely track discretionary spending

Based on our valuation work, the group very much trades in line with consumer confidence.

This makes sense – people feel better about the economy and spend more money on discretionary things, like eating out. When they feel worse, they retrench and cook more often at home. It’s a simple equation.

However, we see more at play within the restaurant industry’s segments. For instance, quick service restaurant (QSR) sales can be more defensive in nature, given a relatively low guest check, but are not entirely immune to economic fluctuations, while casual dining and fast casual dining tend to be more sensitive to consumer confidence. Just as sales tend to follow consumer spending, restaurant stock returns tend to move in line with consumer confidence.

Figure 15: Restaurant stock performance vs. consumer confidence

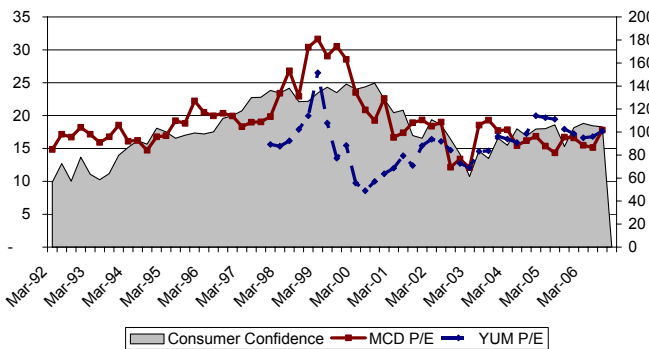


Source: Deutsche Bank, Conference Board, Factset

Valuation also appears well correlated with consumer confidence

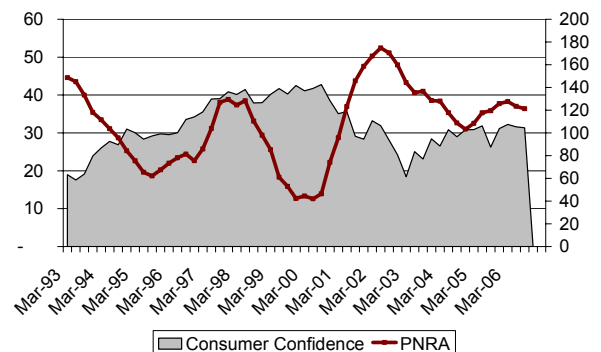
Notice below that both MCD and YUM valuations bubbled right along with the consumer economy between 1997 and 2000, then reverted to a normal range in the early 2000’s. Quick casual—PNRA is the most relevant example with a long history—has been more volatile.

Figure 16: QSR P/Es vs. Consumer Confidence



Source: Deutsche Bank, Factset, Conference Board

Figure 17: Quick Casual P/Es vs. Consumer Confidence



Source: Deutsche Bank, Factset, Conference Board

The higher guest check in quick casual (\$7-10 on average) may make this hybrid segment somewhat more exposed to economic downturns, though the typical consumer in this segment is often more affluent and less likely to trim spending.

In summary, from a macro and demographic standpoint, the restaurant industry has good wind in its sails. Secular trends should continue to drive growth at rates ahead of the overall economy, with even faster growth in certain segments. However, core industry risks bear further discussion.

Current outlook

While gas prices are declining and may provide consumer relief, softening home values could have a psychological and financial impact on spending power. In August, the median sale price of an existing single family home declined 1.7%, the first y/y decline in over ten years. Inventories of unsold homes were up 37.9%. Our DB Economics team does not expect price softness to change any time soon. Consumer confidence, while up vs. a year ago on an average quarterly basis (104.5 vs. 87.5), has deteriorated throughout the year (from 107.5 in Q106). Any further slowdown in consumer confidence and spending could pressure restaurant industry sales.

Other key industry risks

Consumer health issues: Major fast food chains are most at risk

Many have made changes, like providing healthier options and publicizing nutritional information, but there will always be public interest groups targeting these companies, and lawsuits are a possibility. We believe consumer liability and fraud claims are unlikely to gain much ground, however, since the consumer is ultimately making their own food decision and nutritional information is widely accessible. However, the headline risk of such events could cause downside for the industry.

Obesity is a real and measurable problem

According to the National Institute of Health, nearly 31% of the population over 20 years of age is obese. The Department of Health and Human Services estimates that obesity is a factor in some 300,000 deaths per year.

Heart disease

Coronary heart disease (CHD) is a major public health concern because it causes more deaths in the US than any other disease. The American Heart Association estimates that 105 million American adults have total blood cholesterol levels of 200mg per deciliter (borderline high risk) and higher, with 42 million having levels of 240mg/dl or above (considered high risk). Children are not immune either, with about 10% of adolescents aged 12-19 years having total cholesterol levels exceeding 200mg/dl.

Diabetes

The American Diabetes Association estimates that 17 million Americans (or 6% of the population) currently have diabetes, but only 11 million have been diagnosed. Medical personnel are concerned about the increased incidence of adult-onset diabetes, which is partially caused by obesity.

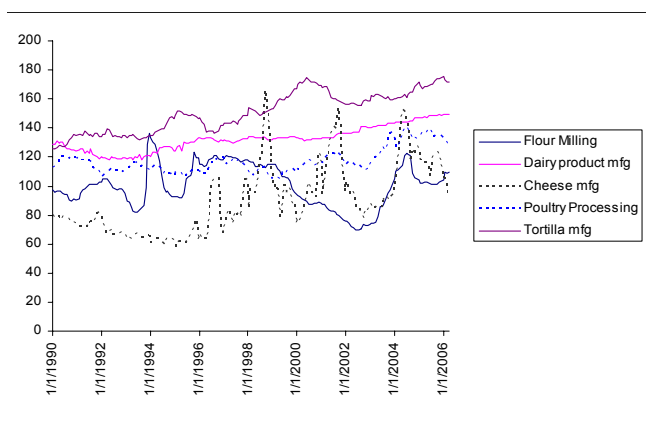
Contamination/disease issues

Restaurant chains are exposed to contamination or other tainting of their supplies and products sold to consumers. Although headline risk of these events is generally far worse than the actual impact on a consumer level, risks related to E Coli, mad cow disease, etc. represent tangible operational risk. A recent example of the significant impact that contamination issues can have on restaurant chains is the 2004-05 avian flu outbreaks and pandemic scares, which most notably impacted YUM's KFC franchise, with interruption of chicken product offerings and negative publicity in the China operations. Given generally tight supply chain oversight by the large chains, we believe that actual risk to consumers in these instances is low, and disease scares have generally led to short-term stock pullbacks and buying opportunities in the sector.

Commodity inputs

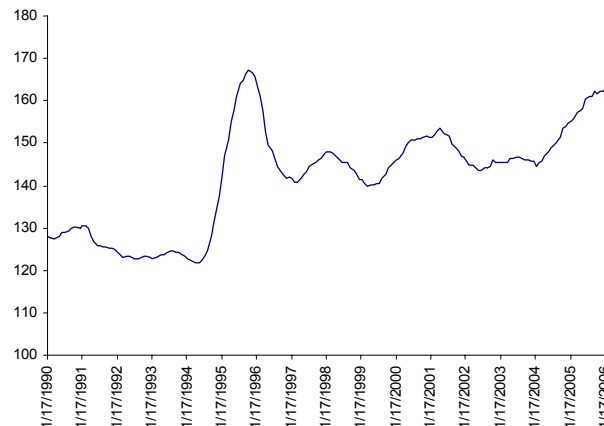
Restaurants are exposed to increases in commodity and input costs, as well as shortages and product safety issues. This impacts direct ingredient supplies such as meat, chicken and cheese, which can be highly volatile, as well as packaging materials such as paper and plastic. Commodity cost inflation is a particular concern in the lower end of the restaurant industry, with less pricing flexibility available to pass through input costs increases to consumers.

Figure 18: Commodities PPI



Source: Deutsche Bank, Bureau of Labor

Figure 19: Paper products PPI



Source: Deutsche Bank, Bureau of Labor

Company valuation & risks

YUM: YUM's evolution as a more consistent earnings performer with an international growth opportunity has driven valuation ahead of MCD, although we believe this is warranted by MCD's more mature profile and lower exposure to international growth, and YUM's multibranding opportunities and greater capital efficiency. Our \$66 target price reflects a midpoint of TEV/EBITDA, P/E, ROIC, DCF methodologies. We believe recent P/E average of 18x is more reflective of growth prospects than longer-term 15x and expect multiple expansion to 18-19x; therefore, 18x our 2007 EPS estimate seems to us appropriate. Similarly, we expect TEV/EBITDA multiple expansion from an 8-9x historical average to 10x, particularly reflecting expansion of ROIC spread from approximately 11-12% toward the mid teens. DCF methodology is based on 5% 10-year EBIT growth, 8.0% WACC—9% K-debt, 0.9 beta, 4.7% Rf rate, 5.4% market premium, 9.6% K-equity, 2.5% long-term growth (assumes slower industry growth vs. recent 4% and YUM slightly ahead of industry over the long-term). We view YUM as a play on multiple expansion and a consistent performer in regard to earnings growth, cash flow generation, and ROIC. We like what we can pay for YUM relative to its fundamental upside, with profit mix shift toward international increasingly driving higher profit growth than peers. The chief risk to our outlook for YUM is the drag from US store sales growth, which recently hit a soft patch and which we expect to gradually improve through 2007. Like most major chains, YUM also faces periodic health concerns (i.e. consumer obesity, trans fat) and food contamination issues, such as the bird flu issue which impacted the KFC business late last year and in early 2006. Finally, ability to execute major strategic initiatives such as China expansion and US multibranding and refranchising pose risks is the company commits significant mis-steps.

PNRA: We believe that sentiment on PNRA has recently shifted too far into negative territory on short term concerns relative to comp store sales, which have rebounded (Sep comp +6%). PNRA is the cheapest stock in our coverage group from a PEG ratio standpoint, at 1.2x forward three-year sales growth forecasts and 1.1x forward three-year EBIT growth forecasts, below both CMG and SBUX, despite similarly strong projected growth. Our \$81 blended price target (EBITDA, P/E, ROIC, DCF) is \$81. Even a conservative 1.5x multiple suggests a P/E of 33x, which equates to \$80 on our 2007E EPS. 15x our 2007 EBITDA forecast falls below SBUX and CMG targets between 17x and 18.5x to reflect modestly lower growth, suggesting \$83 per share. ROIC progression into the mid single digits suggests the same TEV/EBITDA result. DCF generates \$81, based on 17% 10-year EBIT growth, 11.0% WACC—1.2 beta (assume similar to CMG), 4.7% Rf rate, 5.4% market premium, 11% K-equity, 4% long-term growth (assumes slower industry growth vs. recent 4% and continued

growth above industry over the long-term). PNRA is not a story without risks, but over the next three years, we believe the growth prospects are among the most attractive in the industry. We prefer to buy into restaurant industry growth on dips, taking advantage of short term negative moves. We therefore rate the shares a Buy. As a hybrid quick-casual restaurant, PNRA is exposed to slowdowns in consumer spending, although we believe its relatively low average guest check helps insulate it. New product initiatives such as Crispani carry operational risk and could experience setbacks. Finally, as a high-growth vehicle, one of the major risks for PNRA is any indication of a slowdown in new restaurant openings.

MCD: Our \$43 target price reflects an average of several methodologies (P/E, EBITDA, ROIC, DCF). Shares trade close to a five-year average P/E of 16-17x on a 2007E basis. This seems fair, but not an attractive entry point. While valuation moved up during the recovery, both are settling back toward the five-year mean of 16-17x P/E and 9.5x TEV/EBITDA. 9.5x EBITDA multiple based on a similar historical average and forecasted ROIC progression (forecasted 12% ROIC compares to similar levels prior to difficulties in early 2000s). DCF methodology is based on 4% 10-year EBIT growth, 6.0% WACC—4.5% K-debt, 0.82 beta, 4.7% Rf rate, 5.4% market premium, 9.2% K-equity, 2% long-term growth (assumes slower industry growth vs. recent 4% and MCD in line with industry over the long-term). Our target offers only modest total return, and we are looking for a better buying opportunity; the best entry point may come in the form of negative and, we believe, often overdone news on obesity issues, food contamination, and consumer demand softness. As with most quick-service restaurant chains, MCD faces headline risk related to health concerns and obesity, including trans-fats, marketing to children, and consumer liability lawsuits, as well as food contamination (i.e. Mad Cow, Bird Flu). Negative headlines and any subsequent share price weakness could provide better entry points. Consumer slowdown is a risk, but less for MCD vs. most other restaurants given the low guest check. Change in corporate structure to create shareholder value or pacify shareholder activism poses a risk to forecasts, as does any shift in returns of cash to shareholders, which could boost multiples.

CMG: We believe CMG's growth potential deserves a premium valuation, but at 54x and 43x our 2006 and 2007 EPS estimates, the stock appears fairly valued. Our TP of \$57 per share is based on a blend of methodologies (EV/EBITDA, P/E, ROIC spread, DCF): 17x our 2007 EBITDA forecast; 42x our 2007 EPS estimate; 10-year EBIT growth assumption of 20%. We prefer to buy the stock at a P/E below 40x on our 2007 forecast and at 1.5x PEG or better. The best opportunity to get involved may come on an overdone reaction to negative restaurant industry headlines or indications that growth is trending ahead of our forecasts. Most significant risks to our forecasts are the rate of store openings and same store sales, which drive our growth outlook. On an operational front, the most prominent issues are ingredient sourcing, since CMG uses local suppliers and higher quality ingredients and does not engage in significant cost hedging, and we believe is therefore more vulnerable to supply disruption or cost spikes. The pending full separation from McDonald's may also elevate costs or cause short-term operational disruptions.

North America United States
Consumer Restaurants

18 October 2006

YUM Brands, Inc.

Reuters: **YUM.N** Bloomberg: **YUM US**

Initiate at Buy; best large-cap restaurant idea

Buy rating, \$66 target price

Although YUM is one of the world's largest restaurant operators, international piece offers compelling profit growth (20%+ LT). We believe this will drive double-digit EPS growth, ahead of core peers, allowing multiple expansion.

Working the right locations in the right ways...

YUM is the most exposed to international growth opportunities in our restaurant coverage group, with 48% of 2006 EBIT from non-US properties and a head start in the fast-growing China market, as well as emerging markets like Russia/India. A turnaround in US performance should be additive to growth in 07, with US store comps poised for a pick-up through menu innovations at the three key restaurant concepts in 2H06 and 2007.

...Spurring growth of shareholder returns

International growth and margin-improving measures such as store multibranding and re-franchising (long-term target of 20% company ownership vs. franchisees) should drive margin improvement. Coupled with expected share buybacks (expect \$800mn in 2006), we believe this will drive a 13% EPS CAGR at least over the next three years. Shareholders should also benefit from expanding cash returns – we expect that YUM will pay out 80-100% of its FCF annually through dividends/buybacks.

Deserves a valuation premium to other mature operators

YUM trades at a premium to other mature operators, but this is warranted in our view by consistent earnings/FCF, greater international growth, higher capital efficiency, and willingness to pay out FCF. Our \$66 price target is a blend of various methodologies (EV/EBITDA, P/E, ROIC spread, DCF). Key risks are: lagging US store sales growth, significant exposure to China, health issues (obesity, disease scares) and execution of multibranding and re-franchising strategies. (Please see also page 84 and pages 95-97.)

Forecasts and ratios

Year End Dec 31	2005A	2006E	2007E
1Q EPS ¹	0.50	0.59A	0.68
2Q EPS	0.56	0.68A	0.75
3Q EPS	0.68	0.83	0.89
4Q EPS	0.77	0.82	1.00
FY EPS (USD)	2.55	2.93	3.32
P/E (x)	19.4	19.8	17.4
Dividend yield (%)	0.9	0.9	1.1
EV/EBITDA (x)	9.7	9.7	8.7
Revenue (USDm)	9,349	9,537	9,844

Source: Deutsche Bank estimates, company data

¹ Includes the impact of FAS123R requiring the expensing of stock options.

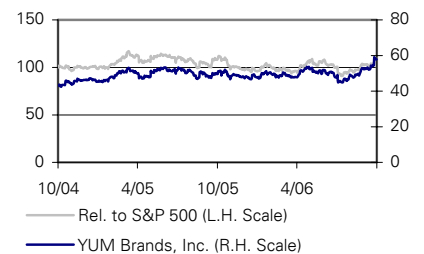
Buy

Price at 17 Oct 2006 (USD)	57.96
Price Target	66.00
52-week range	59.08 - 44.93

Key changes

Rating	No Recommendation to Buy	↑	
Price Target	0.00 to 66.00	↑	-
EPS (USD)	- to 2.93	↑	-
Revenue (USDm)	0 to 9,537	↑	-

Price/price relative



Performance (%)	1m	3m	12m
Absolute	9.6	20.4	16.6
S&P 500	3.3	10.5	14.6

Stock data

Market Cap (USD)	15,707.2
Shares outstanding (m)	271.0
Free float (%)	-
Volume	828,300
S&P 500	1,364.05

Key indicators

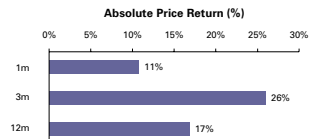
ROE (%)	58.4
ROA (%)	16.8
Net debt/equity (x)	122.5
Book value/share (USD)	5.04
Price/book (x)	11.5
Net interest cover (x)	8.6
EBIT margin (%)	13.5

Model updated: 17 October 2006

Running the Numbers	
North America	
US	
Restaurants	
YUM Brands, Inc.	
Reuters: YUM.N	Bloomberg: YUM US
Buy	
Price as of 17 October	US\$ 57.96
Target price	US\$ 66.00
Company website	
http://www.yum.com	
Company description	

Formed through the spin-off of PepsiCo's restaurant business in 1997, YUM has 34,000 quick-service stores in over 100 countries, with 73% franchised. YUM manages six segments: KFC, Pizza Hut, Taco Bell, LJS/A&W, International and China.

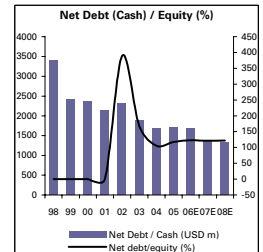
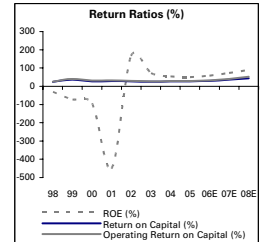
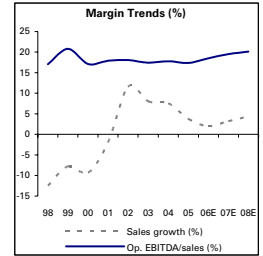
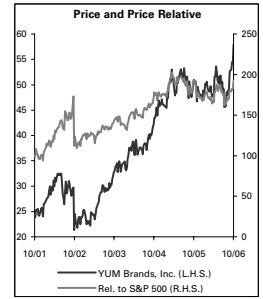
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Andrew Kieley, CFA +1 212 250 7817	andrew.kieley@db.com



52-week Range:	US\$ 44.93 - 59.08
Market Cap (m)	USD 15,707
	EUR 12,525
Company identifiers	
Cusip	988498101
SEDOL	2098876

Source: Company data, Deutsche Bank estimates

Year Ending 31 December	1998	1999	2000	2001	2002	2003	2004	2005	2006E	2007E	2008E
SUMMARY											
Headline EPS (US\$)	1.42	1.96	1.39	1.62	1.88	2.02	2.43	2.55	2.93	3.32	3.77
P/E ratio Headline (x)	12.4	12.9	11.0	13.2	14.9	14.1	16.2	19.4	19.8	17.5	15.4
Headline EPS growth (%)	na	37.8	-29.3	16.8	16.2	7.2	20.3	5.3	14.6	13.4	13.5
EPS FD (US\$)	1.42	1.96	1.39	1.62	1.88	2.02	2.43	2.55	2.93	3.32	3.77
P/E ratio FD (x)	12.4	12.9	11.0	13.2	14.9	14.1	16.2	19.4	19.8	17.5	15.4
Operating CFPS (US\$)	2.21	1.84	1.67	2.84	3.68	3.75	4.08	4.33	4.55	6.15	6.04
Free CFPS (US\$)	3.46	3.63	1.24	1.92	2.05	2.43	3.18	2.99	3.34	4.86	4.77
P/CFPS (x)	8.0	13.7	9.1	7.5	7.6	7.8	9.6	11.5	12.7	9.5	9.6
DPS (US\$)	0.00	0.00	0.00	0.00	0.00	0.00	0.30	0.45	0.54	0.64	0.69
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.8	0.9	0.9	1.1	1.2
BV/Share (US\$)	-3.81	-1.82	-1.10	0.35	2.01	3.82	5.48	5.07	5.04	4.40	4.16
Price/BV (x)	nm	nm	nm	69.31	12.07	9.00	8.61	9.25	11.50	13.18	13.92
Weighted average shares (m)	305	307	294	293	296	293	291	286	271	260	260
Average market cap (USD m)	5,372	7,731	4,474	6,240	8,276	8,326	11,410	14,180	15,707	15,707	15,707
Enterprise value (USD m)	8,537	9,932	6,508	8,130	10,335	10,001	12,842	15,666	17,066	16,762	16,531
EV/Sales	1.01	1.27	0.92	1.17	1.33	1.19	1.43	1.68	1.79	1.70	1.61
EV/EBITDA	5.9	6.1	5.4	6.5	7.4	6.8	8.0	9.7	9.7	8.7	8.0
EV/EBIT	8.3	8.0	7.6	9.1	10.0	9.4	11.1	13.6	13.2	12.0	11.0
EV/Operating Capital	4.1	6.0	3.8	4.1	3.9	3.6	4.2	5.3	6.3	7.6	8.7
INCOME STATEMENT (USD m)											
Sales revenue	8,479	7,822	7,093	6,953	7,757	8,390	9,011	9,349	9,537	9,844	10,273
Operating EBITDA	1,445	1,626	1,214	1,245	1,400	1,460	1,603	1,622	1,766	1,919	2,068
Depreciation	417	386	354	354	370	401	448	469	477	523	565
Amortisation	52	44	38	37	18	13	14	0	0	0	0
EBIT	1,028	1,240	860	891	1,030	1,059	1,155	1,153	1,289	1,396	1,503
Net interest income(expense)	-272	-202	-176	-158	-172	-173	-129	-127	-150	-127	-115
Associates/affiliates	30	19	25	26	29	39	54	0	0	0	0
Investment/other income(expense)	-6	-3	0	-3	1	2	1	0	0	0	0
Exceptionals/extraordinary	0	0	0	0	0	-1	0	0	0	0	0
Income tax expense	311	411	271	241	275	268	286	264	317	366	389
Minorities/preference dividends	0	0	0	0	0	0	0	0	0	0	0
Net income	445	627	413	492	583	617	740	762	822	914	999
CASH FLOW (USD m)											
Cash flow from operations	674	565	491	832	1,088	1,099	1,186	1,238	1,233	1,595	1,970
Movement in net working capital	-106	-227	-207	59	84	65	-202	121	-167	58	-95
Capex	-460	-419	-572	-468	-621	-525	-453	-383	-327	-330	-329
Free cash flow	1,056	1,113	364	532	606	712	925	855	906	1,265	1,241
Other investing activities	1,508	1,947	780	160	-116	111	104	38	32	-9	0
Equity raised(bought back)	0	-134	-170	-42	-103	-168	-369	-908	-800	-1,000	-900
Dividends paid	0	0	0	0	0	0	-58	-123	-145	-166	-180
Net inc/dec in borrowings	-1,133	-1,015	-28	-300	-69	-307	-352	112	350	250	0
Other financing cash flows	10	30	-12	-10	-11	3	4	122	35	-50	-100
Total cash flows from financing	-1,123	-1,119	-210	-352	-183	-472	-775	-797	-560	-969	-1,180
Net cash flow	596	974	486	172	172	216	66	96	378	288	61
Movement in net debt(cash)	-1,729	-1,989	-514	-472	-241	-523	-418	16	-28	-39	-61
BALANCE SHEET (USD m)											
Cash and other liquid assets	121	89	133	110	130	192	62	158	536	825	886
Tangible fixed assets	2,896	2,531	2,540	2,737	3,037	3,280	3,439	3,356	3,206	3,013	2,777
Goodwill	651	527	419	458	849	878	900	868	880	900	900
Other intangible assets	541	450	366	399	364	357	347	0	0	0	0
Associates/investments	246	218	320	248	256	199	248	210	316	330	500
Other assets	76	146	371	436	764	714	700	1,110	1,113	850	882
Total assets	4,531	3,961	4,149	4,398	5,400	5,620	5,696	5,698	6,050	5,918	5,944
Interest bearing debt	3,532	2,508	2,487	2,248	2,445	2,066	1,742	1,860	2,210	2,210	2,210
Other liabilities	2,227	2,020	1,994	2,036	2,361	2,434	2,359	2,389	2,474	2,564	2,651
Total liabilities	5,759	4,528	4,481	4,284	4,806	4,500	4,101	4,249	4,684	4,774	4,861
Shareholders' equity	-1,163	-560	-322	104	594	1,120	1,595	1,449	1,366	1,144	1,083
Minorities	0	0	0	0	0	0	0	0	0	0	0
Total shareholders' equity	-1,163	-560	-322	104	594	1,120	1,595	1,449	1,366	1,144	1,083
Net working capital	-960	-832	-634	-707	-801	-852	-734	-758	-658	-659	-678
Net debt(cash)	3,411	2,419	2,354	2,138	2,315	1,874	1,680	1,702	1,674	1,385	1,324
Capital	2,248	1,859	2,032	2,242	2,909	2,994	3,275	3,151	3,040	2,529	2,407
RATIO ANALYSIS											
Sales growth (%)	-12.5	-7.7	-9.3	-2.0	11.6	8.0	7.5	3.8	2.0	3.2	4.4
Op. EBITDA/sales (%)	17.0	20.8	17.1	17.9	18.0	17.4	17.9	17.3	18.5	19.5	20.1
EBIT/sales (%)	12.1	15.9	12.1	12.8	13.3	12.6	12.8	13.2	13.5	14.2	14.6
Payout ratio (%)	0.0	0.0	0.0	0.0	0.0	0.0	11.8	16.7	17.6	18.2	18.0
ROE (%)	-32.0	-72.8	-93.7	-451.4	167.0	72.0	54.5	50.1	58.4	72.8	89.8
Return on Capital (%)	24.0	36.5	26.7	28.0	27.2	25.0	26.6	26.7	30.1	36.1	43.9
Operating Return on Capital (%)	25.7	40.3	30.8	32.2	30.1	27.1	28.6	28.7	32.9	40.8	52.7
Capex/sales (%)	5.4	5.4	8.1	6.7	8.0	6.3	5.0	4.1	3.4	3.4	3.2
Capex/depreciation (x)	1.0	1.0	1.5	1.2	1.6	1.3	1.0	0.8	0.7	0.6	0.6
Net debt/equity (%)	nm	nm	nm	nm	389.7	167.3	105.3	117.5	122.5	121.1	122.3
Net interest cover (x)	3.8	6.1	4.9	5.6	6.0	6.1	9.0	9.1	8.6	11.0	13.1



Investment thesis

Outlook

From a top-line revenue perspective (3-4% for the next few years), YUM looks fairly similar to MCD (\$42.12, Hold), but this is deceiving, and a superficial comparison in our view. YUM's geographic mix is different, brand equity and mix are different, and the outlook for profit growth and returns is more attractive.

YUM is shifting focus toward non-US properties – International, including China, drives half the company's EBIT. Moreover, YUM is in the right markets, with a head-start in China (which is also more profitable than the U.S. markets at a forecasted 18.9% restaurant margin) and high-opportunity markets like India/Russia and China. Current ownership restructuring also aids profit margins and returns. While YUM's re-franchising efforts dampen sales growth, they have a favorable impact on profits, margins, and capital use. In 2006-07, YUM intends to sell approximately 1,000 US company restaurants to franchisees, ultimately driving the company to a 20% ownership level, and we expect this to help fuel continued margin expansion. Finally, we believe that YUM has significant upside in its U.S. operations, which recently hit a low point in comps growth, but appear poised for a pick-up, and can gradually improve efficiency through the multibranding push. Taco Bell is on track for a 2007 turn on menu innovations and easier comps, KFC lineup innovation should drive a rebound in sales in 2007, and "problem child" Pizza Hut is seeing less severe declines and introducing innovative menu items. Even a modest U.S. recovery could boost sales and profits.

Combined with a steady flow of share buybacks, we believe that YUM's operational evolution will drive strong EPS growth for a relatively mature company, with 12-13% EPS growth from 2007-2010 and steady increases in shareholder returns.

Valuation

Our target price reflects a midpoint of TEV/EBITDA, P/E, ROIC, and DCF methodologies. We believe the recent P/E average of 18x is more reflective of growth prospects than longer-term 15x and expect multiple expansion to 18-19x; therefore, 18x our 2007 EPS estimate seems to us appropriate. Similarly, we expect TEV/EBITDA multiple expansion from an 8-9x historical average to 10x, particularly reflecting expansion of ROIC spread from approximately 11-12% toward the mid teens. DCF methodology is based on 5% 10-year EBIT growth, 8.0% WACC–9% K-debt, 0.9 beta, 4.7% RF rate, 5.4% market premium, 9.6% K-equity, 2.5% long-term growth (assumes slower industry growth vs. recent 4% and YUM slightly ahead of industry over the long-term). We view YUM as a play on multiple expansion and a consistent performer in regard to earnings growth, cash flow generation, and ROIC. We like what we can pay for YUM relative to its fundamental upside, with profit mix shift toward international increasingly driving higher profit growth than peers.

Risks

The chief risk to our outlook for YUM is the drag from U.S. store sales growth, which recently hit a soft patch but which we expect to gradually improve through 2007. Like most major chains, YUM also faces periodic health concerns (i.e. consumer obesity, trans fat) and food contamination issues, such as the bird flu issue which impacted the KFC business late last year and in early 2006. Finally, ability to execute major strategic initiatives such as China expansion and U.S. multibranding and re-franchising pose risks if the company commits significant mis-steps.

Riding the international momentum

Evolving fundamentals deserve multiple expansion

From a total revenue growth perspective, YUM might look fairly similar to MCD, with expected growth close to 3-4% for the next few years. This actually falls below our estimate of 4%-5% growth in MCD sales, but looks are deceiving. Geographic mix is different. Brand equity and mix is different. And in our view, the outlook for profit growth and return improvement is not only different but more attractive. Here's why:

- International, including China, drives half the company's EBIT and we expect this to trend toward 60% by 2010, and just under 70% by 2015. Not only is international a driving piece of the pie, YUM is in the right international markets, with a head start in China, plus focus on other high-opportunity markets like India and Russia. And by the way, China is more profitable than the U.S. with a forecasted 18.9% restaurant margin vs. 14.8%. We believe this demonstrates a level of success not seen at many other global consumer foodservice companies in this market.
- U.S. same store sales hit a low point, setting the stage for a pick-up. Taco Bell is on track for a turn in 2007 after a downtick in H2 (tough comps), on menu innovation and easier comps. KFC lineup of innovation for H2 should drive a rebound in sales in 2007. Pizza Hut, something of a problem child, is seeing less severe declines, and could turn around on innovative menu items like Lasagna Pizza and possibly new strategic initiatives later this year (i.e. a shift to complementary menu items like pastas). Even modest recovery here would be additive to sales and profits.
- Ownership restructuring is additive to profit margins and returns. While the company's re-franchising efforts dampen sales growth (primarily company-owned sales), they tend to have a favorable impact on profits, margins, and capital use. In 2006 and 2007, YUM intends to sell approximately 1,000 company restaurants to franchisees in the U.S., with the ultimate goal of achieving 20% company ownership across the total company.

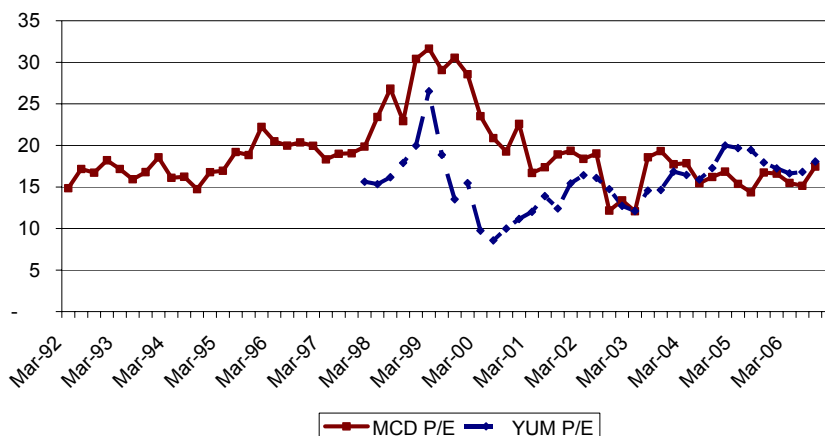
Figure 20: YUM vs. MCD key fundamental measures

	MCD	YUM
Forward 3-year Sales growth	5.2%	3.9%
Forward 3-year EBIT growth	5.9%	7.2%
Forward 3-year EPS growth	8.6%	13.6%
2006E ROIC Spread	11.8%	12.0%
2007E ROIC Spread	11.7%	13.2%
% EBIT International	43.4%	50.2%

Source: Deutsche Bank, Company Info

YUM's evolution as a more consistent earnings performer, with a credible growth opportunity in international, has driven its valuation ahead of MCD. In our view, this is warranted because 1) MCD is simply a more mature company; 2) its geographic mix isn't as growth-oriented and 3) it doesn't have the benefits of multibranding opportunities and the diversification of a brand portfolio.

Figure 21: YUM trading at a premium since mid-2004

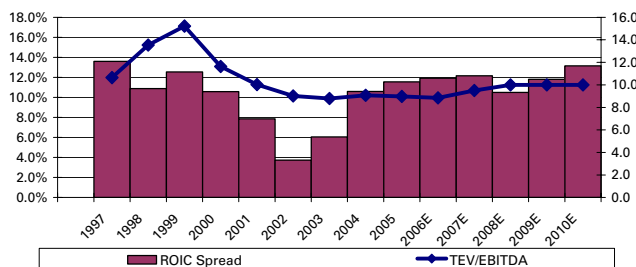


Source: Deutsche Bank, Factset

Multiple evolution

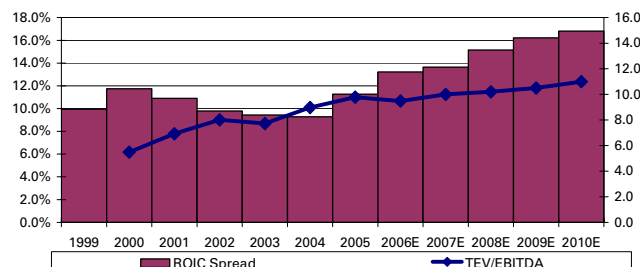
YUM’s five-year average P/E and TEV/EBITDA multiples of 15x and 8x, respectively, fall below MCD’s historical averages. However, the two-year comparable multiples average 18x and 9.5x. We believe this reflects the more consistent earnings performance (10%+ earnings growth since 2001) and the steady northward march of returns.

Figure 22: MCD TEV/EBITDA multiple vs. ROIC spread



Source: Deutsche Bank, Factset, Reuters, Company Info

Figure 23: YUM TEV/EBITDA multiple vs. ROIC spread



Source: Factset, Reuters, Company Info

Figures 22 and 23 demonstrate cash flow multiples for both MCD and YUM vs. ROIC spreads to a market average cost of capital. Why, if MCD has a higher profit margin, does YUM manage to earn higher returns? We believe this reflects ownership structure, the burden of lease obligations MCD bears, and perhaps a greater level of capital efficiency at YUM. In our experience, stocks of cash flow rich, relatively mature companies are rewarded more for the returns they generate over cost of capital than any other valuation measure. This measure alone suggests a share price of \$64 for YUM.

Our \$66 target price (midpoint of various methodologies) offers 15% total return upside. We’re buyers of the stock as a play on multiple expansion and as a consistent performer in regard to earnings growth, cash flow generation, and ROIC.

What could go wrong?

While we like the growth and return profile of YUM relative to current valuation, some challenges could pose risk.

- U.S. business same store sales growth a slight drag. The number one concern, in our view, is the U.S. business. The recent soft patch, while it flattened out in period 9, raised some challenges in the U.S. business. We believe these are turning the corner. Also remember that U.S. profit growth represents only 22% of our total forecasted company profit growth for 2006, and much of that relates to a more favorable cost environment. In our view, this is more of a headline risk than a deal-breaker from a long-term profit growth standpoint.
- Obesity, bird flu, etc. Like MCD, YUM faces periodic noise related to health concerns and food contamination. For instance, bird flu had a significant impact on business late last year and in early 2006 given the chicken-intensive nature of key brand KFC. Also, KFC was recently highlighted in a lawsuit for using trans fats. We believe YUM has taken a proactive stance toward these risks; Taco Bell now allows customization of menu items to create a healthier option (Al Fresco) and KFC aims to eliminate trans fats by next year. Nonetheless, negative buzz in this regard would likely pressure the stock. Barring a widespread food contamination that could impact results for a prolonged period, or a lawsuit of the same impact, we would view this as a buying opportunity.

Playing the best upside

Our call here is not a slam on MCD. Rather, we like what we can pay for YUM relative to its fundamental upside and see potential for multiple expansion. The company is at a point where profit mix is shifting toward international (soon to be more than half of the total) and this will increasingly drive higher profit growth than its peers. This, coupled with improving returns and an increasing willingness to return cash to shareholders, makes this our most attractive large-cap restaurant play in the group.

Financial drivers

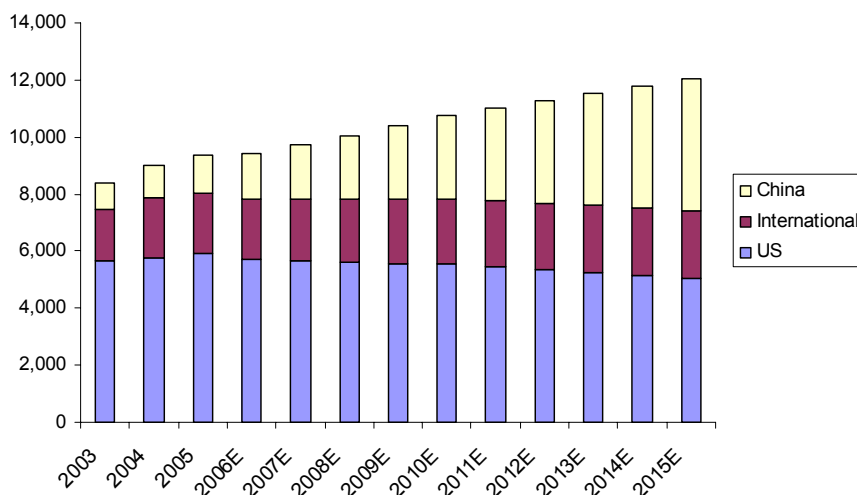
In the right places, doing the right things

YUM is in a good spot, in our view, despite the bumps encountered over the summer as U.S. comparable sales hit a difficult comparison vis-à-vis timing of product introductions. From a broad perspective, the company is achieving very attractive profit growth in both China and YRI, while maintaining its position in the U.S. with a focus on profitability and returns. The most compelling evidence of long-term steady performance include the following: 10%+ EPS growth achieved every year since 2001, return on invested capital spread to market average cost of capital expansion to a forecasted 12.0% in 2006 and growing, and forecasted operating cash return to shareholders of 104%.

Top-line drivers

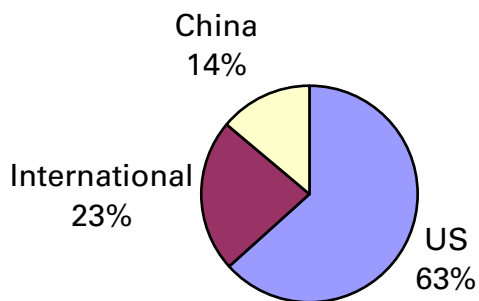
We view YUM as a modest long-term revenue grower, with stagnant U.S. trends offset by the large and growing non-U.S. operations. The U.S. business currently comprises just north of 60% of the revenue base, with the remainder in the International (22%, excluding China) and China (17%) businesses.

Figure 24: YUM revenue growth by geography (\$mn)



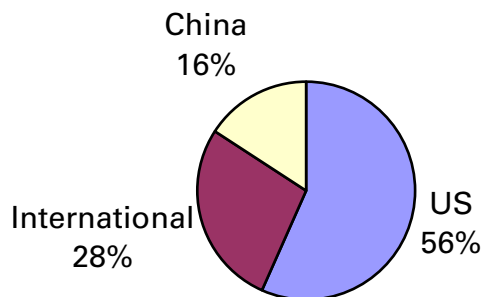
Source: Deutsche Bank, Company Info

Figure 25: Revenue – geographical breakdown



Source: Deutsche Bank, Company Info

Figure 26: Division EBIT – geographical breakdown

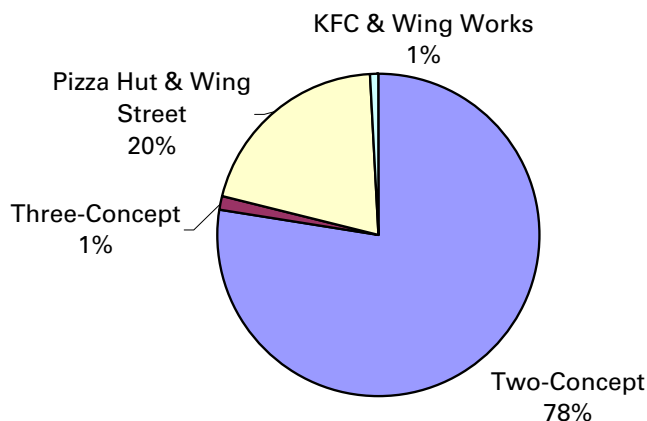


Source: Deutsche Bank, Company Info

YUM restaurant concepts & multibranding strategy

YUM switched to a restaurant multibranding emphasis in May 2002, when it changed its name from Tricon to emphasize the full portfolio vs. a 3-concept strategy. Since 2001, multibranded units have grown from 1,520 to 3,289 worldwide. By expanding menu offerings under one roof, multibranded units tend to generate higher sales volumes and boost returns as the concepts complement one another and share resources.

Figure 27: Multibranded unit dispersion



Source: Deutsche Bank, Company Info

YUM has moved away from the three-concept strategy in multibranding in favor of two, and the top three concepts – KFC, Pizza Hut, and Taco Bell – drive the majority of the company’s global portfolio. Domestically, all three have significant weight, but internationally, KFC and Pizza Hut dominate.

Figure 28: Concept dispersion

	Global	U.S.	Non-U.S.
KFC	40.1%	26.6%	60.0%
Pizza Hut	36.7%	37.0%	36.3%
Taco Bell	17.8%	28.6%	1.8%
LJS	3.5%	5.7%	0.2%
A&W	2.0%	2.2%	1.7%
Total	100.0%	100.0%	100.0%

Source: Deutsche Bank, Company Information

YUM's restaurant concepts

YUM organizes its business around five core restaurant lines, or "concepts":

- **KFC** is grounded in chicken fast-food, with marketing focused on the image of Colonel Saunders and key menu items like the "bucket" of chicken. KFC's menu changes from country to country, although all restaurants offer fried-chicken-on-the-bone products (Original Recipe, Extra Tasty Crispy). Globally, the concept competes with burger fast food chains since there are no global rivals. Many burger chains have begun to offer wider chicken menu options in response to consumer demand for red meat alternatives. The majority (just over 50%) of KFC sales takes place in the dinner daypart, and 80% of sales are takeaway.
- **Pizza Hut** is the leading global pizza brand, operating in fast food, full-service restaurants, and 100% home delivery/takeaway segments. Key menu items include Twisted Crust, The Big New Yorker, Pan Pizza, Thin 'n' Crispy, Stuffed Crust, Hand Tossed, Sicilian, and The Insider, offered with a variety of toppings. Over 60% of sales are generated in the dinner daypart and home delivery/takeaway accounts for 74% of sales.
- **Taco Bell** is the world's leading Mexican fast food chain, with key menu items like tacos, burritos, Gorditas, Chalupas, quesadillas, salads, nachos, etc. Lunch accounts for the largest portion of sales at 44%, while dinner accounts for 41%, and takeaway represented 74% of total sales.
- **Long John Silver's is a fast food seafood chain** with a 50/50 split between lunch and dinner. 58% of sales are takeaway.
- **A&W All-American Food Restaurants** is the oldest U.S. fast food franchise and operates in the burger fast food segment, offering pure-beef burgers, hot dogs, and its signature root beer float. Lunch accounts for 47% of sales, and breakfast/snacks account for 27%. Dine-in represents 52% of sales.
- **Pasta Bravo and WingStreet:** WingStreet/WingWorks is a small flavored chicken wing concept (800 locations) generally paired with Pizza Hut and KFC stores. YUM acquired Pasta Bravo in 2003 for augmenting Pizza Hut stores with made-to-order pastas, pizzas and salads.

Restaurant expansion outlook

Globally, YUM is the largest restaurant company by units, with just over 34,000 restaurants worldwide. Unit growth is quite low at just a 2.4% CAGR over the last five years (through 2005). Unit growth is focused on China (5-year CAGR of 16.5%), while the U.S. strategy, and to a lesser extent the International division, are focused on 1) conversion of existing units to multibrand units and 2) emphasis on higher-volume outlets through closure of under-performing units (namely Pizza Hut and A&W stores).

Given the competitive overall U.S. restaurant environment and expected footprint consolidation, YUM's international expansion is the key leg of its growth and already a major part of its operating base.

International (ex-China): YUM's international business comprises 10.6k restaurants operating in over 100 countries (concentrated in Europe/Asia/Australia), primarily in KFC and Pizza Hut units. As in the U.S., the vast majority of restaurants (87%) are franchised. We expect International to be a steady, low-top-line-growth operation given the large existing base, with more mature operations in countries such as UK/Japan/Mexico but significant growth opportunities in emerging markets such as India, Philippines, Latam, and E. Europe/Russia.

China: We view the China segment (including China, Taiwan and Thailand) as YUM's most significant growth opportunity and an offset to slow growth in the U.S. From a still-small base (over 1,800 restaurants), we believe China can continue to achieve double-digit restaurant growth rates through 2010, due to the underdeveloped competitive field and expanding Chinese consumer wealth. YUM's presence in China is dominated by company-owned stores, with a fledgling franchisee base, as the company builds brand recognition and adapts to local consumer tastes, and seeks to capture higher China returns in-house.

U.S. focus on re-franchising: Re-franchising has been a significant piece of YUM's strategy since its separation from PepsiCo in 1997. At the time, company-owned restaurants made up 34% of total global units vs. 22% as of 2Q06. Under PEP's control, food service outlets were used as a launching pad for soft drink sales. Once separated from PEP, YUM focused more on franchised restaurant growth as a means to enhance performance (believing franchise owners run a better business since it's "their money"). This continues today, albeit at a slower pace, with particular focus on expanding Taco Bell franchises. Re-franchising tends to improve system-wide sales and profitability, and generates capital to invest in growth opportunities (i.e. China, which is largely a company-owned structure).

Figure 29: Refranchising impact to margins]

	U.S.	International	China	Total
Reduced Sales	\$ (240)	\$ (263)	\$ (15)	\$ (518)
Higher Franchise Fees	8	13	-	21
Net Revenue Impact	(232)	(250)	(15)	(497)
Reduced Restaurant Profit	\$ (22)	\$ (34)	\$ (1)	\$ (57)
Higher Franchise Fees	8	13	-	21
G&A Impact	1	10	-	11
Operating Profit Impact	(13)	(11)	(1)	(25)

Margin Impact = 30bps

Source: Deutsche Bank, Company Info

Figure 29 demonstrates the impact of re-franchising across the system in 2005. While it reduced sales by close to \$497mn, operating profits fell by only \$25mn, generating a net 30bp favorable impact on operating margins. In 2004, a similar analysis shows a 40bp favorable impact on operating margin. Returns are also improving, as we estimate ROIC at 20.4% in 2006 vs. 17.5% in 2004.

Net/net, we do not view the U.S. as a unit expansion story for the company. We expect net unit growth to hover close to 1%-1.5% over the next few years, while YUM focuses on unit revenue growth based on concept development, particularly in international markets.

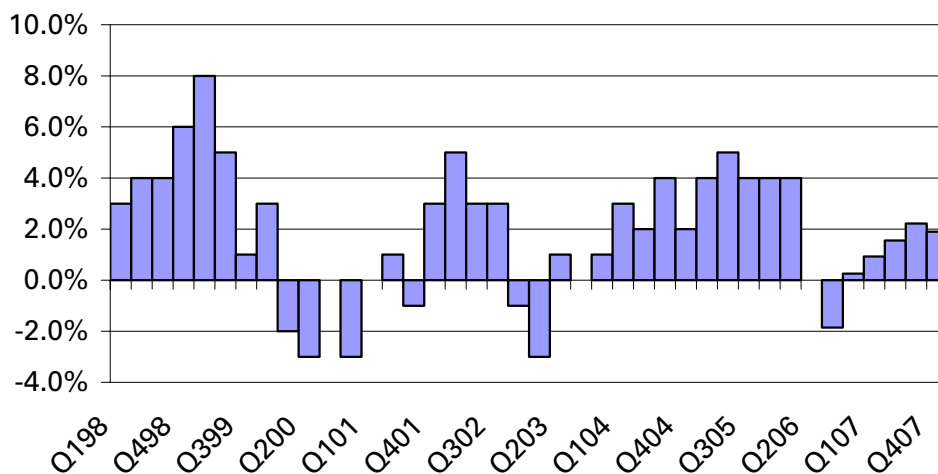
Comparable store sales

We expect comparable sales in international markets and China to drive overall comparable sales. Unlike less mature concept restaurant operators (such as PNRA and SBUX), YUM's major brands are already well-known to consumers in mature U.S. and International markets, providing less opportunity to increase comparable sales by raising brand recognition, not to mention daypart expansion opportunities are already largely tapped.

We project blended U.S. comparable store sales growth of 0-2% for the group through 2007, slightly below management expectations of 2-3%, with modestly higher growth rates expected for Taco Bell and KFC (2-3%) vs. Pizza Hut (0-1%). Increased KFC media activity and new products should drive positive comparable store sales in 2007, while Taco Bell will be

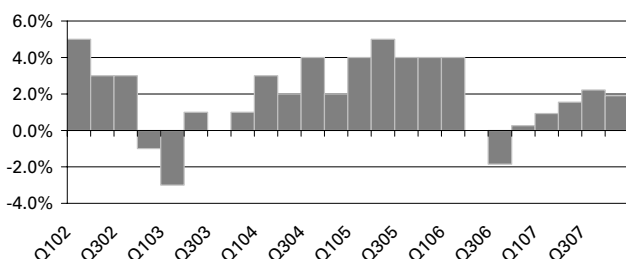
finish lapping a major new product launch and grow units for the first time in years. Pizza Hut remains a declining category which is better categorized as casual dining and is therefore more exposed to blips in consumer spending, slowing housing, energy costs, etc. PH also remains more vulnerable to infringement from the “edge” of the market, as independent pizza shops take share within the category.

Figure 30: U.S. blended same store sales



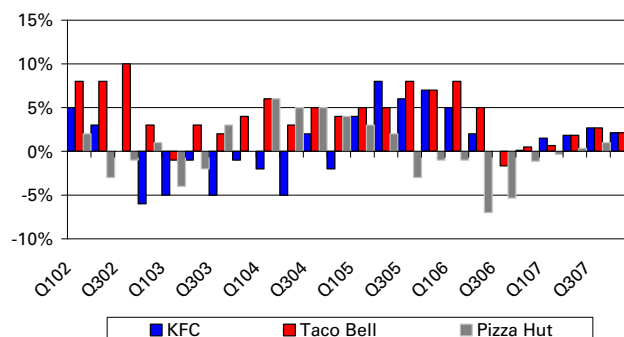
Source: Deutsche Bank, Company Info

Figure 31: U.S. Comparable sales



Source: Deutsche Bank, Company Info

Figure 32: Comparable sales by concept



Source: Deutsche Bank, Company Info

Profit drivers & cost structure

Although YUM’s top-line growth outlook is constrained, we project significant expansion of operating profits over our forecasts. We project long-term EBIT growth of 7.5% on a forward 3-year average basis, with margins expanding from 12.5% in 2005 to 16-17% by the end of our forecasts.

YUM’s primary product inputs are chicken, cheese, beef/pork, paper, flour, produce and beverages. With a relatively low-priced menu, YUM’s ability to pass through ingredient cost is relatively strong, though upside is capped here by affordability and consumer expectations.

YUM centrally organizes purchasing in the U.S. for company-owned stores and franchisees, and this should help wring gains out of the supply chain and leverage scale over the long

term. The Unified Foodservice Purchasing Coop combines the supply purchasing power of the company and its franchisees. Ameriserve (now owned by McLane & Co.) is the principal distributor for Pizza Hut and Taco Bell, and to a lesser extent, KFC. The company also has an ongoing agreement with PepsiCo for the sale of Pepsi products in its stores, which allows for cross-marketing.

- YUM's U.S. business generates the lowest operating margins in the group as a result of the crowded competitive field. We expect this, along with limited comparable store sales growth and increasing rent/wage costs, to weigh on margin expansion going forward. However, we project improvement to 17-18% LT margins (vs. 13.8% in 2005) through store rationalization and efficiency improvements, most notably through continued multibranding and re-franchising, as well as supply chain gains and lowering of G&A.
- International (18%) and China (16%) operating margins are above U.S. levels, but we believe they have more room to improve, with International driving to 31-32% levels (reflects shift to high margin franchise business) and China to 22-23% in our long-term forecasts. We assume greater pricing power for YUM in both segments, especially China, due to a less-developed competitive field and increasing purchasing power as the base expands. Unlike in the U.S., however, ingredient purchasing in these markets is decentralized and left to franchisees, making it less efficient.

Estimates & assumptions

Putting it all together, our financial projections for YUM are as follows:

2006 adjusted EPS forecast of \$2.93 (guidance at least \$2.89) reflects the following:

- Worldwide net revenues of \$9.54bn, +2%
 - Worldwide restaurant growth of 512 or about 1.5%, driven by +18.8% China and 4.8% International offsetting -2.1% rationalization in the U.S.
 - Comp stores growth of -2-0% in 2H06, with TB -2-1, KFC 0-1% and PH -5-1%.
- EBIT growth of 14.5% on flattish revenue growth of 2%, but significant margin expansion from 12.5% to 14%, with margin expansion in all three geographic segments.
- 6% decline in average shares outstanding, reflecting \$800mn in share repurchases. Total expected cash returned to shareholders this year is \$950mn including dividends, equating to 100% of FCF. Management's target is for \$1bn of shareholder returns per year, although a focus on maintenance of investment grade credit ratings constrains upside.

2007 EPS forecast of \$3.32 reflects:

- Worldwide net revenues of \$9.84 billion, +3.2%
 - Worldwide restaurant growth of 495 or 1.4%, driven by +17.9% China and 4% International offsetting -1.6% U.S.
 - Comp stores growth of 1-2%, with TB and KFC 2-3% and PH 0-1%.
- EBIT growth of 5.6%, on 3.2% revenue growth and slight margin expansion from 14% to 14.3%, with modest expansion in all three geographic segments.
- 2% decline in average shares outstanding, reflecting \$1bn share repurchase. Total expected cash returned to shareholders of \$1,17bn, equating to 93% of FCF.

Long-term forecasts beyond 2007:

- Restaurant growth of 0-1.5% p.a., driven by China, with the U.S. modestly declining and an increasing tilt toward franchises within the total base. We estimate YUM will grow from 34.2k restaurants in 2005 to nearly 38.6k by 2015.
- Revenue growth of 2-3.5% p.a., given modest footprint growth outlook and SSS expansion
- EBIT growth of 6-8% with low revenue growth rates but continued expansion of operating margins
- Long-term EPS growth of 10-14%. We assume that YUM's EBIT growth will be compounded by continued reduction of share capital, driving strong EPS growth rates. YUM's subdued capex, modest leverage and limited growth opportunities in U.S. and mature international markets mean a significant portion of FCF growth (4-5% CAGR through 2010) should be available for return to shareholders through dividends and share repurchases.

Valuation

Buying the upside

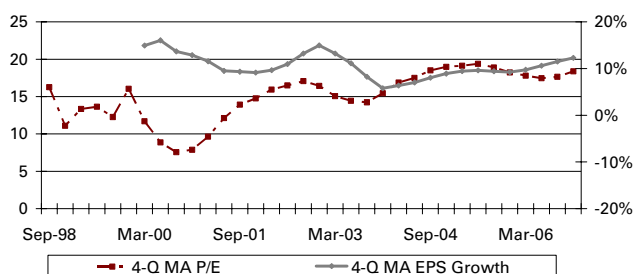
YUM is putting up steady EPS growth of well over 10% – our 2006 forecast calls for a 3-year CAGR (options adjusted) of over 13%) – and return spread continues to expand into the mid-to-high teens. We expect this, and the growing influence of international markets on profit growth, to drive multiple expansion. A blended target price, assuming an average of our five key methodologies, of \$66 suggests total return potential of 15%. We therefore rate YUM a Buy.

Figure 33: Valuation methodology summary (\$)

Methodology	Multiple	Value
TEV/EBITDA	10X	64
P/E	18X	60
ROIC Spread vs. TEV/EBITDA	10x	64
DCF	NA	74
Final Target Price		66
Appreciation Potential		14%
Total Return Potential		15%

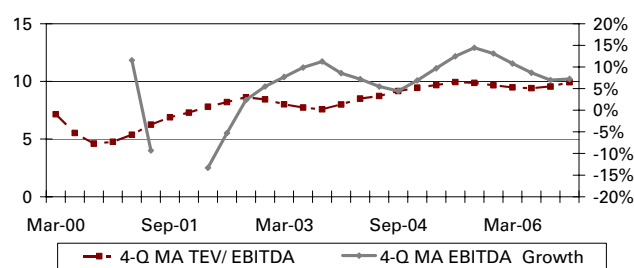
Source: Deutsche Bank, Factset, Reuters, Company Info

Figure 34: YUM P/E vs. EPS growth



Source: Deutsche Bank, Factset

Figure 35: YUM EV/EBITDA vs. EBITDA growth

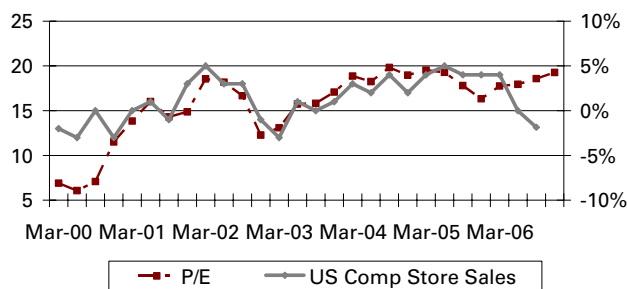


Source: Deutsche Bank, Factset

EPS growth over a period of three years has averaged just under 11% and during the same period, P/E multiples have averaged just under 18x. We are forecasting average EPS growth of 13.5% over the next three years and therefore believe an approximate 18x P/E multiple is fair and could have upside. Applied to our 2007 EPS forecast of \$3.32, this suggests a share value of \$60.

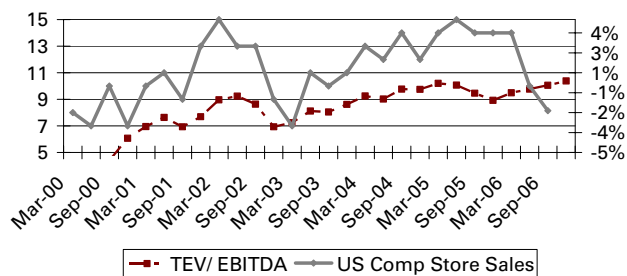
TEV/EBITDA has averaged 9.5x over the last three years while EBITDA growth has averaged 6%. We are forecasting 8% average annual EBITDA growth for the next three years, above the historical average. An above-average TEV/EBITDA multiple of 10x our 2007 EBITDA forecast equates to \$64.

Figure 36: P/E vs. comparable store sales



Source: Deutsche Bank, Factset, Reuters, Company Info

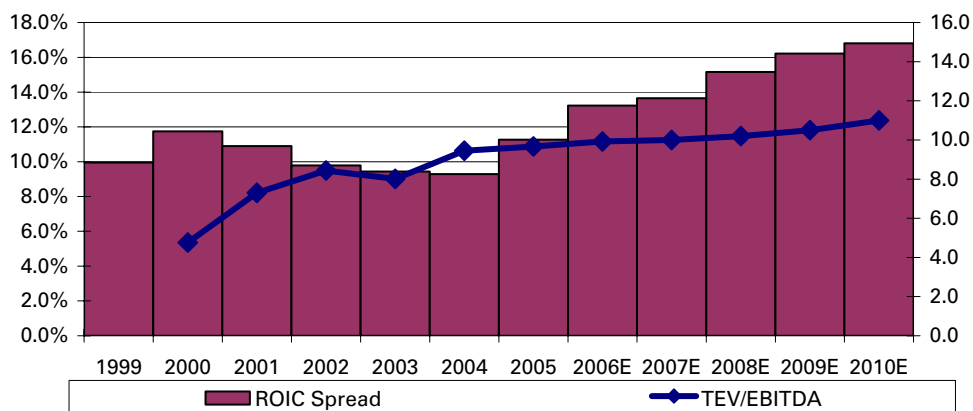
Figure 37: EV/EBITDA vs. comparable store sales



Source: Deutsche Bank, Factset, Reuters, Company Info

Figures 36 and 37 suggest a close relationship between U.S. company-operated comparable store sales and share valuation, regardless of the other half of profits driven by international operations. On the heels of comparable store sales growth acceleration to a rate of 3%-4% between 2004 and 2005, valuation expanded. However, we expect comparable store sales to revert to a 1% to 2% growth rate and valuation multiples should begin to reflect the bigger corporate picture, including the very favorable international trends, profit margin improvement, and return expansion. Elimination of monthly comparable store sales reports could go a long way in shifting the focus to longer-term outlook.

Figure 38: TEV/EBITDA vs. ROIC spread



Source: Deutsche Bank, Factset, company Info

A key metric that would imply a more favorable outlook for valuation multiples is the ROIC spread. We expect continued expansion in returns and the spread to our market average cost of capital measure to near 16% by 2010. Assuming valuation expands with the ROIC spread, a 10x TEV/EBITDA multiple applied to our 2007 forecast suggests a \$64 share value.

Figure 39: Discounted cash flow model

	2003	2004	2005	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E
EBIT*(1-t)	739	833	856	930	1,015	1,100	1,186	1,256	1,310	1,362	1,423	1,478	1,539	1,585
D&A	401	448	469	477	523	565	588	611	630	649	665	683	701	700
EBITDA	1,140	1,281	1,325	1,407	1,538	1,665	1,775	1,867	1,939	2,011	2,088	2,160	2,239	2,285
Chgs in Oper. W/C	65	(202)	121	(167)	56	(95)	(126)	(124)	(278)	(77)	(284)	(181)	(282)	(300)
Capex	525	453	383	327	330	329	342	356	366	378	387	397	408	425
FCF	680	626	1,063	914	1,264	1,241	1,306	1,388	1,295	1,557	1,418	1,582	1,549	1,560
% Growth														
Discount Rate	8.0%													\$13,079
PV of FCF, 2005-2015	\$9,327													
PV of Terminal Value	\$13,079													
Corporate Value	\$22,406													
Less: Debt	\$1,674													
Equity Value	\$20,731													
Share Count (Millions)	281													
Equity Value/Share	\$74													

2006 Valuation	2004	2005	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Year			1	2	3	4	5	6	7	8	9	10
Factor			1.08	1.17	1.26	1.36	1.47	1.59	1.72	1.85	2.00	2.16
PV of FCF			\$1,171	\$1,064	\$1,037	\$1,020	\$881	\$980	\$826	\$854	\$774	\$721
Cumulative			\$1,171	\$2,235	\$3,271	\$4,291	\$5,171	\$6,152	\$6,978	\$7,831	\$8,605	\$9,327

Cost of Debt	9.0%
Rf	4.7%
Beta	0.95
Market risk premium	5.4%
Required Return on Equity	9.9%
Net Debt / Net Capital	55.1%
Tax Rate	27.8%
Required Return on Investment	8.0%
LT Growth Rate	2.5%
FCF Multiple	18.1

Source: Deutsche Bank, Bloomberg, Company Info]

Our discounted cash flow model, assuming 5% 10-year EBIT CAGR, 2.5% growth in perpetuity, 9.6% required return on equity and a cost of debt of 9%, generates a share value of \$74.

Key risks

Consumer slowdown and leverage to China: As discussed, the restaurant industry is highly leveraged to the health of consumer spending. A significant turndown in U.S. consumer spending could depress SSS growth. YUM's significant reliance on the Chinese market for future growth also makes it vulnerable to economic disruption there or lack of brand acceptance.

Sourcing issues & ingredient costs: Although U.S. ingredient sourcing is centralized, YUM remains vulnerable to supply chain disruptions and shortages. Health-related issues such as Avian flu for example (which impacted 2005 results) have threatened poultry pricing and availability in certain markets. YUM is also leveraged to food input costs, such as changes in dairy/cheese costs, poultry, etc.

Obesity issues: YUM is particularly vulnerable to obesity issues given its exposure to the fast food industry and purveyance of soft drinks.

Illness concerns: Like other restaurant chains, YUM is vulnerable to concerns over ingredient safety, such as the negative sentiment around the Avian flu scare in 2005, E. coli outbreaks, etc. This has the potential to affect both product quality perception but also ingredient availability. Despite safety precautions taken by the company, YUM will remain vulnerable to negative public perception of product inputs in these instances, particularly outside of the U.S. market where supply chain precautions are often less stringent.

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Figure 40: YUM income statement

	2004	1Q05	2Q05	3Q05	4Q05	2005	1Q06	2Q06	3Q06	4Q06E	2006E	1Q07E	2Q07E	3Q07E	4Q07E	2007E
Net Revenues																
Company sales	7,992	1,810	1,902	1,975	2,538	8,225	1,819	1,912	1,989	2,597	8,317	1,866	1,965	2,059	2,643	8,533
Franchise and licensee fees	1,019	244	251	268	361	1,124	266	270	288	394	1,219	288	288	309	426	1,311
Total Net Revenues	9,011	2,054	2,153	2,243	2,899	9,349	2,085	2,182	2,278	2,992	9,537	2,154	2,253	2,368	3,069	9,844
Company-operated rest. expenses																
Food & paper	2,538	574	600	619	791	2,584	557	583	606	797	2,543	569	596	624	803	2,593
Payroll & employee benefits	2,112	485	508	502	678	2,171	477	492	492	688	2,149	489	503	504	692	2,189
Occupancy & other operating expenses	2,183	491	530	561	733	2,315	501	536	570	753	2,360	519	554	587	764	2,423
Total	6,833	1,550	1,638	1,682	2,202	7,070	1,535	1,611	1,668	2,239	7,053	1,577	1,653	1,715	2,260	7,205
General & administrative	1,056	248	285	267	374	1,158	254	264	271	377	1,166	267	270	279	384	1,201
Franchise & license expense	26	8	4	12	9	33	8	9	7	10	34	9	9	12	10	41
Other operating expenses, net	(55)	(14)	(25)	(27)	(14)	(80)	(4)	(12)	(17)	(20)	(53)	(2)	(2)	(5)	(5)	(14)
Total operating expenses	7,860	1,792	1,902	1,934	2,571	8,181	1,793	1,872	1,929	2,606	8,200	1,851	1,931	2,002	2,648	8,432
Impairment and other charges (credits), net	(4)	11	4	5	(5)	15	10	3	5	30	48					-
Operating Income	1,155	251	247	304	333	1,153	282	307	344	356	1,289	303	322	366	420	1,412
Operating income Excl. - charges	1,151	262	251	309	328	1,168	292	310	349	386	1,337	303	322	366	420	1,412
Interest expense	129	28	30	28	41	127	35	36	34	45	150	32	32	32	43	139
Pretax Income	1,026	223	217	276	292	1,026	247	271	310	311	1,139	271	290	334	377	1,273
Taxes	286	71	48	74	66	264	77	79	80	81	317	81	81	90	105	357
Net Income - Continuing Operations	740	152	169	202	226	762	170	192	230	230	822	190	209	244	273	915
Cumulative effect of accounting change	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Net Income	740	152	169	202	226	762	170	192	230	230	822	190	209	244	273	915
Net Income Excl.-Charges	736	159	164	206	222	751	177	194	234	252	857	190	209	244	273	915
Average Shares Outstanding - Basic	291	291	288	285	281	286	276	272	268	268	271	265	268	262	260	264
Basic EPS	\$2.54	\$0.52	\$0.59	\$0.71	\$0.80	\$2.66	\$0.62	\$0.71	\$0.86	\$0.86	\$3.03	\$0.72	\$0.78	\$0.93	\$1.05	\$3.47
Average Shares Outstanding - Diluted	305	304	302	298	292	298	286	281	277	280	281	277	278	274	272	275
Diluted EPS	\$2.43	\$0.50	\$0.56	\$0.68	\$0.77	\$2.55	\$0.59	\$0.68	\$0.83	\$0.82	\$2.93	\$0.68	\$0.75	\$0.89	\$1.00	\$3.32
Average Shares Outstanding - Diluted	305	304	302	298	292	298	286	281	277	280	281	277	278	274	272	275
Diluted EPS ex. Charges	\$2.41	\$0.52	\$0.51	\$0.66	\$0.76	\$2.52	\$0.62	\$0.69	\$0.84	\$0.90	\$3.05	\$0.68	\$0.75	\$0.89	\$1.00	\$3.32
Dividend	\$0.30	\$0.10	\$0.12	\$0.00	\$0.23	\$0.45	\$0.12	\$0.12	\$0.00	\$0.30	\$0.54	\$0.15	\$0.15	\$0.00	\$0.34	\$0.64
payout ratio	12%					17%					18%					18%

	2004	1Q05	2Q05	3Q05	4Q05	2005	1Q06	2Q06	3Q06	4Q06E	2006E	1Q07E	2Q07E	3Q07E	4Q07E	2007E
Margin Structure*																
Company-operated rest. expenses	31.8%	31.7%	31.5%	31.3%	31.2%	31.4%	30.6%	30.5%	30.5%	30.7%	30.6%	30.5%	30.4%	30.3%	30.4%	30.4%
Food & paper	26.4%	26.8%	26.7%	25.4%	26.7%	26.4%	26.2%	25.7%	24.7%	26.5%	25.8%	26.2%	25.6%	24.5%	26.2%	25.7%
Payroll & employee benefits	27.3%	27.1%	27.8%	28.4%	28.9%	28.1%	27.5%	28.0%	28.7%	29.0%	28.4%	27.8%	28.2%	28.5%	28.9%	28.4%
Occupancy & other operating expenses		14.4%	13.9%	14.8%	13.2%	14.0%	15.6%	15.7%	16.1%	13.8%	15.2%	15.5%	15.9%	16.7%	14.5%	15.6%
Restaurant Margin	11.7%	12.1%	13.2%	11.9%	12.9%	12.4%	12.2%	12.1%	11.9%	12.6%	12.2%	12.4%	12.0%	11.8%	12.5%	12.2%
General & administrative % total revenue	2.8%	3.3%	1.6%	4.5%	2.5%	2.9%	3.0%	3.3%	2.4%	2.5%	2.8%	3.1%	3.2%	4.0%	2.4%	3.1%
Franchise & license expense as % of franchise & license Fees	12.5%	12.8%	11.7%	13.8%	11.3%	12.5%	14.0%	14.2%	15.3%	12.9%	14.0%	14.1%	14.3%	15.5%	13.7%	14.3%
Operating Margin	17.7%	17.5%	16.8%	18.7%	16.5%	17.5%	18.8%	19.3%	20.2%	18.1%	19.0%	19.3%	19.5%	20.9%	19.1%	19.7%
EBITDA Margin	27.9%	31.8%	22.1%	26.8%	22.6%	25.7%	31.2%	29.2%	25.8%	26.0%	27.8%	30.0%	28.0%	27.0%	27.7%	28.1%
Tax Rate	8.2%	7.8%	7.8%	9.2%	7.7%	8.0%	8.5%	8.9%	10.3%	8.4%	9.0%	8.8%	9.3%	10.3%	8.9%	9.3%
Net Margin																

	2004	1Q05	2Q05	3Q05	4Q05	2005	1Q06	2Q06	3Q06	4Q06E	2006E	1Q07E	2Q07E	3Q07E	4Q07E	2007E
Growth Leverage*																
Company-operated- Revenues	7.4%	3.6%	3.0%	2.1%	3.0%	2.9%	0.5%	0.5%	0.7%	2.3%	1.1%	2.6%	2.8%	3.5%	1.8%	2.6%
Franchised and affiliated - Revenues	8.5%	9.4%	8.7%	9.8%	12.5%	10.3%	9.0%	7.6%	7.8%	9.3%	8.5%	8.2%	6.8%	6.9%	8.0%	7.5%
Net Revenues	7.5%	4.3%	3.7%	2.9%	4.1%	3.8%	1.5%	1.3%	1.6%	3.2%	2.0%	3.3%	3.3%	3.9%	2.6%	3.2%
SG&A	11.7%	4.6%	21.8%	6.8%	11.6%	9.7%	2.4%	-7.4%	1.5%	0.8%	0.7%	5.2%	2.4%	3.1%	1.8%	3.0%
Operating Income	3.6%	4.0%	-7.4%	5.1%	-1.8%	6.6%	11.5%	23.5%	12.9%	17.7%	14.5%	3.8%	3.9%	4.8%	8.9%	5.6%
EBITDA	5.8%	3.5%	-2.4%	4.7%	-0.4%	6.0%	8.9%	16.3%	9.8%	13.2%	10.8%	6.2%	4.4%	7.1%	8.3%	6.6%
Net Income	12.8%	7.7%	-6.6%	9.9%	-1.7%	2.0%	10.9%	18.7%	13.6%	13.6%	14.2%	7.3%	7.6%	4.3%	8.1%	6.8%
Diluted EPS	20.3%	7.4%	-4.4%	11.8%	0.5%	11.2%	18.9%	22.1%	22.5%	6.2%	14.6%	15.2%	9.9%	7.0%	22.1%	13.6%
Diluted EPS ex. Charges	13.2%	8.0%	-11.2%	7.6%	2.7%	10.2%	17.9%	35.0%	27.8%	18.5%	21.2%	10.7%	8.7%	5.3%	11.3%	9.0%

	2004	1Q05	2Q05	3Q05	4Q05	2005	1Q06	2Q06	3Q06	4Q06E	2006E	1Q07E	2Q07E	3Q07E	4Q07E	2007E
Cashflow Points																
Operating Income	1,155	251	247	304	333	1,153	282	307	344	356	1,289	303	322	366	420	1,412
Depreciation & Amortization	448	97	111	111	150	469	99	111	112	155	477	112	117	128	166	523
EBITDA	1,603	348	358	415	483	1,622	381	418	456	511	1,766	415	439	494	586	1,934
Capex	453	87	60	111	125	383	42	70	100	115	327	45	75	95	115	330
Dividends	58	29	33	-	65	123	32	33	-	80	145	40	40	-	88	169

Source: Deutsche Bank, Company Info

Figure 41: YUM Metrics

No. of Restaurants																
Company-operated Restaurants																
US	4,989	4,963	4,866	4,782	4,686	4,686	4,601	4,561	4,458	4,336	4,336	4,381	4,311	4,208	4,036	4,036
China	1,266	1,337	1,380	1,434	1,526	1,526	1,573	1,620	1,657	1,846	1,846	1,823	1,880	1,927	2,196	2,196
International	1,504	1,489	1,439	1,425	1,375	1,375	1,366	1,351	1,289	1,305	1,305	1,266	1,241	1,169	1,185	1,185
Total Company-operated	7,759	7,789	7,685	7,641	7,587	7,587	7,540	7,532	7,404	7,487	7,487	7,470	7,432	7,304	7,417	7,417
Franchised & Licensed Restaurants																
US	15,621	15,606	15,656	15,707	15,786	15,786	15,802	15,547	15,594	15,711	15,711	15,772	15,527	15,574	15,691	15,691
China	198	204	207	210	213	213	215	214	217	220	220	220	222	232	240	240
International	8,385	8,441	8,663	8,755	9,043	9,043	9,123	9,199	9,363	9,613	9,613	9,623	9,719	9,913	10,173	10,173
Total Franchised and Licensed	24,204	24,251	24,526	24,672	25,042	25,042	25,140	24,960	25,174	25,544	25,544	25,615	25,468	25,719	26,104	26,104
Total unconsolidated affiliated restaur	1,664	1,681	1,568	1,595	1,648	1,648	1,652	1,673	1,696	1,758	1,758	1,632	1,643	1,731	1,763	1,763
Total Restaurants	33,627	33,721	33,779	33,908	34,277	34,277	34,332	34,165	34,274	34,789	34,789	34,717	34,543	34,754	35,284	35,284
# growth in Restaurants																
Company-operated Restaurants																
US	(105)	(122)	(166)	(281)	(303)	(303)	(362)	(305)	(324)	(350)	(350)	(220)	(250)	(250)	(300)	(300)
China	206	240	270	287	260	260	236	240	223	320	320	250	260	270	350	350
International	(196)	(208)	(236)	(267)	(129)	(129)	(123)	(88)	(136)	(70)	(70)	(100)	(110)	(120)	(120)	(120)
Total new Company-operated	(95)	(90)	(132)	(261)	(172)	(172)	(249)	(153)	(237)	(100)	(100)	(70)	(100)	(100)	(70)	(70)
Franchised & Licensed Restaurants																
US	(101)	(36)	42	152	165	165	196	(109)	(113)	(75)	(75)	(30)	(20)	(20)	(20)	(20)
China	(3)	(1)	3	10	15	15	11	7	7	7	7	5	8	15	20	20
International	475	466	665	711	658	658	682	536	608	570	570	500	520	550	560	560
Total New Franchised and Licensed	371	429	710	873	838	838	889	434	502	502	502	475	508	545	560	560
Unconsolidated affiliated restaurants	152	154	16	21	(16)	(16)	(29)	105	101	110	110	(20)	(30)	35	5	5
Total new restaurants	428	493	594	633	650	650	611	386	366	512	512	385	378	480	495	495
Restaurants (% growth)																
Company-operated Restaurants																
US	-2.1%	-2.4%	-3.3%	-5.6%	-6.1%	-6.1%	-7.3%	-6.3%	-6.8%	-7.5%	-7.5%	-4.8%	-5.5%	-5.6%	-6.9%	-6.9%
China	19.4%	21.9%	24.3%	25.0%	20.5%	20.5%	17.7%	17.4%	15.6%	21.0%	21.0%	15.9%	16.0%	16.3%	19.0%	19.0%
International	-11.5%	-12.3%	-14.1%	-15.8%	-8.6%	-8.6%	-8.3%	-6.1%	-9.5%	-5.1%	-5.1%	-7.3%	-8.1%	-9.3%	-9.2%	-9.2%
Total Company-operated	-1.2%	-1.1%	-1.7%	-3.3%	-2.2%	-2.2%	-3.2%	-2.0%	-3.1%	-1.3%	-1.3%	-0.9%	-1.3%	-1.4%	-0.9%	-0.9%
Franchised & Licensed Restaurants																
US	-0.6%	-0.2%	0.3%	1.0%	1.1%	1.1%	1.3%	-0.7%	-0.7%	-0.5%	-0.5%	-0.2%	-0.1%	-0.1%	-0.1%	-0.1%
China	-1.5%	-0.5%	1.5%	5.0%	7.6%	7.6%	5.4%	3.4%	3.3%	3.3%	3.3%	2.3%	3.7%	6.9%	9.1%	9.1%
International	6.0%	5.8%	8.3%	8.8%	7.8%	7.8%	8.1%	6.2%	6.9%	6.3%	6.3%	5.5%	5.7%	5.9%	5.8%	5.8%
Total Franchised and Licensed	1.6%	1.8%	3.0%	3.7%	3.5%	3.5%	3.7%	1.8%	2.0%	2.0%	2.0%	1.9%	2.0%	2.2%	2.2%	2.2%
Total	1.3%	1.5%	1.8%	1.9%	1.9%	1.9%	1.8%	1.1%	1.1%	1.5%	1.5%	1.1%	1.1%	1.4%	1.4%	1.4%
US Total	-1.0%	-0.8%	-0.6%	-0.6%	-0.7%	-0.7%	-0.8%	-2.0%	-2.1%	-2.1%	-2.1%	-1.2%	-1.3%	-1.3%	-1.6%	-1.6%
China Total	16.1%	18.4%	20.8%	22.0%	18.8%	18.8%	16.0%	15.6%	14.0%	18.8%	18.8%	14.3%	14.6%	15.2%	17.9%	17.9%
International Total	2.9%	2.7%	4.4%	4.6%	5.3%	5.3%	5.6%	4.4%	4.6%	4.8%	4.8%	3.8%	3.9%	4.0%	4.0%	4.0%
Company Owned Revenue per Store analysis																
Comparable Sales																
US	3.0%	4.0%	5.0%	4.0%	4.0%	4.0%	4.0%	0.0%	-1.9%	-0.1%	0.5%	0.9%	1.6%	2.2%	1.9%	1.7%
US New stores	0.7%	1.2%	0.9%	2.7%	5.4%	4.6%	2.6%	1.3%	1.0%	1.0%	1.9%	1.0%	1.2%	1.3%	1.5%	2.4%
Revenue per Store, incl Comp																
China	4.8%	3.5%	-7.3%	-4.7%	-12.9%	-4.5%	0.9%	14.0%	12.0%	13.0%	7.8%	8.0%	5.0%	6.0%	5.0%	3.9%
International	28.9%	8.3%	10.4%	7.9%	7.2%	4.5%	1.8%	2.8%	12.6%	10.0%	5.0%	12.0%	11.0%	8.0%	3.0%	8.6%
Franchised Revenue per Store analysis																
US	5.2%	4.0%	2.6%	6.0%	7.6%	4.8%	7.6%	4.8%	1.4%	2.0%	3.9%	2.5%	3.0%	3.5%	4.0%	3.3%
China	28.2%	14.8%	-1.5%	-5.0%	9.1%	0.3%	-5.4%	34.1%	33.0%	22.0%	22.4%	15.0%	10.0%	8.0%	9.0%	7.0%
International	7.7%	11.8%	11.2%	6.9%	9.8%	9.7%	1.9%	4.0%	8.6%	12.0%	7.7%	10.0%	6.0%	4.5%	6.0%	6.4%

Source: Deutsche Bank, Company Info

Figure 42: YUM operating segment P&L (US\$)

	2004	1Q05	2Q05	3Q05	4Q05	2005	1Q06	2Q06	3Q06	4Q06E	2006E	1Q07E	2Q07E	3Q07E	4Q07E	2007E
US Division																
Company sales	5,163	1,199	1,240	1,239	1,616	5,294	1,191	1,179	1,145	1,511	5,026	1,157	1,147	1,121	1,457	4,882
Franchise and license fees	600	136	145	154	200	635	148	151	155	203	657	151	155	160	211	678
Total Revenues	5,763	1,335	1,385	1,393	1,816	5,929	1,339	1,330	1,300	1,714	5,683	1,308	1,302	1,281	1,668	5,560
Food and paper	1,546	363	374	368	471	1,576	340	332	319	431	1,422	325	320	320	415	1,380
Payroll and employee benefits	1,573	367	373	367	495	1,600	359	350	346	468	1,523	349	340	332	446	1,468
Occupancy and other	1,333	311	317	332	425	1,385	313	308	319	412	1,352	307	302	305	393	1,307
Total Company restaurant expenses	4,452	1,041	1,064	1,067	1,391	4,561	1,012	990	984	1,311	4,297	980	962	957	1,255	4,154
General and administrative expenses	501	123	125	121	171	536	126	125	129	170	550	123	124	118	158	523
Franchise and license expenses	19	6	3	9	8	26	4	7	4	8	23	4	7	10	11	31
Closures and impairment expenses	14	8	14	13	11	46	1	14	-	15	30	1	14	12	10	37
Other expenses / (income)	-	-	-	-	-	-	8	-	-	-	8	8	-	-	-	8
Total expenses	4,986	1,178	1,206	1,210	1,581	5,169	1,151	1,136	1,117	1,504	4,908	1,116	1,107	1,096	1,434	4,753
Restaurant Operating profit	1,311	294	321	326	425	1,368	327	340	316	402	1,385	328	340	325	413	1,406
Operating profit	777	157	179	183	235	760	188	194	183	209	774	192	196	185	234	807
Restaurant Operating profit Y/Y %	-0.2%	0.0%	0.9%	2.5%	11.5%	4.3%	11.2%	5.9%	-3.1%	-2.1%	2.3%	0.3%	0.0%	2.8%	2.6%	1.5%
Operating profit Y/Y %	-4.3%	-8.7%	-10.1%	-6.6%	11.9%	0.7%	19.7%	8.4%	0.0%	-2.7%	4.6%	2.2%	0.8%	1.3%	11.8%	4.2%
International Division																
Company sales	1,747	384	394	387	511	1,676	359	381	399	536	1,675	376	392	394	503	1,664
Franchise and license fees	381	100	98	103	147	448	110	108	119	174	511	127	121	131	194	573
Total Revenues	2,128	484	492	490	658	2,124	469	489	518	710	2,186	503	512	525	697	2,238
Food and paper	591	128	128	128	170	554	120	126	131	177	554	125	129	130	166	550
Payroll and employee benefits	414	91	96	93	124	404	84	94	95	130	403	88	97	96	123	404
Occupancy and other	513	115	119	118	163	515	109	115	118	170	512	115	119	120	161	514
Total Company restaurant expenses	1,518	334	343	339	457	1,473	313	335	344	478	1,470	328	345	345	450	1,468
General and administrative expenses	271	64	68	67	92	284	58	64	65	97	284	63	67	68	94	291
Franchise and license expenses	7	2	1	3	1	7	4	2	3	2	11	4	2	3	2	11
Closures and impairment expenses	20	1	1	4	3	9	4	3	1	4	12	5	3	4	3	15
Other expenses / (income)	(25)	(9)	(5)	(4)	(3)	(21)	(5)	(3)	-	(4)	(12)	(6)	(3)	(4)	(3)	(16)
Total expenses	1,791	392	408	409	550	1,752	374	401	413	578	1,766	393	414	416	546	1,769
Restaurant Operating profit	229	50	51	48	54	203	46	46	55	58	205	48	47	48	53	196
Operating profit	337	92	84	81	108	372	95	88	105	132	420	109	98	109	152	469
Restaurant Operating profit Y/Y %	6.5%	-5.7%	-5.6%	-15.8%	-16.9%	-11.4%	-8.0%	-9.8%	14.6%	18.2%	3.5%	4.6%	1.4%	-11.9%	-7.9%	-4.1%
Operating profit Y/Y %	11.6%	4.5%	13.5%	2.5%	12.5%	14.8%	3.3%	4.8%	29.6%	29.5%	14.8%	15.2%	11.6%	4.2%	14.8%	11.6%
China Division																
Company sales	1,082	227	268	349	411	1,255	269	352	445	551	1,617	333	426	544	683	1,986
Franchise and license fees	38	8	8	11	14	41	8	11	15	18	52	9	13	17	21	60
Total Revenues	1,120	235	276	360	425	1,296	277	363	460	568	1,668	343	439	561	703	2,046
Food and paper	401	83	98	123	150	454	97	125	156	198	576	117	149	183	238	687
Payroll and employee benefits	125	27	39	42	59	167	34	48	51	77	210	42	58	66	102	268
Occupancy and other	337	65	94	111	145	415	79	113	133	192	517	95	132	166	233	625
Total Company restaurant expenses	863	175	231	276	354	1,036	210	286	340	467	1,303	253	339	416	573	1,580
General and administrative expenses	80	14	22	24	32	92	15	26	30	43	114	18	31	39	52	141
Franchise and license expenses	-	-	-	-	-	7	-	1	1	-	5	-	-	1	-	8
Closures and impairment expenses	4	-	2	-	5	-	1	1	-	3	-	1	1	2	-	-
Other expenses / (income)	(32)	(6)	(3)	(24)	(17)	(50)	(7)	(7)	(15)	(17)	(46)	(8)	(9)	(39)	(28)	(84)
Total expenses	915	183	252	276	374	1,085	219	306	355	496	1,376	264	362	417	600	1,644
Restaurant Operating profit	257	60	45	84	71	260	67	77	120	101	365	89	100	146	131	466
Operating profit	205	52	24	84	51	211	58	57	105	72	292	78	76	144	103	402
Restaurant Operating profit Y/Y %	27.2%	27.7%	-4.3%	12.0%	-19.3%	1.2%	11.7%	71.1%	42.9%	42.6%	40.5%	33.4%	29.7%	21.4%	29.0%	27.5%
Operating profit Y/Y %	27.3%	23.8%	-31.4%	31.3%	-20.3%	5.0%	11.5%	137.5%	25.0%	41.7%	38.5%	35.2%	33.6%	37.1%	42.8%	37.5%
Unallocated	(168)	(39)	(36)	(39)	(66)	(175)	(49)	(29)	(44)	(28)	(150)	(77)	(48)	(73)	(68)	(266)
Total Operating Profit	1,319	262	251	309	328	1,343	292	310	349	386	1,337	303	322	366	420	1,412

Source: Deutsche Bank, Company Info

Figure 43: YUM balance sheet

	2004	1Q05	2Q05	3Q05	4Q05	2005	1Q06	2Q06	3Q06	4Q06E	2006E	1Q07E	2Q07E	3Q07E	4Q07E	2007E
Cash/Marketable Securities	62	118	113	263	158	158	134	267			536					722
ST investments	54	74	87	89	43	43	61	74			125					80
Accounts and notes receivables	192	200	212	227	236	236	258	223			286					295
Inventory	76	81	77	74	85	85	84	84			86					98
Prepaid and other current assets	142	149	91	81	75	75	95	100			95					98
Deferred tax	156	147	143	157	163	163	159	158			195					200
Advertising cooperative assets, restricted	65	76	78	76	77	77	102	97			105					130
Total Current Assets	747	845	801	967	837	837	893	1,003	-	-	1,428	-	-	-	-	1,624
Plant & Equipment, Net	3,439	3433	3371	3373	3,356	3,356	3,295	3,300			3,206					3,013
Goodwill & Intangible assets	900	897	890	882	868	868	867	881			880					900
Investments in unconsolidated affiliates	194	208	179	190	173	173	157	173			191					250
Other assets	416	415	434	462	464	464	505	507			345					127
Total Assets	5,696	5,798	5,675	5,874	5,698	5,698	5,717	5,864	-	-	6,050	-	-	-	-	5,915
Accounts Payable & other	1,189	1184	1214	1240	1,238	1,238	1,208	1,185			1,234					1,261
Taxes Payable	111	102	60	136	79	79	118	64			95					89
ST borrowings	11	16	222	213	211	211	223	13			15					15
Advertising cooperative liabilities	65	76	78	76	77	77	102	97			95					130
Total Current Liabilities	1,376	1,378	1,574	1,665	1,605	1,605	1,651	1,359	-	-	1,440	-	-	-	-	1,494
Long-term Debt	1,731	1708	1562	1590	1,649	1,649	1,710	2,027			2,195					2,195
Other Long-term Liabilities	994	1,004	992	1,019	995	995	1,026	1,073			1,049					1,083
Total Liabilities	4,101	4,090	4,128	4,274	4,249	4,249	4,387	4,459	-	-	4,684	-	-	-	-	4,772
Common Stock	659	628	328	174	-	-	-	-			-					-
Retained Earnings	1,067	1,205	1,359	1,573	1,619	1,619	1,484	1,548			1,496					1,243
Accumulated other comprehensive loss	(131)	(125)	(140)	(147)	(170)	(170)	(154)	(143)			(130)					(100)
Total Shareholders' Equity	1,595	1,708	1,547	1,600	1,449	1,449	1,330	1,405	-	-	1,366	-	-	-	-	1,143
Total Liabilities & Shareholders' Equity	5,696	5,798	5,675	5,874	5,698	5,698	5,717	5,864	-	-	6,050	-	-	-	-	5,915

Source: Deutsche Bank, Company Info

Figure 44: YUM cash flows

	2000	2001	2002	2003	2004	2005	2006E	2007E
Operating Cash Flows								
Net income	413	492	583	617	740	762	822	915
Depreciation and amortization	354	354	370	401	448	469	477	523
Other	(69)	(73)	51	16	200	(114)	100	100
<u>Net change in working capital</u>	<u>(207)</u>	<u>59</u>	<u>84</u>	<u>65</u>	<u>(202)</u>	<u>121</u>	<u>(167)</u>	<u>56</u>
Net Operating Cash Flows	491	832	1,088	1,099	1,186	1,238	1,233	1,595
Capex	(572)	(468)	(621)	(525)	(453)	(383)	(327)	(330)
Dividends	-	-	-	-	(58)	(123)	(145)	(169)
FCF				716	623	1,074	948	1,264
Investing Cash Flows								
Acquisitions	(94)	(108)	(288)	(41)	(38)	(2)		
Equity investments							(18)	(59)
<u>Other</u>	<u>429</u>	<u>73</u>	<u>24</u>	<u>1</u>	<u>(50)</u>	<u>40</u>	<u>50</u>	<u>50</u>
Net Investing Cash Flows	335	(35)	(264)	(40)	(88)	38	32	(9)
Financing Cash Flows								
Debt issuances / (payments)	(28)	(300)	(69)	(307)	(352)	112	350	150
Share issuances / (repurchases)	(170)	(42)	(103)	(168)	(369)	(908)	(800)	(1,000)
<u>Other</u>	<u>(12)</u>	<u>(10)</u>	<u>(11)</u>	<u>3</u>	<u>4</u>	<u>122</u>	<u>35</u>	<u>(50)</u>
Net Financing Cash Flows	(210)	(352)	(183)	(472)	(717)	(674)	(415)	(900)
Net increase/ (decrease) in cash	44	(23)	20	62	(130)	96	378	186
Cash and equivalents beginning of year	89	133	110	130	192	62	158	536
Cash and equivalents end of year	133	110	130	192	62	158	536	722

Source: Deutsche Bank, Company Info

Figure 45: YUM EVA

NOPAT	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006E	2007E
Income for Common	-\$111	\$445	\$627	\$413	\$492	\$583	\$617	\$740	\$762	\$822	\$915
Increase in Deferred taxes		(101)	2	52	(34)	94	30	(127)	(32)	16	(7)
Goodwill Amortization		651	(124)	(108)	39		29	22	(32)	12	20
Increase in LIFO reserve											
Advertising Expense	517	435	385	325	328	384	419	458	497	429	443
Special Charges/Gains		(260)	(330)	28	(2)	5	52	(4)	15	48	-
Increase in Equity Equivalents	517	725	(67)	297	331	483	530	349	448	506	456
Adjusted Income for Common	406	1,170	560	710	823	1,066	1,147	1,089	1,210	1,328	1,372
Interest Expense	\$276	\$272	\$202	\$176	\$158	\$172	\$173	\$129	\$127	\$150	\$139
Tax Benefit of Interest Expense	(173)	(160)	(122)	(106)	(106)	(117)	(121)	(93)	(94)	(108)	(100)
Tax Shield	103	112	80	70	52	55	52	36	33	42	39
NOPAT	509	1,282	640	780	875	1,121	1,199	1,125	1,243	1,369	1,411
Capital	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006E	2007E
Short-term Debt	\$124	\$96	\$117	\$90	\$696	\$146	\$10	\$11	\$211	\$15	\$15
Current Portion of Long-term Debt											
Senior Long-term Debt	\$4,551	\$3,436	\$2,391	\$2,397	\$1,552	\$2,299	\$2,056	\$1,731	\$1,649	\$2,195	\$2,195
PV of Non-Cap Leases	1,541	1,363	1,156	1,224	1,534	1,702	2,133	2,063	2,106	2,148	2,191
Total Debt & Leases	6,216	4,895	3,664	3,711	3,782	4,147	4,199	3,805	3,966	4,358	4,401
Common Equity	-\$1,620	-\$1,163	-\$560	-\$322	\$104	\$594	\$1,120	\$1,595	\$1,449	\$1,366	\$1,143
Deferred Income Tax		94	96	148	114	208	238	111	79	95	89
Capitalized Advertising											
LIFO Reserve											
Accumulated Goodwill Amortization		651	527	419	458	849	878	900	868	880	900
Restructuring Charge											
Equity Equivalents		745	623	567	572	1,057	1,116	1,011	947	975	989
Adjusted Common Equity	(1,620)	(418)	63	245	676	1,651	2,236	2,606	2,396	2,342	2,131
Capital	4,596	4,477	3,727	3,956	4,458	5,798	6,435	6,411	6,362	6,700	6,533
ROIC	11.1%	28.6%	17.2%	19.7%	19.6%	19.3%	18.6%	17.5%	19.5%	20.4%	21.6%
MACC-Mkt. Adjusted Cost of Capital	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006E	2007E
Required Rate of Return	11%	11%	11%	11%	11%	11%	11%	11%	11%	11%	11%
Cost of Debt	6.3%	8.0%	8.4%	7.5%	7.4%	7.4%	9.2%	8.3%	7.9%	8.0%	8.0%
Forward Relative P/E	73%	73%	54%	49%	60%	69%	82%	109%	106%	120%	120%
% Debt	135%	109%	98%	94%	85%	72%	65%	59%	62%	65%	67%
% Equity	-35%	-9%	2%	6%	15%	28%	35%	41%	38%	35%	33%
Weighted Cost of Debt	8.5%	8.7%	8.2%	7.0%	6.3%	5.3%	6.0%	4.9%	4.9%	5.2%	5.4%
Weighted Cost of Equity	-5.3%	-1.4%	0.3%	1.4%	2.8%	4.5%	4.6%	4.1%	3.9%	3.2%	3.0%
Market Adj. Cost of Capital	3.1%	7.3%	8.6%	8.4%	9.1%	9.9%	10.7%	9.0%	8.8%	8.4%	8.4%
Spread	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006E	2007E
ROIC	11.1%	28.6%	17.2%	19.7%	19.6%	19.3%	18.6%	17.5%	19.5%	20.4%	21.6%
MACC	3.1%	7.3%	8.6%	8.4%	9.1%	9.9%	10.7%	9.0%	8.8%	8.4%	8.4%
Spread	7.9%	21.3%	8.6%	11.3%	10.6%	9.5%	8.0%	8.5%	10.7%	12.0%	13.2%

Source: Deutsche Ban, Company Info

North America United States
Consumer Restaurants

18 October 2006

Panera Bread Co

Reuters: **PNRA.OQ** Bloomberg: **PNRA UW**

PNRA: Initiating coverage, Buy the dip

Initiate with Buy rating & \$81 price target

PNRA is a growth story – 20% to 25% on both top and bottom lines – but the market is under-appreciative. While comp sales softened over the summer (along with the share price), we believe expansion into new day-parts and a rebound in consumer confidence should drive growth. We recommend taking advantage of the dip in valuation.

Store expansion opportunity drives robust growth projections

With about 940 stores in 36 states and limited or no presence in numerous major markets (NYC, DC, LA, Northern CA, Dallas), PNRA has plenty of room to run on new store growth. We expect 150-200 new stores per year in our forecasts, to a long-term level of about 2,500, driving top-line growth of 20-30% through 2010.

Concern over comps, but outlook is positive on new day-parts

The summer slowdown in comps growth to below 2% was short-lived as Sept. comps bounced to +6%. We believe the market overreacted and that long-term comps are sustainable in the 3-5% range through 2010 as PNRA adds menu innovations and new dinner day-part offerings, such as the current Crispani roll-out. Margin expansion opportunities are more limited (13-14% LT EBIT margins), and rapid store growth and healthy comps should drive 20-25% EPS growth over the next four-five years.

Shares are “cheap” relative to growth prospects...Buy on the dip

We prefer to buy into restaurant growth stories on negative short-term news and pullbacks, and PNRA fits the bill. We believe the LT growth story remains on track, and valuation is low relative to high-growth peers (with a discount on PEG ratios relative to peers CMG and SBUX) and by historical standards. Our valuation frameworks (EV/EBITDA, P/E, ROIC spread, DCF) yield an average \$81 price target, which offers 22% upside from current levels. Key risks to our outlook include slowdown in store openings or comps weakening, consumer spending slowdown and operational risk from new product launches.

Forecasts and ratios

Year End Dec 31	2005A	2006E	2007E
1Q EPS ¹	0.39	0.47A	0.58
2Q EPS	0.34	0.44A	0.55
3Q EPS	0.37	0.36	0.49
4Q EPS	0.55	0.67	0.80
FY EPS (USD)	1.65	1.96	2.41
P/E (x)	34.8	33.9	27.5

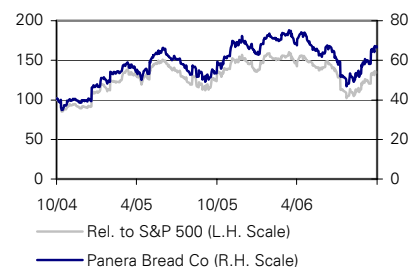
Source: Deutsche Bank estimates, company data

¹ Includes the impact of FAS123R requiring the expensing of stock options.

Buy

Price at 17 Oct 2006 (USD)	66.47
Price Target	81.00
52-week range	75.18 - 46.85

Price/price relative



Performance (%)	1m	3m	12m
Absolute	12.9	9.5	24.5
S&P 500	3.3	10.5	14.6

Stock data

Market Cap (USD)	2,074.3
Shares outstanding (m)	31.2
Free float (%)	–
Volume	311,333
S&P 500	1,364.05

Key indicators

ROE (%)	17.6
ROA (%)	13.4
Net debt/equity (x)	-1.7
Book value/share (USD)	12.67
Price/book (x)	5.2
Net interest cover (x)	984.9
EBIT margin (%)	11.4

Model updated: 16 October 2006

Running the Numbers

North America

US

Restaurants

Panera Bread Co

Reuters: PNRA.OQ Bloomberg: PNRA.UW

Buy

Price as of 17 October US\$ 66.47

Target price US\$ 81.00

Company website

http://www.panerabread.com

Company description

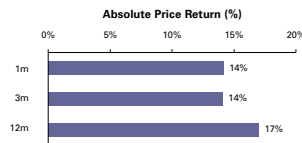
The company operates and franchises Panera Bread & St. Louis Bread bakery-cafes, with 939 stores in 36 states. Panera targets suburban residents/workers with high-end baked goods, sandwiches, soups/salads and beverages. It also sells dough directly to franchisees.

Research Team

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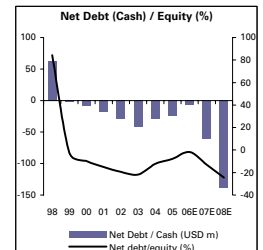
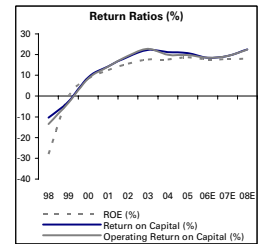
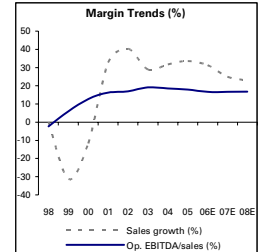
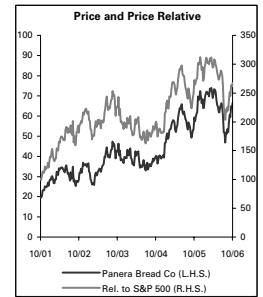


52-week Range: US\$ 46.85 - 75.18
Market Cap (m) USD 2,074 EUR 1,654

Company identifiers
Cusip 69840W108
SEDOL 2063034

Source: Company data, Deutsche Bank estimates

Year Ending 31 December	1998	1999	2000	2001	2002	2003	2004	2005	2006E	2007E	2008E
SUMMARY											
Headline EPS (US\$)	-0.86	-0.01	0.26	0.46	0.71	1.00	1.25	1.65	1.96	2.41	2.96
P/E ratio Headline (x)	nm	nm	24.5	37.4	43.8	36.9	30.6	34.8	33.9	27.5	22.5
Headline EPS growth (%)	na	98.8	nm	74.5	56.5	40.7	24.5	32.0	18.9	23.2	22.5
EPS FD (US\$)	-0.86	-0.01	0.26	0.46	0.71	1.00	1.25	1.65	1.96	2.41	2.96
P/E ratio FD (x)	nm	nm	24.5	37.4	43.8	36.9	30.6	34.8	33.9	27.5	22.5
Operating CFPS (US\$)	0.86	0.28	0.77	1.10	1.68	2.50	2.84	3.55	3.80	4.66	5.79
Free CFPS (US\$)	-0.05	-0.25	0.00	0.11	0.66	0.97	0.19	0.90	-0.06	1.59	2.33
P/CFPS (x)	4.6	12.0	8.3	15.5	18.6	14.8	13.4	16.1	17.5	14.3	11.5
DPS (US\$)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
BV/Share (US\$)	3.07	3.02	3.65	4.31	5.31	6.51	7.99	10.27	12.67	15.14	18.22
Price/BV (x)	1.10	1.28	3.13	6.03	6.55	6.07	5.05	6.40	5.25	4.39	3.65
Weighted average shares (m)	23.9	24.3	25.1	27.8	28.9	29.8	30.2	30.9	31.2	31.2	31.1
Average market cap (USD m)	93	81	161	473	903	1,102	1,152	1,769	2,074	2,074	2,074
Enterprise value (USD m)	155	79	152	455	869	1,054	1,120	1,708	2,018	1,963	1,886
EV/Sales	0.62	0.46	1.00	2.26	3.08	2.90	2.34	2.67	2.40	1.87	1.46
EV/EBITDA	nm	7.8	7.9	14.0	18.2	15.2	12.6	15.0	14.4	11.3	8.7
EV/EBIT	nm	21.1	14.1	21.0	25.5	21.1	18.2	21.1	21.1	16.5	12.8
EV/Operating Capital	1.1	1.1	1.8	4.4	7.3	6.6	4.8	6.0	5.4	4.8	4.4
INCOME STATEMENT (USD m)											
Sales revenue	250	171	151	201	282	364	479	640	841	1,050	1,290
Operating EBITDA	-6	10	19	33	48	69	89	114	140	174	216
Depreciation	13	6	8	11	14	19	27	33	45	55	68
Amortisation	0	0	0	0	0	0	0	0	0	0	0
EBIT	-18	4	11	22	34	50	62	81	96	119	148
Net interest income(expense)	-6	-3	0	0	0	0	0	0	0	0	0
Associates/affiliates	0	0	0	0	0	0	0	0	0	0	0
Investment/other income(expense)	-1	-1	0	0	0	-2	-1	1	3	3	1
Exceptionals/extraordinaries	0	0	0	0	0	0	0	0	0	0	0
Income tax expense	-6	1	4	8	12	18	22	30	36	44	54
Minorities/preference dividends	0	0	0	0	0	0	0	0	0	0	0
Net income	-20	0	7	13	21	31	38	52	63	77	94
CASH FLOW (USD m)											
Cash flow from operations	21	7	19	31	49	74	86	110	119	145	180
Movement in net working capital	7	-5	-1	-2	1	8	10	18	3	5	10
Capex	-22	-15	-19	-28	-29	-46	-80	-82	-121	-96	-108
Free cash flow	-1	-9	0	3	19	29	5	28	-2	50	72
Other investing activities	10	73	-1	-1	-13	-21	-22	-48	-23	-5	-5
Equity raised(bought back)	1	1	7	7	4	5	5	14	10	10	10
Dividends paid	0	0	0	0	0	0	0	0	0	0	0
Net inc/dec in borrowings	-9	-64	0	0	0	0	0	0	0	0	0
Other financing cash flows	-1	0	0	0	1	1	1	0	0	0	0
Total cash flows from financing	-8	-64	8	7	6	6	5	14	10	10	10
Net cash flow	1	0	7	9	12	14	-11	-6	-15	55	77
Movement in net debt(cash)	-10	-64	-7	-9	-12	-14	11	6	15	-55	-77
BALANCE SHEET (USD m)											
Cash and other liquid assets	2	2	9	18	30	42	30	24	7	61	139
Tangible fixed assets	39	47	60	80	99	146	202	269	347	388	427
Goodwill	20	19	18	18	19	33	35	52	52	45	45
Other intangible assets	0	0	0	0	0	0	0	0	0	0	0
Associates/investments	0	0	0	0	4	5	2	36	50	50	50
Other assets	93	23	25	29	36	30	56	56	76	102	109
Total assets	154	91	112	144	188	257	325	438	531	646	770
Interest bearing debt	64	0	0	0	0	0	0	0	0	0	0
Other liabilities	16	18	20	24	35	63	83	121	136	173	203
Total liabilities	80	18	20	24	35	63	83	121	136	173	203
Shareholders' equity	73	73	92	120	154	194	241	317	395	472	567
Minorities	0	0	0	0	0	0	0	0	0	0	0
Total shareholders' equity	73	73	92	120	154	194	241	317	395	472	567
Net working capital	-10	-5	-6	-4	-7	-26	-29	-45	-47	-52	-62
Net debt(cash)	62	-2	-9	-18	-30	-42	-30	-24	-7	-61	-139
Capital	135	71	83	102	124	151	212	293	389	411	428
RATIO ANALYSIS											
Sales growth (%)	na	-31.4	-11.7	32.8	40.3	28.9	31.7	33.6	31.3	24.9	22.9
Op. EBITDA/sales (%)	-2.3	5.9	12.7	16.2	16.9	19.1	18.6	17.8	16.7	16.6	16.8
EBIT/sales (%)	-7.3	2.2	7.1	10.8	12.1	13.7	12.9	12.7	11.4	11.3	11.5
Payout ratio (%)	nm	nm	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
ROE (%)	-27.9	-0.3	8.3	12.4	15.6	17.6	17.7	18.7	17.6	17.8	18.1
Return on Capital (%)	-10.4	-2.7	9.0	14.3	18.9	22.3	21.2	20.7	18.4	19.3	22.5
Operating Return on Capital (%)	-13.5	-3.3	8.5	14.2	19.4	22.7	19.8	19.8	18.5	19.3	22.3
Capex/sales (%)	8.7	8.9	12.9	13.7	10.4	12.6	16.8	12.8	14.3	9.1	8.4
Capex/depreciation (x)	1.7	2.4	2.3	2.5	2.1	2.3	2.9	2.5	2.7	1.7	1.6
Net debt/equity (%)	84.5	-2.6	-9.8	-15.1	-19.5	-21.9	-12.3	-7.7	-1.7	-13.0	-24.5
Net interest cover (x)	nm	1.4	65.8	301.6	1063.8	1061.6	3626.2	619.4	984.9	1227.7	10557.1



Investment thesis

Outlook

Panera Bread is a growth play, with the ability to grow sales and profits at a sustainable rate of 20-25% in our view. Like CMG, we believe that PNRA possesses a vast store expansion opportunity, although it is slightly further down the curve, with over 900 stores in operation. PNRA operates in only 36 states, with untapped and under-penetrated major markets like NYC, DC, Phoenix, LA, Miami, Seattle and Dallas. We forecast store openings of approximately 165 per year for at least the next three years, with unit growth in the mid-to-high teens, and a long-term store base of 2,500-2,600.

Comp store growth has recently come under the microscope. PNRA's long-term expectation of a 2-5% growth rate is somewhat low vs. other fast-growing chains, but should be supportable – we expect comps growth of 3-5% through 2010. Despite a recent summer slowdown (July and August below 2%), we believe that ongoing menu refinements will expand daypart opportunities for PNRA and support growth. Crispani is a key product in this regard – a clear effort to move into the dinner day-part, which currently represents only 20% of sales. New product initiatives imply some near-term operational disruption as labor and operations adjust, but should help drive gradual comps growth.

Although we do not view PNRA as a margin leverage story, we do see longer-term opportunities to leverage the supply chain and improve cost efficiency as the company gains critical mass in its store base. The Crispani rollout and a tighter consumer could minimize near-term margin improvement through 2006, but as new fresh dough facilities come on-line and facilitate greater efficiency and new markets, margin benefits could accrue in 2007. We see EBIT margins expanding from 11-12% currently to 13-14% long term. Coupled with store expansion, this should drive 20-25% EPS growth through 2010.

Valuation

We believe sentiment on PNRA has recently shifted too far into negative territory on short-term concerns over comp sales, which have rebounded (Sept. +6%). PNRA is the cheapest stock in our coverage group from a PEG ratio standpoint, below both CMG and SBUX on our estimates, despite similarly strong projected growth. Our \$81 blended price target reflects an averaging of EBITDA, P/E, ROIC and DCF methodologies. Even a conservative 1.5x PEG multiple suggests a P/E of 33x. 15x our 2007 EBITDA forecast falls below SBUX and CMG targets between 17x and 18.5x to reflect modestly lower growth. ROIC progression into the mid-single digits suggests the same TEV/EBITDA result. DCF is based on 17% 10-year EBIT growth, 11.0% WACC-1.2 beta (assume similar to CMG), 4.7% Rf rate, 5.4% market premium, 11% K-equity, 4% long-term growth (assumes slower industry growth vs. recent 4% and continued growth above industry over the long term). PNRA is not a story without risks, but over the next three years, we believe the growth prospects are among the most attractive in the industry. We prefer to buy into restaurant industry growth on dips, taking advantage of short-term negative moves. We therefore rate the shares a Buy.

Risks

As a hybrid quick-casual restaurant, PNRA is exposed to slowdowns in consumer spending, although we believe its relatively low average guest check helps insulate against this risk. New product initiatives such as Crispani carry operational risk and could experience setbacks. Finally, as a high-growth vehicle, one of the major risks for PNRA is any indication of a slowdown in new restaurant openings.

Buy while it's down

Long-term growth stories don't often come "cheap"

Our call here can be framed in fairly simple terms. Panera Bread is a growth play, with the ability to grow sales and profits at a sustainable rate of 20% to 25% (this year we forecast EPS growth close to 27% options adjusted). Yet, it's the "cheapest" – and cheap is a relative term here – stock among its restaurant growth brethren from a PEG ratio standpoint. Both CMG and SBUX trade at 2x forward three-year sales growth forecasts. Historically, restaurant growth stocks have traded at 1.5x to 2x sales growth, which we view as a reasonable proxy. Even a conservative 1.5x multiple suggests a P/E of 33, which equates to \$80 when applied to our 2007 EPS forecast of \$2.41.

Figure 46: Comparable company PEG ratios

	P/E	Forward 3-Year Sales Growth	PEG	Forward 3-Year EBIT Growth	PEG
PNRA	28	22.6%	1.2	24.4%	1.1
CMG	43	23.0%	1.9	28.4%	1.5
SBUX	42	21.0%	2.0	21.9%	1.9

Source: Deutsche Bank, Factset, Company Info

Okay so maybe it's not that simple. More than just a call on valuation relative to growth, we believe sentiment shifted too far into negative territory on short-term concerns relative to long-term growth prospects. Sure, consumers could pull back on spending, but sales and profit growth could still comfortably remain above 20% for the following key reasons:

- Unit growth opportunities are vast. While further along the growth curve than CMG, PNRA is still only in 36 states, and has yet to tap into many markets, including several key metro areas, such as New York City, Salt Lake City, Memphis, DC, Phoenix and Toronto, among others. Low penetration markets include those such as Los Angeles, Miami, Northern California, Seattle, Dallas/Fort Worth, Houston, and Philadelphia. Forecasted store openings of approximately 165 per year for at least the next three years suggest unit growth alone in the mid-to-high teens.
- Comparable store sales growth is perhaps the measure of concern at the moment. The company has forecasted long-term comparable store sales growth of 2% to 5%, which we view as reasonable given an average of 6% for the past five years and 3.6% for the last three years. Despite the recent slowdown in July and August below 2% and management's indication of slower traffic, September comparable sales bounced back to +6%. We believe the move into evening daypart sales (represent only 20% of sales at present) represents a significant opportunity to drive comparable sales, despite likely near-term operational disruption. We would expect some volatility in productivity as the Crispani initiative is rolled out – it requires new labor and modest change to operations – but this is likely temporary, and the initiative enhances the long-term growth outlook.
- This isn't a margin leverage story, but longer-term, we see potential leverage opportunities as the supply chain becomes more efficient and as the company gains critical mass in its stores. Near-term (H206), some noise relating to the Crispani rollout and a tighter consumer could minimize margin improvement, but as new fresh dough facilities come on-line and facilitate greater efficiency and new markets, margin benefits could accrue in 2007.

What could go wrong?

The two greatest risks to our forecasts and rating are the consumer economy and more substantial than expected disruptions relating to the Crispani rollout.

- Since PNRA is a hybrid quick-casual restaurant, it does find itself exposed to the slowdown in consumer spending on casual dining occasions. We believe its lower guest check (Quick Casual average \$9) relative to traditional casual dining (average \$20) helps insulate it from severe traffic declines, but the company did report a modest slowdown over the summer months. As we discuss in our industry piece, moderating gas prices could ease some pressure off the consumer, although the weakness in housing prices could somewhat offset this effect.
- Crispani is a key idea for PNRA. It's the segue into the dinner daypart and could be the beginning of a new spectrum of menu offerings that cater to the dinner occasion. However, as a new initiative that will alter the operation in some ways (new employee to make the Crispani, table delivery for this product, etc), we would not expect it to go off without a hitch or two. Our forecasts for H206 reflect some margin drag, but in our view, the sales benefits should offset the costs over time.

Most attractive restaurant growth for the money

This is not a story without risks, but looking out over the next three years, we believe the growth prospects are one of the most attractive in the industry. We prefer to buy growth on dips, taking advantage of short-term negative moves to buy into the longer-term growth. PNRA is one of those opportunities. We therefore rate the shares a Buy.

Financial drivers

Expansion opportunities drive the growth story

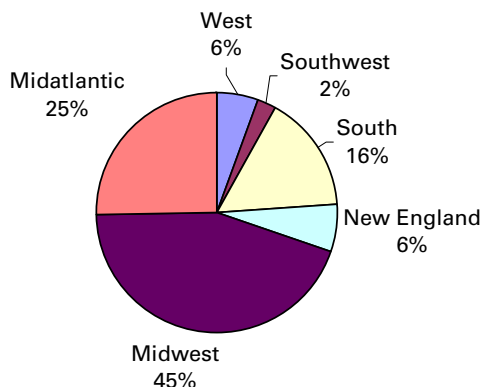
PNRA is clearly a growth story, but this deserves more detail, particularly given the recent ups and downs seen in comparable store sales. We believe this is an expansion story in several ways. First, unit expansion. This is a clear strategy and one everyone recognizes from examining other growth plays like SBUX and CMG. PNRA is largely a Midwest and Mid-Atlantic chain, with plenty of opportunity to expand west, south, and into New England. Second, PNRA is just beginning to tap into the dinner daypart with the recent launch of Crispani, a pizza product designed to bring customers in for dinner in addition to lunch. PNRA's atmosphere and relaxed dining experience can parlay fairly well into a dinner business, aiding both comparable store and new store sales by boosting productivity.

Unit expansion opportunities – Go West

We expect unit growth to remain steady at 15% to 17% for at least the next few years as the company expands into under-penetrated markets. We expect new store growth of about 165 (+19%) for 2006, driven by 98 new company-operated locations (+32%—includes recent acquisition of 13 stores from franchisee) and a rebound in franchise store growth. Franchises are operated in conjunction with 42 franchisee groups, and we expect new growth to rise from 51 in 2005 to 67 units in 2006 given a strong new-build pipeline. The current franchisee commitment backlog is nearly equivalent to the existing franchisee base, with 423 backlogged stores as of Q106 vs. 578 in operation.

PNRA currently operates in 36 states, with expansion opportunities most evident in the West/Southwest region. Current expansion plans focus on Northern California (ten current locations), Pacific NW, and South Florida. Under-penetrated major metro markets include New York City, Phoenix, DC, San Antonio, Miami (two), Seattle (five), and Dallas (ten). Clearly there is room for growth here over the next several years. Key to watch will be productivity of new openings, which of late has fallen off. We believe the new launch of Crispani has likely caused some modest disruption to store operations, but expect this to improve over the next few quarters.

Figure 47: PNRA café geographic dispersion

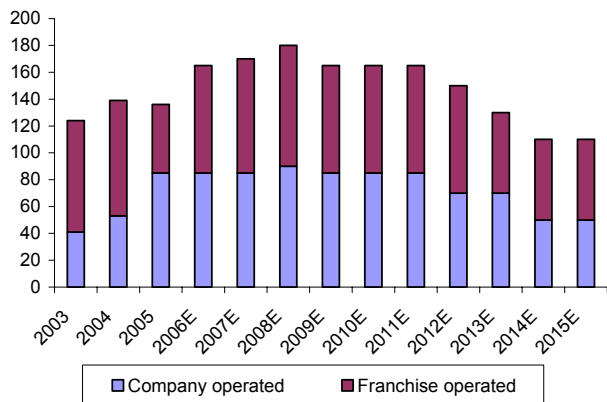


Source: Deutsche Bank, Company Info

Our projected store growth projection puts us on the top end of 2006 guidance for 70-75 new company stores and below the guidance of 80-85 new franchise stores. Longer term, we expect flattening of new store growth, at 170-195 through 2007-08 (as indeed the company has indicated a stable level of growth through 2007), before progressively slowing

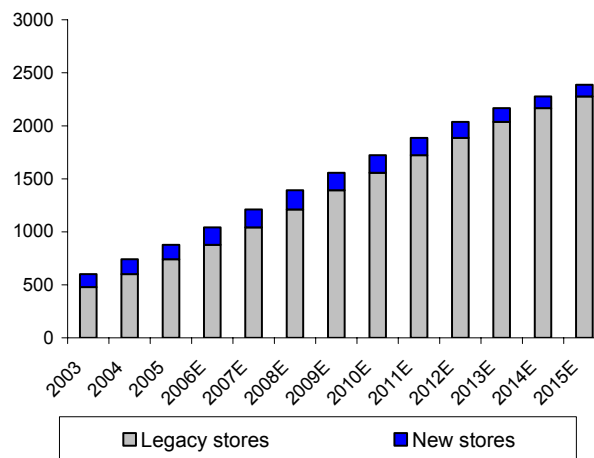
to 150-140/year as more marginal locations are pursued through 2016, equating to 6-10% annual growth. Management is aiming for 17% annual stores growth for the next 3-5 years vs. our projections for 15-19% in 2006-08.

Figure 48: New store openings



Source: Deutsche Bank, Company Info

Figure 49: Total stores



Source: Deutsche Bank, Company Info

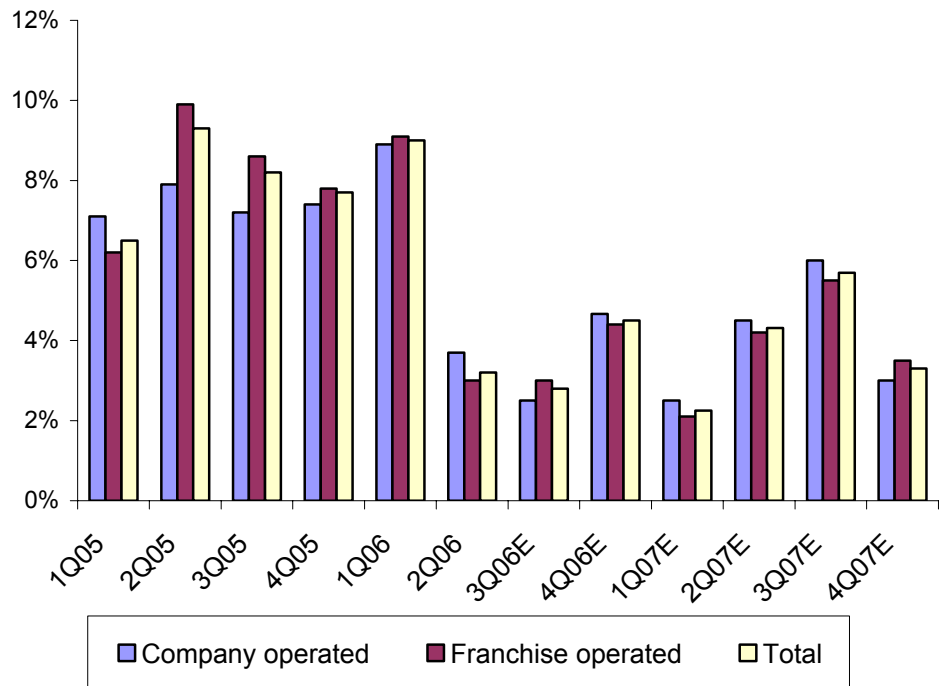
In short, we believe PNRA can achieve its unit expansion goals. Unit growth averaged an annual rate of 27% through 2005, and while the growth curve is slowing into the high teens, there is still plenty of room to expand. Our long-term forecasts assume that total stores expand from 877 as of 2005 to about 2,582 by 2015. And while PNRA currently lacks a non-US presence, longer-term growth opportunities could eventually include international expansion.

Comparable store sales – moving into the dinner daypart

Comparable store sales have been a source of question among investors over the last quarter. After showing a strong 7.8% comp in 2005, followed by a 9% comp in Q106, the trend slowed to 3% in Q2 and down to 2.8% in Q3. Comparisons became more difficult, Midwest weather and power outages also negatively impacted traffic, and perhaps the slowdown in consumer economy put a damper on trends. However, we believe a few things will help offset this in H206: 1) relief from falling gas prices and 2) a successful launch of the Crispani product, which could add 2% to 4% incremental sales. Softness in housing prices could cause an overall headwind, but we believe 2006 comparable store sales will remain in the company’s 2% to 5% long-term target range at a forecasted 4.9% growth rate.

Longer term, increasing transaction frequency on growing brand awareness should continue to support comparable store sales near 4% for the next several years (PNRA research suggests that 57% of consumers who have ever tried PNRA reappear as customers within 30 days). Continued menu refinement and efforts to increase use occasions in the PM hours are also key to future growth. PNRA continuously launches new items, which in 2006 has included new salads, soups, and bakery items, kid’s meals and beverages/smoothies. Evening hours currently comprise approx. 20% of sales, although this should continue to increase through more afternoon snack items and dinner fare, along the lines of the current Crispani pizza roll-out program (available in around 40% of stores).

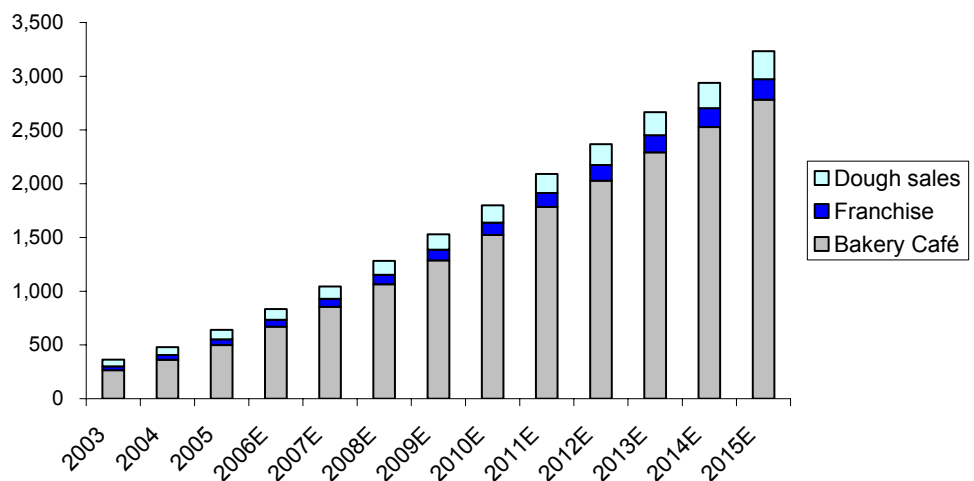
Figure 50: Comp store growth



Source: Deutsche Bank, Company Info

We expect new store openings and moderating but still healthy comparable store sales growth to drive revenue growth well in excess of 20% for the next few years. Expanding dough sales should also continue contributing to revenue growth, with 17% growth expected for 2006 and slowing toward 10% long-term.

Figure 51: PNRA revenue (\$mn)



Source: Deutsche Bank, Company Info

Margins stable to modestly improving, but not a leverage story

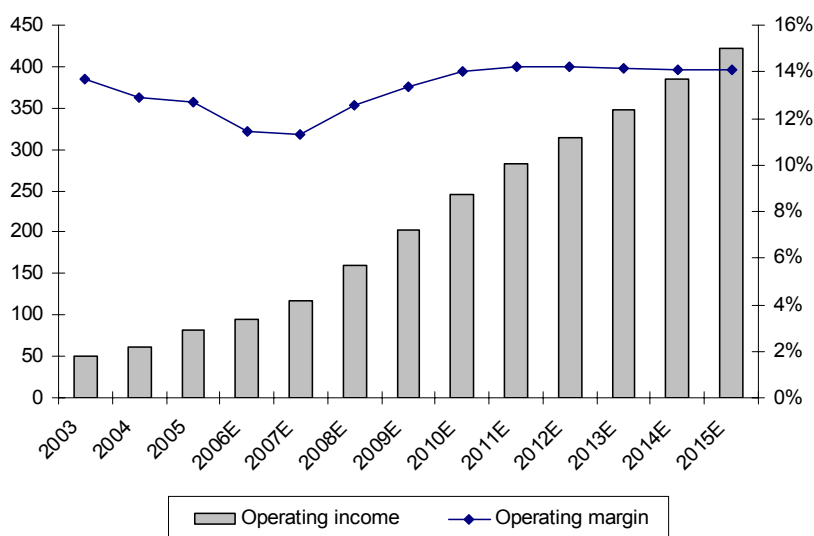
- Food and paper.** PNRA’s largest expenses are product inputs (food & paper, as well as dough costs for sales to franchisees), with most major commodity items forward-hedged. Store labor expense is the other major expense item. Given the higher-end pricing of PNRA’s products, we expect that the company has adequate pricing flexibility

to maintain steady gross margins over time, supported by some gains in supply chain leverage. However, we do not expect significant pricing increases beyond those needed to offset input prices, given PNRA's attention to the price/value proposition for consumers.

- Labor.** We expect labor cost pressure to accompany unit growth and expansion into the dinner daypart as PNRA will continually need to invest in its workforce and possibly pay higher wages. People are a crucial part of the restaurant experience, and particularly so in a quick casual setting with a higher average guest check than QSR. Consumers want to feel good – taken care of – but not overwhelmed. We believe most higher-end operations like PNRA and CMG need to invest more in their workforce than other QSR's counterparts.
- We expect gradual scale gains in central G&A** costs and dough manufacturing infrastructure, new store openings, ramp-ups and potential mis-steps on new product trial launches/trials (i.e. Crispani), and additions of new dough facilities, which carry up-front negative margin impact as utilization ramps up. However we also expect the increasing proportion of company-operated stores expected in the mix (rising from 78% of revenues in '05 to 85% by 2010) vs. high-margin franchise revenues (4-5% of annual sales royalties) and increasing competition in the fast-casual category to pressure long-term margins. On the whole, expect only modest expansion – following a margin fall-off from 2005-06 from 12.7% to 11.4%, we expect 12-14% long-term margins. Restaurant margins could move more significantly from 19.1% forecasted in 2006 to 21%-22% longer term.

In short, this is not a margin expansion story. PNRA is willing to invest in its growth and its brand, which we expect will drive 23%-25% EBIT growth through 2010. Despite recent moderation in comparable store sales, this is a robust, attractive growth rate and well-supported by the market opportunity for fast-casual concepts with unique plays on higher-end dining and/or healthier eating, both of which apply to PNRA.

Figure 52: PNRA operating income (\$mn)



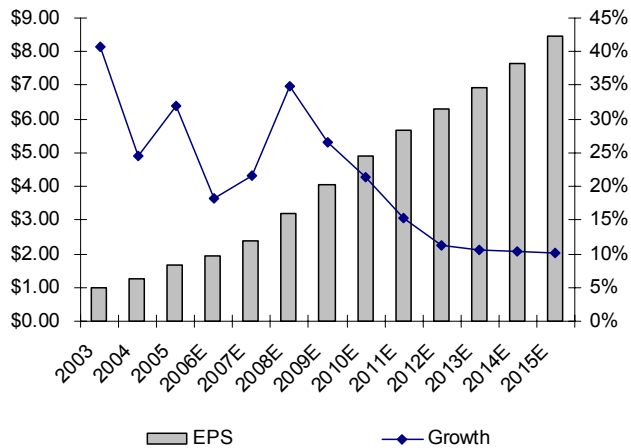
Source: Deutsche Bank, Company Info

Free cash flow potential

While free cash flow may be modest over the next few years, the company could begin generating more substantial cash flow beyond 2010. PNRA's capital commitments relate to new store growth and remodeling (new company-owned store construction/outfitting expenses average about \$0.9mn per store), purchasing existing franchise stores and construction of dough-making facilities. We expect an increase in 2006 capital expenditures

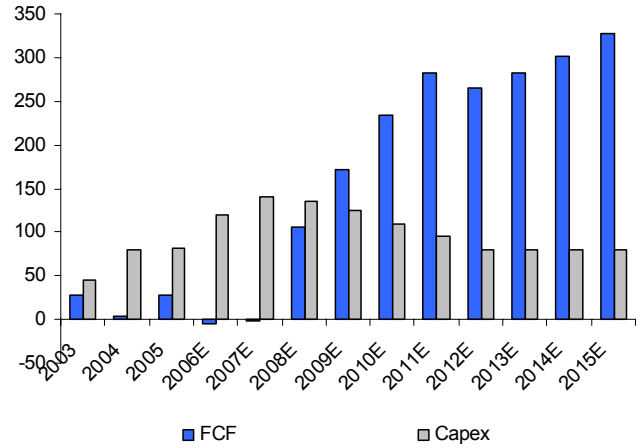
to \$120mn (vs. \$82mn in 2005), primarily to accommodate construction of an expected three new dough-making facilities. This is at the low end of guidance of \$120-130 (including \$75-80mn for new cafes, \$15-18mn for remodeling, \$15-17mn for the new dough facilities). Capital expenditures should remain at relatively elevated levels through 2008 (16% of company-operated sales) relating to the continued expansion of stores and remodeling activity, falling off longer term as store expansion slows.

Figure 53: EPS



Source: Deutsche Bank, Company Info

Figure 54: FCF



Source: Deutsche Bank, Company Info

Estimate review

Our 2006 EPS estimate of \$1.96 (guidance of \$1.93-\$2.0) reflects the following key assumptions:

- Net sales of \$840.6mn, +31.3%, driven by addition of 165 units (19% growth) and 4.9% comparable store sales growth.
- EBIT of \$95.5mn, +17.0%, reflecting a 50bp decline in restaurant level margin to 19.1%, and a 130bp decline in overall margin to 11.4%.
- Tax rate of 36.2%.

Our 2007 EPS estimate of \$2.41 reflects the following key assumptions:

- Net sales of \$1.05bn, +24.9%, driven by addition of 172 units(17%) growth and 3.8% comparable store sales growth.
- EBIT of \$119.1mn, +24.6%, reflecting sales growth, a slight improvement in restaurant level margin at 19.5%, and a flat overall margin at 11.3%.
- Tax rate of 36.5%.

Our long-term projections through 2015 assume the following:

- 140-190 new stores per year, bringing total stores from 877 to 2,582 by 2015
- Comparable store sales growth of 3-5% from 2006-010 and 2.5% from 2011-15. Company and franchised stores are expected to maintain similar comps.
- Revenue growth of 25-30% for 2006-07, slowing to 17% by 2010 and 10% by 2015
- Restaurant margin expansion from 19.1% in 2006 to 20.6% by 2010 and to 21.7% by 2015, while total operating margin expansion from 11.4% in 2006 to 12.3% by 2010 and to 13.4 by 2015. We expect average annual EBIT growth of 22.6% for the five years through 2010.
- We estimate that after 2006, PNRA will be able to grow EPS by 20-25% p.a. through 2010 and EPS growth will start tapering off to touch 10.3% by 2015.

Valuation

Grab it while you can

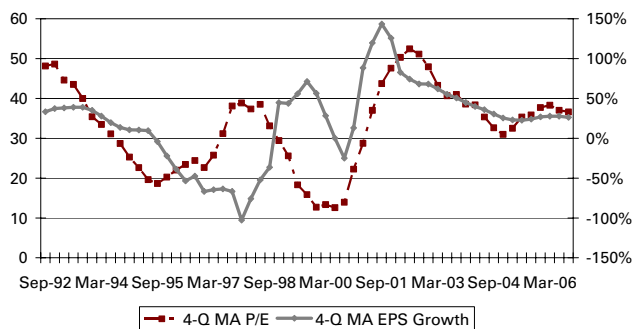
A few bumps on the road over the last few months for PNRA have generated a buying opportunity into what we view as one of the most compelling growth stories in the restaurant sector. Over the next three years, we expect revenue growth of 20% to 25%, EBIT growth of 23% to 25%, and EPS growth of 22% to 24%. This level of profit growth is comparable to other high-growth plays like SBUX and CMG and consistent with historical averages, despite periods of slower performance. We believe PNRA should trade in line with its peer group range, perhaps at a modest discount to SBUX and CMG given recent increase in uncertainty. Even considering that, the stock looks like the best value for growth in the group. The current 2007 P/E multiple of 28x and TEV/EBITDA multiple of 12x both fall substantially below historical averages and comparable peer group valuations. A combination of various valuation methodologies suggests a target price of \$81, which offers 22% upside. We therefore rate the shares of PNRA a Buy.

Figure 55: Valuation summary (\$)

Methodology	Multiple	Value
TEV/EBITDA	15X	83
ROIC Spread vs. TEV/EBITDA	15x	83
P/E	33X	80
DCF	NA	81
Final Target Price		81.0
Upside		21.5%
Total Return		21.5%

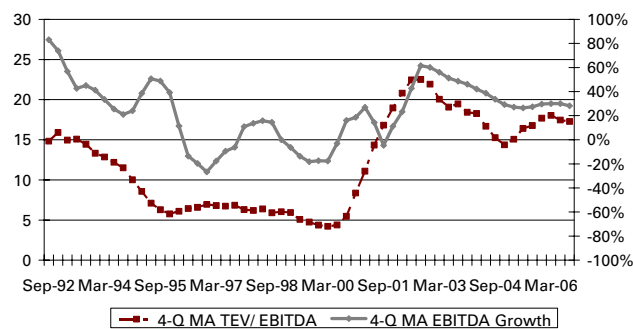
Source: Deutsche Bank, Factset, Reuters, Company Info

Figure 56: PNRA P/E vs. EPS growth



Source: Deutsche Bank, Factset

Figure 57: PNRA EV/EBITDA vs. EBITDA growth



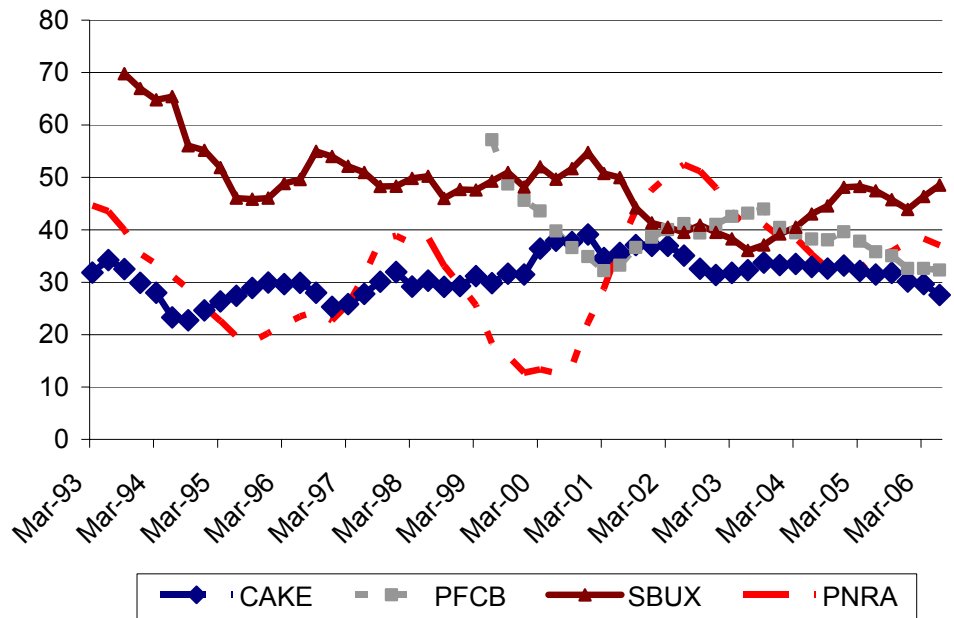
Source: Deutsche Bank, Factset

Figures 56-57 appear very choppy, owing to the difficult period in the late 1990s that led up to the sale of Au Bon Pain. Following this sale, the company paid off outstanding debt and repositioned itself for the growth period seen beginning in early 2000.

Average TEV/EBITDA ratio of 17x between 2002 and the present reflects average EBITDA growth of 39% during the same period, and falls just below SBUX's historical average of 18x-19x. We are forecasting average annual EBITDA growth of 24% for the next three years, which we believe justifies a modestly lower than historical average 15x multiple applied to our 2007 EBITDA forecast, or \$83 per share.

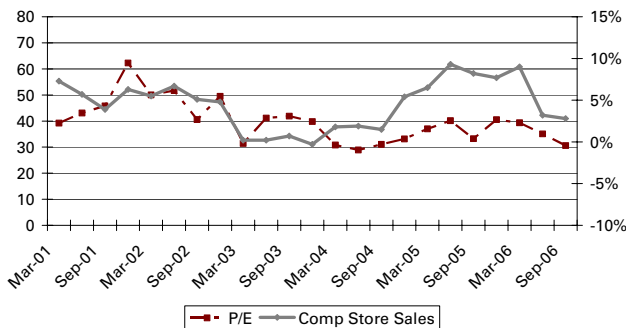
Between 2002 and the present, forecasted EPS growth has averaged 39% and the associated P/E has averaged close to 40x. We believe our forecasted 3-year average EPS growth of 23% deserves a 33x multiple applied to our 2007 EPS forecast of \$2.41 or \$80 per share, which also falls within a recent restaurant growth stock peer group range of 30x to 50x.

Figure 58: Restaurant growth stock P/E history



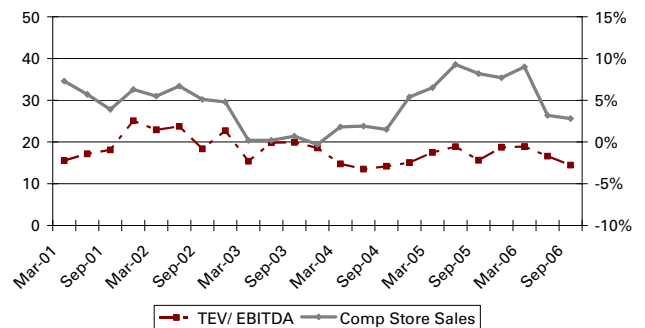
Source: Deutsche Bank, Factset, Reuters, Company Info

Figure 59: P/E vs. comparable store sales



Source: Deutsche Bank, Factset Reuters, Company Info

Figure 60: EV/EBITDA vs. comparable store sales

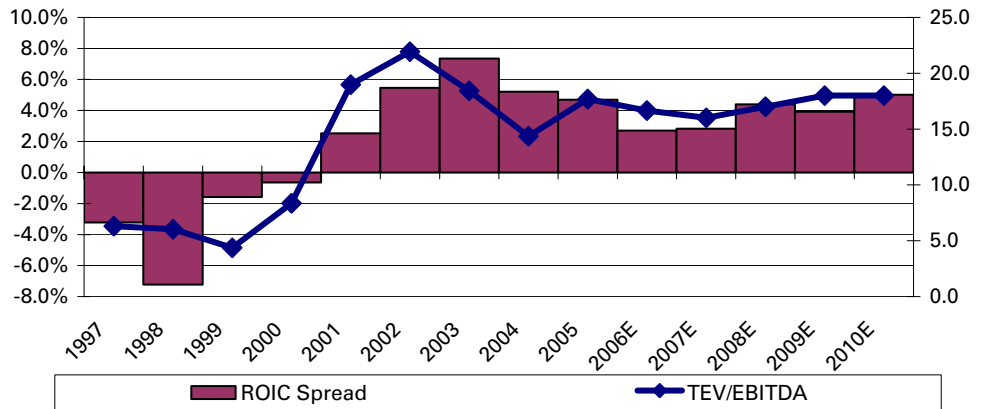


Source: Deutsche Bank, Factset, Reuters, Company Info

Notice in Figures 59 and 60, while comparable store sales accelerated into the high single digits in 2005 and early 2006, valuation multiples have held relatively steady. We don't see why a moderation of comparable store sales to a more steady rate of 4% (within the

company's long-term expectation of 2% to 5%) should knock the shares down to a 2007 P/E below 30x, particularly considering that 23%-25% profit growth appears very achievable.

Figure 61: Return spread to MACC vs. TEV/EBITDA



Source: Deutsche Bank, Factset, Reuters, Company Info

While PNRA's return on invested capital spread to a market average cost of capital has dipped since the early 2000s, we believe this reflects substantial ramp-up in unit additions and investment in the business, which should pay off over the next few years. We expect the spread to improve toward 3%-4% through 2010, and even higher beyond that. Notice that TEV/EBITDA has moved in synch with this measure. We therefore believe a 15x TEV/EBITDA multiple, below the current 2006 average, is reasonable as the spread lingers at a relatively low level through 2007. Applied to our 2007 EBITDA forecast, this equates to a share price of \$83.

Figure 62: Discounted cash flow

	2002	2003	2004	2005	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E
EBIT*(1-t)	22	32	39	52	61	76	94	117	142	170	196	221	246	271	290
D&A	14	18	25	33	42	55	68	79	91	102	113	123	136	147	145
EBITDA	35	50	64	85	103	131	162	196	233	272	309	344	382	418	435
Chgs in Oper. W/C	1	8	10	18	3	5	10	10	11	11	11	11	11	12	10
Capex	29	46	80	82	121	96	108	108	120	114	108	111	104	98	100
FCF	7	12	(6)	20	(14)	40	64	98	124	169	211	245	289	332	345
% Growth															
Discount Rate	11.2%														\$1,647
PV of FCF, 2005-2015	\$937														
PV of Terminal Value	\$1,647														
Corporate Value	\$2,584														
Less: Debt, net + Leases	(\$7)														
Equity Value	\$2,591														
Share Count (Millions)	32														
Equity Value/Share	\$81														

2006 Valuation	2004	2005	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E
Year				1	2	3	4	5	6	7	8	9	10
Factor				1.11	1.24	1.38	1.53	1.70	1.89	2.11	2.34	2.61	2.90
PV of FCF				\$36	\$52	\$71	\$81	\$99	\$112	\$116	\$123	\$127	\$119
Cumulative				\$36	\$88	\$159	\$240	\$339	\$451	\$567	\$690	\$818	\$937

Cost of Debt	7.5%
Rf	4.7%
Beta	1.20
Market risk premium	5.4%
Required Return on Equity	11.2%
Net Debt / Net Capital	0.0%
Tax Rate	36.2%
Required Return on Investment	11.2%
LT Growth Rate	4.0%
FCF Multiple	13.8

Source: Deutsche Bank, Company Info

Our two-stage discounted cash flow model assumes a 10-year EBIT CAGR of 17% (expect 25% EBIT growth to moderate after the next few years) and required return of 11%. We have assumed a long-term growth rate of 4% below our other quick casual growth play, CMG (assumption of 5%), given a somewhat later stage of growth, and higher than the 2% to 2.5% we've assigned to the more traditional QSR stocks in our universe. This methodology yields an \$81 share price.

The author of this report wishes to acknowledge the contribution made by Zarvan Tatfi, an employee of Progeon, a third-party provider to Deutsche Bank of offshore research support services.

Figure 63: PNRA Income Statement (\$mn)

	2004	1Q05	2Q05	3Q05	4Q05	2005	1Q06	2Q06	3Q06E	4Q06E	2006E	1Q07E	2Q07E	3Q07E	4Q07E	2007E	
Net Revenues																	
Bakery Café Sales	362.1	110.6	117.8	124.0	147.1	499.4	155.8	157.2	165.0	198.8	676.7	197.1	202.3	213.8	248.0	861.3	
Franchise royalties and fees	44.4	12.4	13.2	13.4	15.2	54.3	14.5	15.3	16.0	17.5	63.4	16.5	17.9	18.9	20.5	73.7	
Fresh dough sales to franchisees	72.6	21.1	20.8	20.7	23.8	86.5	24.4	24.6	24.0	27.5	100.5	27.8	27.8	27.4	31.6	116.6	
Total Net Revenues	479.1	144.1	151.9	158.1	186.2	640.3	194.0	197.1	205.0	243.8	840.6	241.4	248.0	260.1	300.1	1,049.6	
Food & paper	101.4	29.5	34.9	36.9	41.4	142.7	45.7	46.2	50.5	55.7	198.1	57.8	59.5	64.1	69.9	251.3	
Labor	110.8	34.0	36.3	37.9	43.3	151.5	47.4	48.1	51.6	58.8	205.9	59.7	61.5	66.5	73.2	260.9	
Occupancy	25.2	8.6	8.8	9.4	10.6	37.4	11.0	11.5	13.0	14.5	50.1	14.2	14.8	16.5	17.9	63.3	
Other operating expenses	51.0	15.5	17.2	17.6	19.7	70.0	20.2	22.3	24.1	26.6	93.2	25.6	28.5	31.0	33.0	118.1	
Fresh dough cost of sales to franchisees	65.6	19.0	17.8	17.6	20.6	75.0	21.7	20.8	20.5	23.7	86.7	24.8	23.5	23.3	27.3	98.9	
D&A	27.5	7.3	7.9	8.6	9.2	33.0	10.2	10.5	11.7	12.4	44.8	12.5	12.8	14.6	15.3	55.2	
G&A	33.3	10.3	11.8	11.1	13.1	46.3	14.2	14.6	14.6	17.1	60.5	17.4	18.2	18.5	21.0	75.1	
Pre-opening expenses	2.6	0.6	0.6	0.8	1.3	3.2	0.8	1.7	1.2	2.0	5.7	1.2	2.2	1.6	2.7	7.7	
Total operating expenses	417.5	124.8	135.2	139.9	159.2	559.1	171.3	175.7	187.2	210.9	745.1	213.2	221.1	236.0	260.3	930.5	
Impairment and other charges (credits), net																	
Operating Income	61.6	19.3	16.7	18.1	27.0	81.1	22.7	21.4	17.8	32.9	95.5	28.2	26.9	24.1	39.8	119.1	
Operating income Excl. - charges	61.6	19.3	16.7	18.1	27.0	81.1	22.7	21.4	17.8	32.9	95.5	28.2	26.9	24.1	39.8	119.1	
Interest expense	0.0	0.0	0.0	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.1	
Non operating expense	1.1	0.0	(0.1)	(0.5)	(0.6)	(1.1)	(1.0)	(0.7)	(0.6)	(0.6)	(2.9)	(0.9)	(0.6)	(0.6)	(0.5)	(2.6)	
Pretax Income	60.6	19.2	16.9	18.5	27.5	82.1	23.6	22.1	18.4	33.5	98.3	29.1	27.5	24.7	40.3	121.6	
Taxes	22.1	7.0	6.2	6.8	10.0	30.0	8.6	8.1	6.7	12.2	35.6	10.6	10.0	9.0	14.7	44.4	
Net Income - Continuing Operations	38.5	12.2	10.7	11.7	17.5	52.1	15.0	14.0	11.7	21.3	62.7	18.5	17.5	15.7	25.6	77.2	
Charges	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
Net Income	38.5	12.2	10.7	11.7	17.5	52.1	15.0	14.0	11.7	21.3	62.7	18.5	17.5	15.7	25.6	77.2	
Net Income Excl.-Charges	38.5	12.2	10.7	11.7	17.5	52.1	15.0	14.0	11.7	21.3	62.7	18.5	17.5	15.7	25.6	77.2	
Average Shares Outstanding - Basic	30	31	31	31	31	31	31	31	31	31	31	31	31	31	31	31	
Basic EPS	\$1.27	\$0.40	\$0.35	\$0.38	\$0.56	\$1.69	\$0.48	\$0.45	\$0.37	\$0.68	\$2.01	\$0.59	\$0.56	\$0.50	\$0.82	\$2.47	
Average Shares Outstanding - Diluted	31	31	32	32	32	32	32	32	32	32	32	32	32	32	32	32	
Diluted EPS	\$1.25	\$0.39	\$0.34	\$0.37	\$0.55	\$1.65	\$0.47	\$0.44	\$0.36	\$0.67	\$1.96	\$0.58	\$0.55	\$0.49	\$0.80	\$2.41	
Average Shares Outstanding - Diluted																	
Diluted EPS Excl. Charges																	
Dividend payout ratio																	
																23%	

	2004	1Q05	2Q05	3Q05	4Q05	2005	1Q06	2Q06	3Q06E	4Q06E	2006E	1Q07E	2Q07E	3Q07E	4Q07E	2007E
Margin Structure*																
Bakery-café expenses	28.0%	26.7%	29.6%	29.8%	28.1%	28.6%	29.4%	29.4%	30.6%	28.0%	29.3%	29.3%	29.4%	30.0%	28.2%	29.2%
Food & paper	30.6%	30.8%	30.8%	30.6%	29.4%	30.3%	30.4%	30.6%	31.3%	29.6%	30.4%	30.3%	30.4%	31.1%	29.5%	30.3%
Labor	6.9%	7.8%	7.4%	7.6%	7.2%	7.5%	7.1%	7.3%	7.9%	7.3%	7.4%	7.2%	7.3%	7.7%	7.2%	7.3%
Occupancy	14.1%	14.0%	14.6%	14.2%	13.4%	14.0%	13.0%	14.2%	14.6%	13.4%	13.8%	13.0%	14.1%	14.5%	13.3%	13.7%
Other operating expenses	20.3%	20.7%	17.6%	17.9%	21.8%	19.6%	20.2%	18.5%	15.6%	21.7%	19.1%	20.2%	18.8%	16.7%	21.8%	19.5%
Restaurant Margin	90.4%	89.9%	85.4%	85.0%	86.4%	86.7%	89.0%	84.4%	85.3%	86.5%	86.3%	89.1%	84.4%	85.1%	86.5%	86.3%
Fresh dough cost	5.7%	5.1%	5.2%	5.5%	4.9%	5.1%	5.3%	5.3%	5.7%	5.1%	5.3%	5.2%	5.2%	5.6%	5.1%	5.3%
D&A	7.0%	7.1%	7.8%	7.0%	7.0%	7.2%	7.3%	7.4%	7.1%	7.0%	7.2%	7.2%	7.4%	7.1%	7.0%	7.2%
G&A	0.6%	0.4%	0.4%	0.5%	0.7%	0.5%	0.4%	0.8%	0.6%	0.8%	0.7%	0.5%	0.9%	0.6%	0.9%	0.7%
Pre-opening expenses	12.9%	13.4%	11.0%	11.5%	14.5%	12.7%	11.7%	10.9%	8.7%	13.5%	11.4%	11.7%	10.9%	9.3%	13.3%	11.3%
Operating Margin	12.9%	19.7%	15.9%	16.9%	19.4%	18.0%	16.9%	16.2%	13.9%	18.0%	16.4%	16.9%	16.0%	14.9%	18.4%	16.6%
EBITDA Margin	36.5%	36.5%	36.5%	36.6%	36.5%	36.5%	36.5%	36.6%	36.5%	36.5%	36.2%	36.5%	36.5%	36.5%	36.5%	36.5%
Tax Rate	8.0%	8.5%	7.0%	7.4%	9.4%	8.1%	7.7%	7.1%	5.7%	8.7%	7.5%	7.7%	7.0%	6.0%	8.5%	7.4%
Net Margin																

	2004	1Q05	2Q05	3Q05	4Q05	2005	1Q06	2Q06	3Q06E	4Q06E	2006E	1Q07E	2Q07E	3Q07E	4Q07E	2007E
Growth Leverage*																
Sales	31.7%	11.0%	44.2%	38.9%	43.0%	33.6%	34.6%	29.8%	29.7%	31.0%	31.3%	24.5%	26.8%	26.9%	23.1%	24.9%
Bakery-café expenses	37.0%	8.6%	54.1%	52.4%	50.8%	40.6%	55.2%	32.3%	36.8%	34.6%	38.9%	26.3%	28.7%	27.0%	25.7%	26.9%
Food & paper	36.5%	11.5%	47.8%	46.7%	45.0%	36.8%	39.1%	32.7%	36.1%	35.9%	35.9%	26.1%	27.9%	26.9%	24.3%	26.7%
Labor	39.8%	27.5%	58.2%	52.3%	58.7%	48.6%	27.6%	31.5%	38.8%	36.6%	33.9%	28.9%	28.3%	26.3%	23.1%	26.4%
Occupancy	38.7%	9.7%	40.0%	34.8%	70.2%	37.1%	30.5%	29.4%	37.0%	35.2%	33.2%	26.6%	28.1%	28.7%	23.8%	26.7%
Other operating expenses	19.4%	1.6%	21.3%	14.1%	22.7%	14.3%	14.4%	16.6%	16.4%	15.1%	15.6%	14.1%	13.1%	13.7%	15.0%	14.0%
Fresh dough cost	40.9%	-2.7%	28.6%	30.0%	27.5%	20.1%	39.6%	33.7%	35.5%	35.6%	36.0%	22.5%	22.1%	24.6%	23.1%	23.1%
D&A	18.5%	12.0%	43.1%	40.2%	43.2%	38.9%	37.9%	24.1%	31.3%	30.1%	30.8%	22.5%	24.5%	26.3%	23.1%	24.2%
G&A	23.6%	26.3%	59.8%	31.0%	22.3%	31.6%	17.5%	27.9%	-1.9%	22.2%	17.7%	24.6%	25.8%	35.4%	20.8%	24.6%
Operating Income	23.6%	86.1%	130.5%	93.2%	63.9%	87.3%	15.7%	32.3%	6.1%	21.3%	19.3%	24.0%	24.6%	38.1%	25.7%	26.5%
EBITDA	25.5%	29.1%	66.0%	37.5%	24.8%	35.6%	22.8%	31.0%	-0.7%	21.7%	20.2%	23.3%	24.6%	34.3%	20.2%	23.2%
Net Income	24.5%	26.4%	61.4%	33.6%	21.3%	32.0%	20.4%	29.4%	-1.7%	21.7%	18.9%	23.3%	24.6%	34.3%	20.2%	23.2%
Diluted EPS																

	2004	1Q05	2Q05	3Q05	4Q05	2005	1Q06	2Q06	3Q06E	4Q06E	2006E	1Q07E	2Q07E	3Q07E	4Q07E	2007E
Cashflow Points																
Operating Income	61.6	19.3	16.7	18.1	27.0	81.1	22.7	21.4	17.8	32.9	95.5	28.2	26.9	24.1	39.8	119.1
Depreciation & Amortization	0.0	9.1	7.4	8.6	9.2	34.3	10.2	10.5	10.6	10.9	42.2	12.5	12.8	14.6	15.3	55.2
EBITDA	61.6	28.4	24.1	26.8	36.1	115.5	32.9	31.9	28.4	43.8	137.8	40.8	39.8	38.7	55.1	

Figure 64: PNRA Metrics (\$mn)

	2004	1Q05	2Q05	3Q05	4Q05	2005	1Q06	2Q06	3Q06E	4Q06E	2006E	1Q07E	2Q07E	3Q07E	4Q07E	2007E
Revenues																
Company operated	362.1	110.6	117.8	124.0	147.1	499.4	155.8	157.2	165.0	198.8	676.7	197.1	202.3	213.8	248.0	861.3
Franchise operated	44.4	12.4	13.2	13.4	15.2	54.3	14.5	15.3	16.0	17.5	63.4	16.5	17.9	18.9	20.5	73.7
Fresh dough sales to franchisees	72.6	21.1	20.9	20.7	23.9	86.5	24.4	24.6	24.0	27.5	100.5	27.8	27.8	27.4	31.6	114.6
Total Revenues	479.1	144.1	151.9	158.1	186.2	640.3	194.7	197.1	205.0	243.8	840.6	241.4	248.0	260.1	300.1	1049.6
Revenue (% growth)																
Company operated	36%	14%	49%	43%	48%	38%	41%	33%	33%	35%	36%	27%	29%	30%	25%	27%
Franchise operated	23%	1%	33%	30%	28%	22%	16%	16%	19%	15%	17%	14%	16%	18%	17%	16%
Fresh dough sales to franchisees	18%	3%	30%	22%	26%	19%	16%	18%	16%	15%	16%	14%	13%	14%	15%	14%
Total Revenue	32%	11%	44%	39%	43%	34%	35%	30%	30%	31%	31%	24%	26%	27%	23%	25%
No. of Cafes																
Company operated	226	243	255	265	311	311	319	337	353	409	409	394	417	438	496	496
Franchise operated	515	530	540	560	566	566	578	602	623	633	633	648	677	703	718	718
Total Cafes	741	773	795	825	877	877	897	939	976	1042	1042	1042	1094	1141	1214	1214
Cafes (% Total)																
Company operated	30%	31%	32%	32%	35%	35%	36%	36%	36%	39%	39%	38%	38%	38%	41%	41%
Franchise operated	70%	69%	68%	68%	65%	65%	64%	64%	64%	61%	61%	62%	62%	62%	59%	59%
Total Cafes	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
# growth in Cafes																
Company operated	53	59	58	53	85	85	76	82	88	98	98	75	80	85	87	87
Franchise operated	86	77	68	71	51	51	48	62	63	67	67	70	75	80	85	85
Total Cafes	139	136	126	124	136	136	124	144	151	165	165	145	155	165	172	172
Cafes (% growth)																
Company operated	31%	32.1%	29.4%	25.0%	37.6%	38%	31%	32%	33%	32%	32%	24%	24%	24%	21%	21%
Franchise operated	20%	17.0%	14.4%	14.5%	9.9%	10%	9%	11%	11%	12%	12%	12%	12%	13%	13%	13%
Total Cafes	23%	21.4%	18.8%	17.7%	18.4%	18%	16%	18%	18%	19%	19%	16%	17%	17%	17%	17%
Same Store Sales																
Company operated	2.9%	7.1%	7.9%	7.2%	7.4%	7.4%	8.9%	3.7%	2.5%	4.7%	4.9%	2.5%	4.5%	5.0%	3.0%	3.8%
Franchise operated	2.6%	6.2%	9.9%	8.6%	7.8%	8.0%	9.1%	3.0%	3.0%	4.4%	4.9%	2.1%	4.2%	5.5%	3.5%	3.8%
Total Cafes	2.7%	6.5%	9.3%	8.2%	7.7%	7.8%	9.0%	3.2%	2.8%	4.5%	4.9%	2.3%	4.3%	5.3%	3.3%	3.8%
Revenue Per New Restaurant/Fallout																
Company operated	2.6%	-25.3%	11.2%	11.2%	3.2%	-7.1%	0.7%	-2.5%	-2.6%	-1.0%	-0.9%	0.5%	0.5%	0.5%	0.5%	2.2%
Franchise operated	0.0%	-21.9%	8.6%	7.3%	10.0%	4.3%	-1.9%	1.7%	4.9%	-1.0%	-0.1%	-0.2%	-0.2%	-0.2%	-0.2%	-0.9%

Source: Deutsche Bank, company data

Figure 65: PNRA Balance Sheet (\$mn)

	2004	1Q05	2Q05	3Q05	4Q05	2005	1Q06	2Q06	3Q06E	4Q06E	2006E	1Q07E	2Q07E	3Q07E	4Q07E	2007E
Cash/Marketable Securities	29.6	27.6	36.4	42.3	24.5	24.5	8.5	23.0			6.7					61.4
Investments in government securities	2.0	8.1	18.0	31.3	36.2	36.2	61.8	50.3			50.0					50.0
Accounts receivables (Trade+Others)	17.3	16.7	16.2	16.7	25.2	25.2	19.2	22.1			25.2					31.5
Inventory	5.4	5.4	5.7	5.9	7.4	7.4	7.2	7.6			8.4					10.5
Prepaid and other current assets	3.9	4.1	7.5	7.7	9.6	9.6	9.6	11.1			12.6					21.0
Total Current Assets	58.2	61.9	83.7	103.9	102.8	102.8	106.3	114.1			103.0					174.4
Plant & Equipment, Net	201.7	214.4	223.3	239.1	268.8	268.8	274.2	292.0			347.1					387.6
Investments in government securities	26.4	35.3	30.1	16.1	10.1	10.1	4.1	0.0			0.0					0.0
Goodwill & Other intangible	35.5	35.7	35.4	35.4	51.8	51.8	51.8	51.7			52.0					45.0
Deposit & Other	2.8	5.0	4.8	5.5	4.2	4.2	5.6	5.6			29.4					38.7
Total Assets	324.7	352.2	377.3	400.0	437.7	437.7	441.9	463.4			531.5					645.6
Accounts Payable	5.8	7.7	8.7	3.9	4.4	4.4	3.0	5.2			5.0					10.0
Accrued expenses	48.9	48.0	54.4	62.5	81.6	81.6	64.3	66.1			88.3					105.0
Deferred revenue	1.0	0.9	0.7	1.4	0.9	0.9	0.6	0.0			0.0					0.0
Other current																
Total Current Liabilities	55.7	56.6	63.8	67.8	86.9	86.9	67.9	71.3			93.3					115.0
Deferred Tax	5.6	5.9	6.3	9.1	5.0	5.0	4.1	2.6			8.4					15.7
Deferred Rent	20.2	22.6	23.1	24.0	23.9	23.9	24.9	25.0			27.0					33.0
LT debt																
Other Long-term Liabilities	1.8	2.7	2.8	3.9	4.9	4.9	7.1	7.8			7.6					9.4
Total Liabilities	83.3	87.9	96.0	104.7	120.7	120.7	104.0	106.8			136.2					173.2
Common Stock	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0			0.0					0.0
Additional Paid in Capital	131.0	140.0	146.5	153.6	159.0	159.0	160.4	165.0			170.0					170.0
Retained Earnings	111.3	125.2	135.6	147.3	163.5	163.5	178.5	192.5			226.2					303.4
Unearned deferred compensation		0.0	0.0	-4.7	-4.6	-4.6	0.0	0.0			0.0					0.0
Treasury Shares	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9			-0.9					-0.9
Total Shareholders' Equity	241.4	264.3	281.3	295.3	317.0	317.0	338.0	356.6			395.3					472.5
Total Liabilities & Shareholders' Equity	324.7	352.2	377.3	400.0	437.7	437.7	441.9	463.4			531.5					645.6

Source: Deutsche Bank, company data

Figure 66: PNRA cash flows (\$mn)

	1996	1997	2000	2001	2002	2003	2004	2005	2006E	2007E
Operating Cash Flows										
Net income	(4)	2	7	13	21	30	39	52	63	77
Depreciation and amortization	16	17	8	11	14	18	25	33	42	55
Other	4	(3)	5	8	12	16	10	7	8	8
Net change in working capital	(1)	(2)	(1)	(2)	1	8	10	18	3	5
Net Operating Cash Flows	15	13	19	31	49	73	84	110	116	145
Capex	(17)	(15)	(19)	(28)	(29)	(46)	(80)	(82)	(121)	(96)
Dividends	-	-	-	-	-	-	-	-	-	-
FCF	(2)	(1)	(0)	3	19	27	3	28	(4)	50
Investing Cash Flows										
Acquisitions		6	-	-	(3)	(21)	(5)	(28)	(15)	-
Equity investments		2			(9)	(4)	(29)	(20)	(10)	(8)
Other	(5)	(1)	(1)	(1)	(1)	4	12	1	2	3
Net Investing Cash Flows	(5)	7	(1)	(1)	(13)	(21)	(22)	(48)	(23)	(5)
Financing Cash Flows										
Debt issuances / (payments)	4	(7)	0	(0)	0	-	-	-		
Share issuances / (repurchases)	1	0	7	7	4	5	5	14	10	10
Other	(2)	(0)	(0)	0	1	1	1	-	-	-
Net Financing Cash Flows	3	(8)	8	7	6	6	5	14	10	10
Net increase/ (decrease) in cash	(4)	(2)	7	9	12	12	(13)	(6.0)	(18)	55
Cash and equivalents beginning of year	6	3	2	9	18	30	42	30	24	7
Cash and equivalents end of year	3	1	9	18	30	42	29	24	7	61

Source: Deutsche Bank. Company data

Figure 67: PNRA EVA analysis (\$mn)

NOPAT	2000	2001	2002	2003	2004	2005	2006E	2007E
Income for Common	\$7	\$13	\$21	\$31	\$38	\$52	\$63	\$77
Increase in Deferred taxes	-	-	-	-	6	(1)	3	7
Goodwill Amortization	(1)	(0)	1	14	3	16	0	(7)
Increase in LIFO reserve								
Advertising Expense	3	4	6	6	8	10	17	21
Special Charges/Gains	0	-	-	-	-	-	-	-
Increase in Equity Equivalents	3	4	7	20	16	26	20	21
Adjusted Income for Common	9	17	28	50	55	78	83	99
Interest Expense	0	0	0	0	0	0	0	0
Tax Benefit of Interest Expense	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)
Tax Shield	0	0	0	0	0	0	0	0
NOPAT	9	17	28	50	55	78	83	99
Capital	2000	2001	2002	2003	2004	2005	2006E	2007E
Short-term Debt								
Current Portion of Long-term Debt								
Senior Long-term Debt								
PV of Non-Cap Leases	56	74	98	166	219	406	507	609
Total Debt & Leases	56	74	98	166	219	406	507	609
Common Equity	92	120	154	194	241	317	395	472
Deferred Income Tax	-	-	-	-	6	5	8	16
Capitalized Advertising								
LIFO Reserve								
Accumulated Goodwill Amortization	18	18	19	33	35	52	52	45
Restructuring Charge								
Equity Equivalents	18	18	19	33	41	57	60	61
Adjusted Common Equity	109	137	173	227	282	374	456	533
Capital	166	211	271	393	501	780	963	1,142
ROIC	5.7%	8.0%	10.5%	12.8%	10.9%	10.0%	8.6%	8.6%
MACC-Mkt. Adjusted Cost of Capital	2000	2001	2002	2003	2004	2005	2006E	2007E
Required Rate of Return	11%	11%	11%	11%	11%	11%	11%	11%
Cost of Debt	7.5%	7.0%	6.5%	5.0%	5.0%	6.0%	6.5%	6.5%
Forward Relative P/E	191%	234%	264%	190%	178%	239%	210%	220%
% Debt	34%	35%	36%	42%	44%	52%	53%	53%
% Equity	66%	65%	64%	58%	56%	48%	47%	47%
	2000	2001	2002	2003	2004	2005	2006E	2007E
Weighted Cost of Debt	2.6%	2.4%	2.4%	2.1%	2.2%	3.1%	3.4%	3.5%
Weighted Cost of Equity	3.8%	3.1%	2.7%	3.3%	3.5%	2.2%	2.5%	2.3%
Market Adj. Cost of Capital	6.3%	5.5%	5.0%	5.4%	5.7%	5.3%	5.9%	5.8%
Spread	2000	2001	2002	2003	2004	2005	2006E	2007E
ROIC	5.7%	8.0%	10.5%	12.8%	10.9%	10.0%	8.6%	8.6%
MACC	6.3%	5.5%	5.0%	5.4%	5.7%	5.3%	5.9%	5.8%
Spread	-0.6%	2.5%	5.5%	7.3%	5.2%	4.7%	2.7%	2.8%

Source: Deutsche Bank, company data

North America United States
Consumer Restaurants

18 October 2006

McDonald's

Reuters: **MCD.N** Bloomberg: **MCD UN**

Initiate at Hold, Likin' it not lovin' it

Initiating with a Hold rating & \$43 price target

Following a period of malaise in the early 2000's, MCD has come back into its own thanks to a restructuring program based on asset rationalization, new marketing and menu options, and a renewed focus on operations. However, we believe these improvements have been adequately rewarded by the market, and our \$43 PT offers only modest total return.

A global leader, but relatively mature

Europe and US markets comprise about 81% of 2006E profits, but are relatively mature – we expect only 3-5% top-line growth in our LT forecasts. Key initiatives such as menu innovations (focus on chicken – i.e. Chicken Snack Wrap), customer convenience initiatives and store revamping have bolstered recent comps, but low-hanging fruit is mostly picked. APMEA and Latam regions provide the most growth upside (expect 12% sales growth in 2006), but represent only around 20% of the sales base.

Operational resurgence the key to current performance...

MCD has made operational improvements over the past 2-3 years through reduced restaurant openings, lower capital investment, more nimble marketing, standardized operating processes and new products more in tune with modern lifestyles. MCD is also one of the most profitable companies in the industry, reflecting economies of scale and a low-cost structure. Refranchising should help improve returns, and we forecast high single-digit EPS growth and significant free and operating cash flow, 130% of which will be returned to shareholders.

...But is already reflected in shares

Our \$43 PT is a blend of EV/EBITDA, P/E, ROIC spread and DCF and offers only 4% total return. Best entry points could come on negative "headline" events, which often have minimal operational impact but cause ST pullbacks. Key risks to our forecasts include health concerns (i.e. obesity, food contamination lawsuits), changes in corporate structure or shifts in cash returns to shareholders.

Forecasts and ratios

Year End Dec 31	2005A	2006E	2007E
1Q EPS ¹	0.56	0.49A	0.56
2Q EPS	0.40	0.67A	0.65
3Q EPS	0.58	0.68	0.74
4Q EPS	0.50	0.57	0.61
FY EPS (USD)	2.04	2.41	2.55
EV/EBITDA (x)	8.5	9.9	9.3
Revenue (USDm)	20,460	22,030	22,711

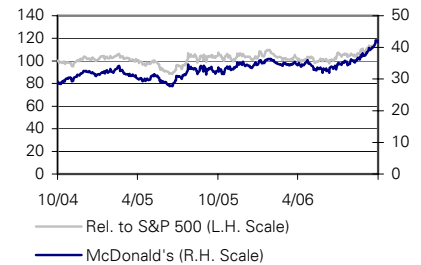
Source: Deutsche Bank estimates, company data

¹ Includes the impact of FAS123R requiring the expensing of stock options.

Hold

Price at 17 Oct 2006 (USD)	41.60
Price Target	43.00
52-week range	42.23 - 31.55

Price/price relative



Performance (%)	1m	3m	12m
Absolute	10.3	19.8	27.2
S&P 500	3.3	10.5	14.6

Stock data

Market Cap (USD)	51,858.6
Shares outstanding (m)	1,246.6
Free float (%)	–
Volume	6,373,400
S&P 500	1,364.05

Key indicators

ROE (%)	19.8
ROA (%)	12.6
Net debt/equity (x)	39.0
Book value/share (USD)	12.02
Price/book (x)	3.5
Net interest cover (x)	11.1
EBIT margin (%)	20.2

Model updated: 16 October 2006

Running the Numbers

North America

US

Restaurants

McDonald's

Reuters: MCD.N Bloomberg: MCD UN

Hold

Price as of 17 October **US\$ 41.60**

Target price **US\$ 43.00**

Company website

NA

Company description

The company operates and franchises McDonald's restaurants offering value-priced menus in more than 100 countries. It also operates Chipotle and Boston Market. Globally, McDonald's stores number 32,000, 71% of which are franchised and 57% located outside the US.

Research Team

Laurie D. Hahn, CFA

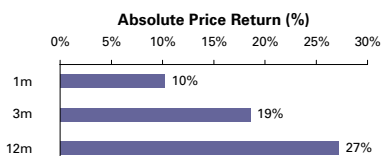
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52-week Range: **US\$ 31.55 - 42.23**

Market Cap (m) **USD 51,859**
EUR 41,354

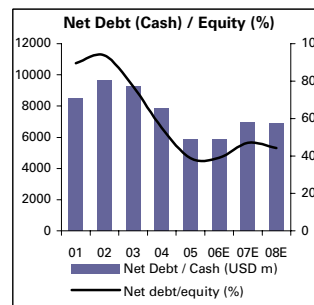
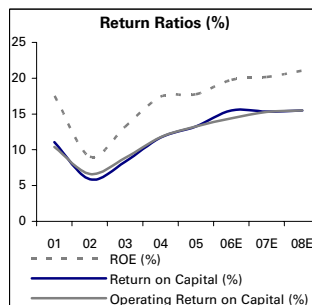
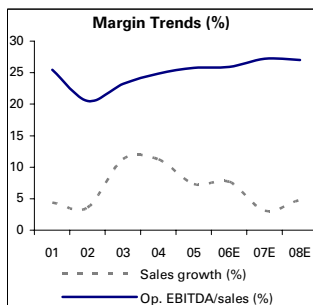
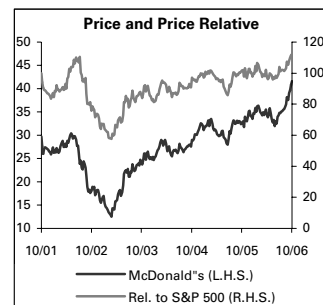
Company identifiers

Cusip **580135101**

SEDOL **2550707**

Year Ending 31 December

	2001	2002	2003	2004	2005	2006E	2007E	2008E
SUMMARY								
Headline EPS (US\$)	1.25	0.70	1.15	1.79	2.04	2.41	2.55	2.80
P/E ratio Headline (x)	22.7	34.7	17.5	15.6	15.6	17.3	16.3	14.9
Headline EPS growth (%)	-14.2	-44.2	65.3	55.2	14.2	17.8	6.2	9.5
EPS FD (US\$)	1.25	0.70	1.15	1.79	2.04	2.41	2.55	2.80
P/E ratio FD (x)	22.7	34.7	17.5	15.6	15.6	17.3	16.3	14.9
Operating CFPS (US\$)	2.08	2.27	2.57	3.10	3.44	3.55	3.71	3.95
Free CFPS (US\$)	0.61	0.70	1.54	1.97	2.17	2.10	2.12	2.35
P/CFPS (x)	13.6	10.7	7.8	9.0	9.3	11.7	11.2	10.5
DPS (US\$)	0.23	0.24	0.40	0.55	0.67	1.00	1.24	1.34
Dividend Yield (%)	0.8	1.0	2.0	2.0	2.1	2.4	3.0	3.2
BV/Share (US\$)	7.36	8.08	9.44	11.27	12.02	12.02	12.20	13.14
Price/BV (x)	3.60	1.99	2.63	2.84	2.81	3.46	3.41	3.17
Weighted average shares (m)	1290	1273	1270	1260	1260	1247	1211	1191
Average market cap (USD m)	36,639	30,795	25,617	35,076	40,194	51,859	51,859	51,859
Enterprise value (USD m)	44,149	39,406	33,765	41,805	45,038	56,606	57,637	57,545
EV/Sales	2.97	2.56	1.97	2.19	2.20	2.57	2.54	2.42
EV/EBITDA	11.7	12.5	8.5	8.8	8.5	9.9	9.3	9.0
EV/EBIT	16.4	18.7	11.9	11.8	11.2	12.7	11.9	11.3
EV/Operating Capital	2.4	2.0	1.6	1.9	2.1	2.7	2.7	2.6
INCOME STATEMENT (USD m)								
Sales revenue	14,870	15,406	17,141	19,065	20,460	22,030	22,711	23,816
Operating EBITDA	3,783	3,164	3,980	4,742	5,271	5,710	6,173	6,428
Depreciation	1,086	1,051	1,148	1,201	1,250	1,262	1,335	1,334
Amortisation	0	0	0	0	0	0	0	0
EBIT	2,697	2,113	2,832	3,541	4,022	4,448	4,838	5,094
Net interest income(expense)	-452	-374	-388	-358	-356	-399	-398	-348
Associates/affiliates	0	0	0	0	0	0	0	0
Investment/other income(expense)	85	-77	-98	20	36	350	35	30
Exceptionals/extraordinaries	0	-99	-37	0	0	0	0	0
Income tax expense	693	670	838	924	1,099	1,422	1,477	1,576
Minorities/preference dividends	0	0	0	0	0	0	0	0
Net income	1,637	894	1,471	2,279	2,602	2,976	2,998	3,200
CASH FLOW (USD m)								
Cash flow from operations	2,688	2,890	3,269	3,904	4,337	4,421	4,490	4,702
Movement in net working capital	53	892	-89	190	412	83	57	68
Capex	-1,906	-2,004	-1,307	-1,419	-1,607	-1,800	-1,920	-1,905
Free cash flow	782	886	1,961	2,484	2,730	2,621	2,570	2,796
Other investing activities	-162	-463	-62	36	-211	433	-220	-191
Equity raised(bought back)	-1,068	-475	-220	-41	-434	-2,000	-1,800	-1,500
Dividends paid	-288	-297	-504	-695	-842	-1,247	-1,499	-1,600
Net inc(dec) in borrowings	527	146	-892	-816	1,612	-1,400	-500	0
Other financing cash flows	205	116	-122	-83	25	224	-162	-144
Total cash flows from financing	-624	-511	-1,737	-1,634	362	-4,423	-3,962	-3,244
Net cash flow	-4	-88	162	887	2,881	-1,369	-1,611	-638
Movement in net debt(cash)	531	233	-1,054	-1,703	-1,268	-31	1,111	638
BALANCE SHEET (USD m)								
Cash and other liquid assets	418	330	493	1,380	4,260	2,892	1,280	642
Tangible fixed assets	17,290	18,583	19,925	20,703	19,908	20,446	21,031	21,602
Goodwill	1,320	1,560	1,665	1,828	1,951	2,036	2,156	2,256
Other intangible assets	0	0	0	0	0	0	0	0
Associates/investments	990	1,038	1,090	1,110	1,035	1,102	1,181	1,238
Other assets	2,516	2,459	2,353	2,816	2,834	2,379	2,430	2,548
Total assets	22,535	23,971	25,525	27,838	29,989	28,854	28,078	28,287
Interest bearing debt	8,918	9,979	9,731	9,220	10,140	8,740	8,240	7,567
Other liabilities	4,128	3,710	3,813	4,417	4,703	5,132	5,057	5,066
Total liabilities	13,046	13,690	13,543	13,636	14,843	13,872	13,297	12,632
Shareholders' equity	9,488	10,281	11,982	14,202	15,146	14,982	14,781	15,654
Minorities	0	0	0	0	0	0	0	0
Total shareholders' equity	9,488	10,281	11,982	14,202	15,146	14,982	14,781	15,654
Net working capital	-485	-762	-705	-1,180	-1,244	-1,321	-1,378	-1,446
Net debt(cash)	8,500	9,649	9,238	7,840	5,880	5,848	6,960	6,925
Capital	17,988	19,930	21,220	22,041	21,026	20,830	21,741	22,579
RATIO ANALYSIS								
Sales growth (%)	4.4	3.6	11.3	11.2	7.3	7.7	3.1	4.9
Op. EBITDA/sales (%)	25.4	20.5	23.2	24.9	25.8	25.9	27.2	27.0
EBIT/sales (%)	18.1	13.7	16.5	18.6	19.7	20.2	21.3	21.4
Payout ratio (%)	18.1	34.2	34.5	30.4	32.5	41.9	50.0	50.0
ROE (%)	17.5	9.0	13.2	17.4	17.7	19.8	20.1	21.0
Return on Capital (%)	11.1	5.9	8.4	11.7	13.2	15.5	15.3	15.5
Operating Return on Capital (%)	10.4	6.6	8.9	11.8	13.2	14.4	15.3	15.5
Capex/sales (%)	12.8	13.0	7.6	7.4	7.9	8.2	8.5	8.0
Capex/depreciation (x)	1.8	1.9	1.1	1.2	1.3	1.4	1.4	1.4
Net debt/equity (%)	89.6	93.9	77.1	55.2	38.8	39.0	47.1	44.2
Net interest cover (x)	6.0	5.6	7.3	9.9	11.3	11.1	12.2	14.6



Source: Company data, Deutsche Bank estimates

Investment thesis

Outlook

Following a period of cultural and financial malaise in the early 2000s, McDonald's has come back into its own by reinventing itself domestically and emphasizing international growth. A 2003 multi-year revitalization plan featured more measured growth and asset rationalization, new marketing, and a new focus on operations. MCD appears to have done what it intended. Average annual sales growth of 9% over the last three years compares to 3-4% in 2001-2002 period, while average annual EPS growth of 29% over the last three years compares to a 14% decline in 2001 and 44% decline in 2002.

Within the geographic mix, Europe has recovered after a few stumbles, and offers attractive opportunities for market share and profit growth. Australia, Japan, and China drive the APMEA segment which boasts the highest rates of growth, with company-operated sales forecasted to grow 7% this year. In the US, we expect total comp store sales for co.-owned restaurants to moderate to the 3-5% range. Key initiatives such as menu innovations, convenience initiatives and store reimaging have recently pushed up comps, but possibly to unsustainable levels since much of the low-hanging fruit has been picked.

MCD is one of the most profitable companies in the industry, reflecting economies of scale and a low-cost structure. However, operating margins have declined since the mid-to-late 90's from 25% to around 20%. Refining company ownership is a key initiative, with the view that franchised units are more efficient, and MCD still owns almost 30% of stores vs. 21% for YUM. We believe this initiative could help improve margins and returns – our forecasts show MCD achieving high single-digit EPS growth while throwing off significant CF, much of which it will return to shareholders. We view MCD primarily as a mature, cash flow story.

Valuation

Our \$43 PT reflects an average of several methodologies (P/E, EBITDA, ROIC, DCF). Shares trade close to a 5-year average P/E of 16-17x on an '07E basis. This seems fair, but not an attractive entry point. While valuation moved up during the recovery, both measures are settling back toward the five-year mean of 16-17x P/E and 9.5x TEV/EBITDA. Our 9.5x EBITDA estimate is based on a similar historical average and forecasted ROIC progression (forecasted 12% ROIC compares to similar levels prior to difficulties in early 2000s). DCF methodology is based on 4% 10-year EBIT growth, 6.0% WACC—4.5% K-debt, 0.82 beta, 4.7% Rf rate, 5.4% market premium, 9.2% K-equity, 2% long-term growth (assumes slower industry growth vs. recent 4% and MCD in line with industry over the long-term). Our target offers only modest total return, and we are looking for a better buying opportunity – the best entry point may come on negative and, we believe, often overdone news on obesity, food contamination, and consumer demand softness.

Risks

As with most quick-service restaurant chains, MCD faces headline risk related to health concerns and obesity, including trans-fats, marketing to children, and consumer liability lawsuits, as well as food contamination (i.e. Mad Cow, Bird Flu). We generally view negative headlines and any subsequent share price weakness as a buying opportunity. Consumer slowdown is a risk, but less for MCD vs. most other restaurants given the low guest checks. Change in corporate structure to create shareholder value or pacify shareholder activism poses a risk to forecasts, as does any shift in returns of cash to shareholders, which could boost multiples.

Not lovin' the valuation

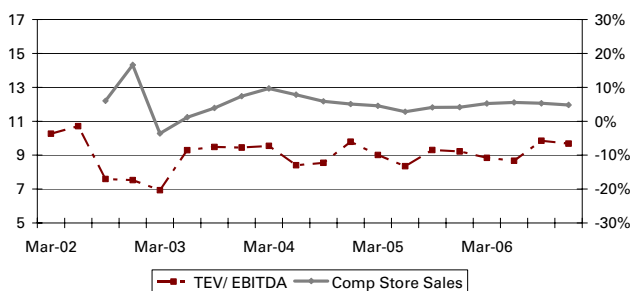
Steady recovery has been rewarded

McDonald's has come a long way from the mid 2000's. Several management changes and strategic overhauls later, the company appears to be on the right track with regard to menu innovation, image reconstruction, and return enhancement through asset rationalization. If these sound like vague concepts, then take a look at the hard numbers:

- Average annual sales growth over the last three years of 9% compares to 3%-4% in the 2001-2002 period.
- 2006 restaurant margin forecast of 15.7% vs. low of 13.9% in 2002. 2006 total company EBIT margin forecast of 20.8% vs. low of 13.7% in 2002.
- Average annual EPS growth of 29% over the last three years vs. 14% decline in 2001 and 44% decline in 2002.
- ROIC spread to market average cost of capital forecasted at 11.8% for 2006 vs. low of 3.0% in 2002.
- We expect MCD to return 130% of operating cash after capital expenditure to shareholders vs. 64% in 2002.

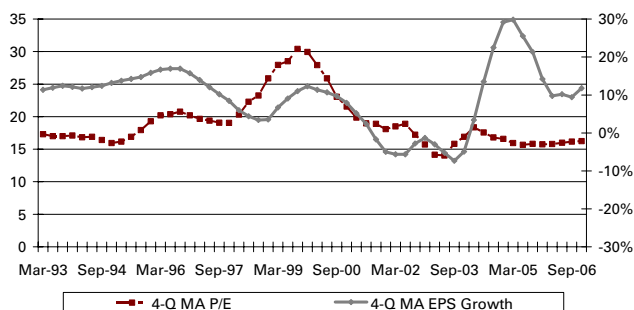
The company has clearly done what it set out to do, but we believe performance has been adequately rewarded by the market. MCD shares have returned an average of 28.6% to shareholders through the end of 2005 and now trade at 17.5x our 2006E EPS forecast of \$2.41 and 16.5x our 2007E forecast of \$2.55 vs. a five-year average on current year consensus forecast of 16x-17x. This seems fair to us, but not an attractive entry point.

Figure 68: TEV/EBITDA vs. Comp store Sales



Source: Deutsche Bank, Factset, Reuters, Company Info

Figure 69: P/E history vs. EPS growth



Source: Deutsche Bank, Factset, Reuters, Company IINfo

Figures 68 and 69 demonstrate our point best; while growth and valuation moved up during the recovery period, both are settling back toward the five-year mean of 16x-17x P/E and 9.5x TEV/EBITDA, suggesting a fair valuation in the low \$40s for MCD shares, based on our forecasts. Our target price of \$43 offers only modest return potential. We are therefore looking for a better buying opportunity into a steady cash flow story.

So when *is* the right time to buy?

We believe the best entry point may come in the form of negative, and often overdone buzz related to obesity issues, food contamination, and consumer demand softness, particularly as MCD is somewhat recession-resistant with one of the lowest average guest checks in the industry (fast food average guest check – \$5).

- **Headline risk related to health concerns and obesity.** On this point, there's a lot to work with out there since the health movement seems to be constantly looking for a culprit to blame for America's obesity problem. You name it: trans-fats, marketing to children, etc, have come under the microscope. Consumer liability lawsuits have been filed and the headlines crop up from time to time. We're not here to say that this will never cost MCD business or money—it might, if say, someone manages to pass a law restricting trans fats, or some judge decides to take up the cause of the "unsuspecting" obese consumer. The possibility exists. But over the last few years, most noise surrounding the obesity issue has generated buying opportunities in MCD shares. And for the most part, none of it diminished the company's long-term financial outlook.
- **Mad Cow, Bird Flu, etc.** Again, we aren't treating these potential disasters lightly, but the chances of them causing widespread contamination are fairly low. Instances of Mad Cow Disease can impact input prices and near-term profits, but not long-term cash flow and return outlook. Bird flu has yet to spread to humans in a meaningful way. For the most part, we would view negative headlines and any subsequent share price weakness as a potential buying opportunity.
- **Consumers on edge?** The consumer may be taking a breather, but compared to the early 2000's, confidence is still quite healthy. Soft housing prices could impact spending. And oil prices could trend upwards as winter sets in. But our DB economics team sees this as a soft landing and furthermore, a trip to MCD is less likely to get cut than more frivolous retail spending. In other words, five bucks for a burger and fries is a pretty good deal. The company has seen only minimal slowdown in previous cycles.

Beyond headline risk, any change in corporate structure designed to create shareholder value could change the game somewhat. Shareholder activism has come knocking from time to time at MCD and while the proposals to spin off company-owned stores seemed radical, changes to company store ownership could unlock profit and real estate value. Further shift to developmental licensees is constructive in this regard. Other options, such as a spin-off of Boston Market, could be strategically considered. And finally, any shift to return additional cash to shareholders could cause us to take another look at valuation and boost our multiples.

Timing

In sum, we view MCD as a mature, high quality, cash flow story. Consistent earnings growth and modest margin leverage should lead to steady improvement over the next few years, although at a slower pace vs. the recent period of recovery. Emerging markets will aid growth, but remain a fairly small driver of profits at this point. We therefore view a mean valuation as fair, and at the current price, see minimal upside. Provided a pullback or significant boost to profit growth, we would take another look at MCD.

Financial drivers

MCD resurgence – The key to current performance

Following a period of cultural and financial malaise in the early 2000s, McDonald’s has come back into its own by reinventing itself domestically and emphasizing international growth opportunities. Take a look at returns and the picture is fairly clear. The return on invested capital spread to WACC, while still favorable, hit a ten-year low at 4% in 2002. In 2003, management and cultural changes ushered in a multi-year revitalization plan that featured the following:

- More measured growth
- New marketing (“I’m lovin’ it” campaign)
- New focus on restaurant operations

These changes pulled the company out of a static state and allowed it to take greater advantage of favorable trends in the industry. The changes were drastic and vital and comprised the following: reduced restaurant openings; lower capital investment; more nimble advertising and marketing strategies; standardized restaurant operating processes, with regular shopper surveys; new products more in tune with modern lifestyles and tastes (i.e. more emphasis on chicken as consumers eat lower fat meats). All of these efforts have not gone without payoff. Our forecast for 2006 calls for an ROIC spread of 12.5%, better than the high reached in 1999. The key question is this – is current growth, particularly in the U.S., sustainable? We believe the last few years have shown impressive recovery, but expect growth to moderate over the next few years.

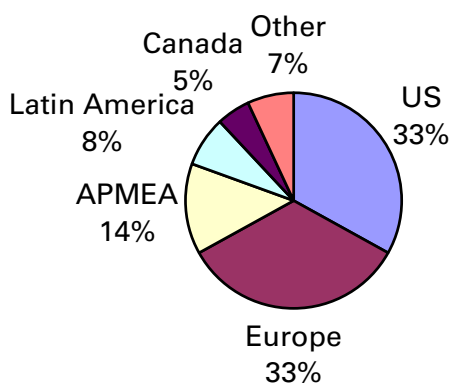
A global company, but growth is relatively mature

We expect several key trends to fuel financial results at MCD for the next few years:

International growth

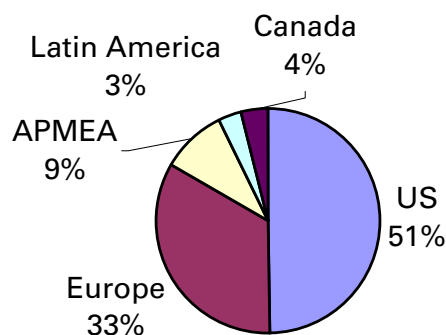
Almost every major national brand has gone global. It’s the thing to do. Consumers across the globe are embracing all things American – what could be more American than fast food, namely McDonald’s? This company is very much a global story, with 67% of sales and almost 50% of operating profits coming from outside the U.S.

Figure 70: Revenue – geographical breakdown



Source: Deutsche Bank, Company Info

Figure 71: EBIT – geographical breakdown



Source: Deutsche Bank, Company Info

Outside of the U.S., Europe is the next most important market, followed by APMEA (Asia Pacific, Middle East, and Africa). These three key segments cover 93% of the company's total EBIT. In this section we'll focus on Europe and APMEA.

- **Europe.** France, Germany, and the U.K. drive 2/3 of the EBIT for this segment. While France has proven to be a steady performer, both Germany and the U.K. have hit several bumps.
 - **France:** Reimaging, which we'll discuss in greater detail in our U.S. discussion, began in France and has driven major strides in market share and growth. Similarly, innovation on the product side has helped better establish MCD in this market, particularly with more relevant products to the local consumer – i.e. hamburgers with varied cheese toppings to address the importance of cheese in France. MCD holds the largest market share as a company at 6.7%, which has expanded from 5.2% in 2001.
 - **Germany:** Germany is a difficult market. MCD isn't as easy of a sell given local food tastes, which tend to favor pork products. The company lost ground when the economy deteriorated two years ago, and took the opportunity to reinvent itself into an "every day" platform, with a three-tier menu that included a "One for One" menu (one product for one Euro), much like the Dollar Menu in the U.S. MCD is still trying to find the right balance between premium and its One for One menu, but the company continues to make progress and there's opportunity for profit expansion here. Market share stands at 8.8%, the largest single company share, vs. 7.4% in 2001.
 - **U.K.** Obesity and public perception has driven much of the difficulty in the U.K. in recent years. Famous Chef Jaime Oliver took up the cause of school lunches, criticizing nuggets and hamburgers, and stirred a publicity battle in the tabloids. MCD became something of a "poster child" for all things bad and unhealthy about fast food. Perception is improving, following new marketing designed to enhance the company's image and focus on responsible eating and lifestyles. However, this is a very tabloid sensitive market and could crop up as a problem area given the prevalence of obesity as a key consumer issue in both the U.S. and Europe. MCD is also working toward a reduced company-owned structure in this market (currently 50-50) by way of re-franchising and developmental licensing opportunities. We believe this makes sense given the competitive and market environment; MCD's share has declined from 4.6% in 2001 to 4.0% as of 2005.

Broadly speaking, Europe is a mixed bag, performance-wise, but it still offers attractive opportunities for market share and profit growth. We expect revenue growth to track close to or slightly ahead of the U.S., as Europe is fairly mature.

- **APMEA.** Australia, Japan, and China drive the bulk of the sales and profits in this segment. It's the most significant growth segment for MCD, with company-operated sales forecasted to grow 7% this year.
- **China.** While MCD dominates the fast food restaurant industry in the U.S and much of Europe, it is surprisingly small in China, with only 600 locations compared to YUM's close to 2,500. The company estimates it can reach 1,000 locations by the 2008 Olympics, but its key competitor has a clear head start and experience advantage. We expect this to drive growth (company-operated) but not nearly to the extent we expect at YUM. MCD's market share in China stands at 0.6% as of 2005 vs. 0.4% in 2001, compared to YUM at 1.3% in 2005 and a barely meaningful share in 2001.
- **Australia.** It's steady as she goes here. This market is a consistent performer, with strong innovation-led growth and well-run stores. Market share has grown steadily from 6.9% in 2001 to 7.2% in 2005. We expect continued strong performance here given a growing economy and seasoned management.

- **Japan.** Economic difficulties have caused some setbacks here, along with fits and starts from a menu position standpoint. The company has implemented what has worked in other markets – a three-tiered menu, offering a premium tier, everyday offerings, and a value tier. However, the execution hasn't measured up to other markets. Too much couponing trained the consumer to go for the deal, which could take time to reverse. We have learned from our experience in the beverage world that consumer habits, once established, can take time and effort to break. It's not surprising that market share waned in the early 2000's from 2.1% to 1.8% and has remained at this level through 2005.

U.S. – growth sustainability is a key question

MCD doesn't give guidance on comparable sales, but we expect total comparable store sales for company-owned restaurants to hover in the 3% to 5% range, much like the trend over the last few years, with possible moderation since MCD has been in recovery mode. This has become a key concern of late since consumer demand hit a rough patch over the summer. Our DB economics team expects softening home prices to impact consumer spending in the near term, but it remains to be seen just how much it might impact restaurant sales, particularly for lower guest check chains like MCD. We sense it could cause modest slowing of consumer spending, but not to a dramatic degree as consumers would still consider a meal at MCD to be very affordable.

Since the company began its "makeover", several key initiatives have pushed up comparable store sales, possibly to unsustainable levels since much of the low-hanging fruit has been picked.

- **Product and menu innovation.** Give the consumers what they want. It's a philosophy employed by the more successful consumer companies, and one that MCD has adopted. The company, using more extensive research, has focused its innovation on getting in tune with what modern people want. What might sound like an interesting product often doesn't translate to real palates or expectations. For instance, the McGriddle was at first launched as a square-shaped sandwich, then subsequently rejected by consumers because pancakes are round. MCD targets approximately two to three new product launches a year, aiming in particular at young adults and women with children. Advertising campaigns emphasize fun and relaxation with friends – a clear play to the young adult. And new products often tend to be a little healthier (i.e. recent Asian Salad) in order to provide something for Mom to eat when she brings the kids to MCD. The company is also playing the premium angle, offering Premium Roast Coffee and its Premium Chicken Sandwich Line.
- **Convenience initiatives.** Cashless payment options, gift cards, extended hours – all of these efforts are designed to capture additional consumer transactions. Take the individual who walks in and realizes he needs to hit the ATM. A cashless payment option means MCD won't lose that transaction. In today's modern, technologically advanced world, this is a competitive advantage. Extended hours also allow MCD to capture additional market share typically served by competitors like Taco Bell and Dunkin Donuts.
- **Reimaging.** Prior to the last few years, MCD's look had become out-dated. It might not seem all that important, given the high proportion of the company's business in takeaway, but even if no one wants to admit it, looks matter. It reflects upon the image of the food. It's basically in-store advertising that consumers digest both consciously and subconsciously. We believe re-imaging could continue to drive additional transactions and therefore growth in comparable store sales.

Profit and margin drivers

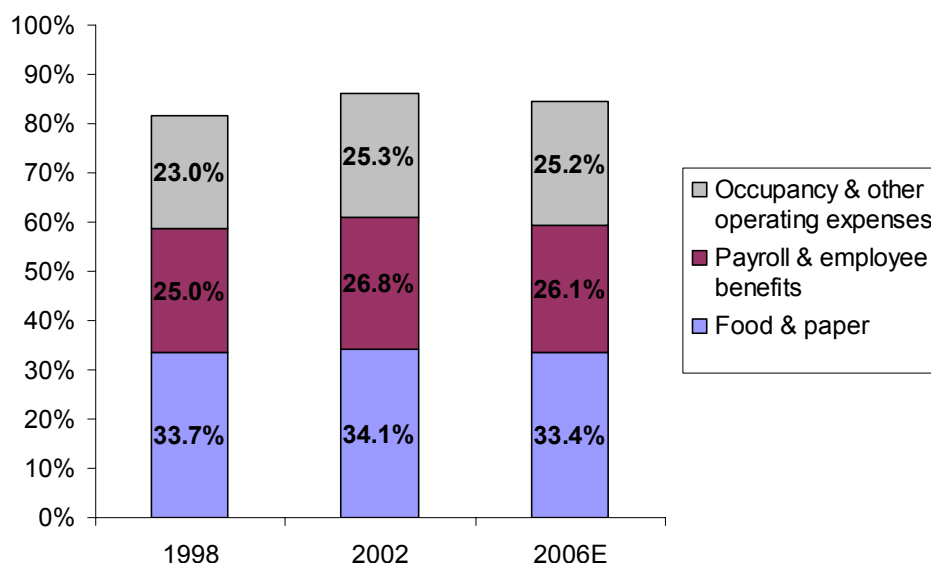
Figure 72: 2005 margin comparison

	YUM	MCD
Company-operated rest. expenses		
Food & paper	31.4%	33.9%
Payroll & employee benefits	26.4%	26.3%
Occupancy & other operating expenses	<u>28.1%</u>	<u>25.2%</u>
Restaurant Margin	14.0%	14.6%
General & administrative % total revenue	12.4%	10.9%
Franchise & license expense as % of franchise & license Fees	<u>2.9%</u>	<u>20.0%</u>
Operating Margin	12.5%	19.5%

Source: Deutsche Bank, Company Info

MCD is one of the most profitable companies in the industry at the corporate level, reflecting significant economies of scale and a relatively low-cost structure. However, restaurant operating margins and total company operating margins have declined since the mid-to-late 90's from around 18% and 25% to around 15% and 20%, respectively.

Figure 73: Restaurant expenses as % of company restaurant revenues

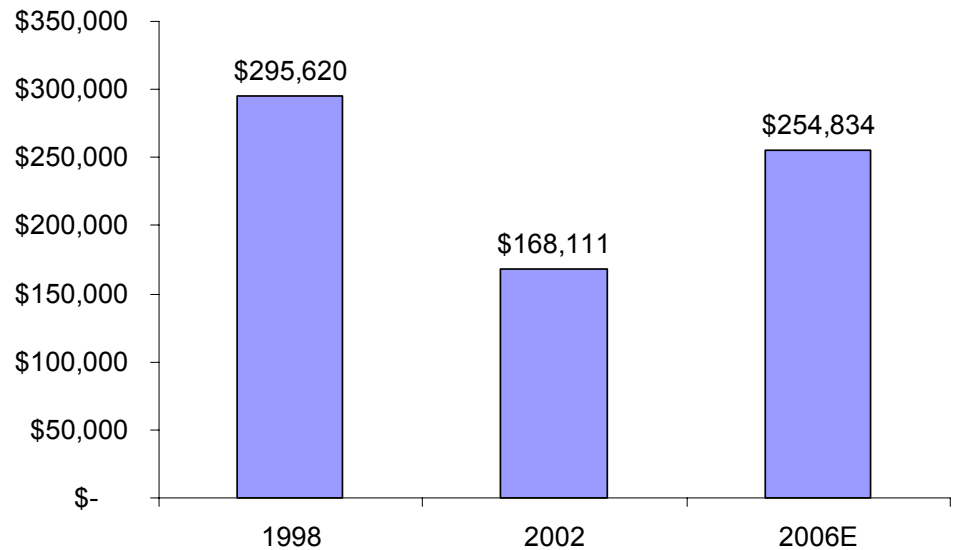


Source: Deutsche Bank, Company Info

At the company restaurant profit level, both occupancy and payroll expenses have increased since 1998, owing to both the need to retain employees with better pay and benefits and a general decline in profit per store. However, the improvement between 2002 and 2006E reflects the company's turnaround, which involved efforts to reduce employee turnover. Regardless, now that the economy has recovered since the early 2000's, labor costs may continue to see modest upward pressure.

We believe the decline in margins also reflects the decline consumer confidence since the late 1990s. Arguably, it was the best consumer environment seen in years and would therefore be difficult to top from a top line leverage standpoint. Indeed, MCD net sales were growing between 7% and 9% during this period. MCD is likely not seeing the traffic and transaction levels seen in the late 90's. In fact, EBIT per store, while up from 2002, is still not up to 1998 levels. Perhaps it's an asset utilization issue. Or perhaps the level seen in 1999 is unsustainable.

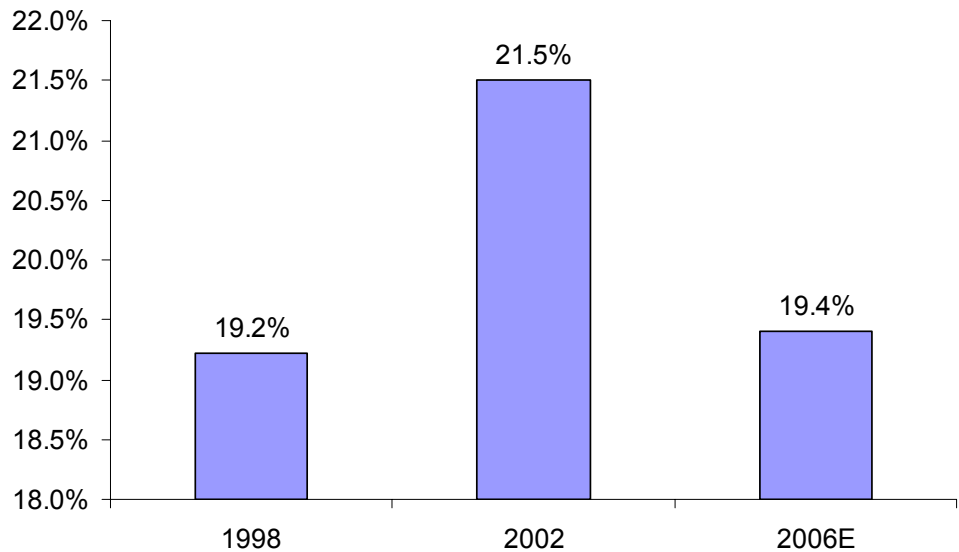
Figure 74: EBIT per company-owned store



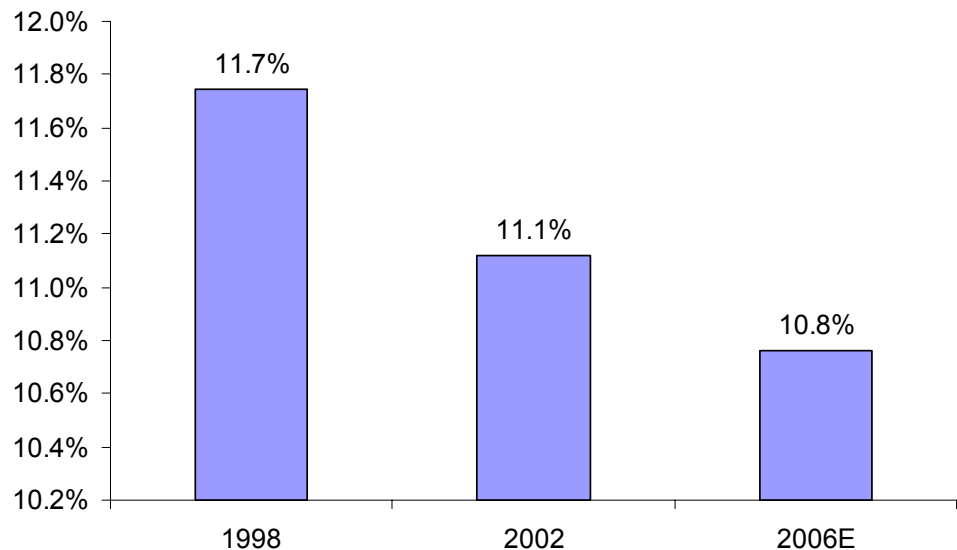
Source: Deutsche Bank, Company Info

Refining company ownership is a key initiative at MCD, with the idea that franchised units are more efficient since the franchisee is risking his/her own investment. The company has also committed to converting 15 to 20 markets into developmental licensee structures. In 2006, so far, Honduras, Nicaragua, and Bulgaria have been converted. The company still owns almost 30% of its stores worldwide, which falls above our estimated 21% at YUM for 2006. We believe this could continue to improve margins and returns for the overall company.

Figure 75: Franchise expenses % of franchise revenues



Source: Deutsche Bank, Company Info

Figure 76: G&A % of revenues

Source: Deutsche Bank, Company Info

G&A costs, unlike most of the other expense categories, have declined nicely since the late 1980s. We believe this owes much to improvements in store operations. While up in recent quarters, this reflects a rise in employee-related costs, such as performance compensation, and spending related to MCD's biennial worldwide operator conference and sponsorship of the Olympics. Spending should ease in H206, and generally, we expect this to remain constant as a % of revenue or achieve modest leverage.

Estimates and key assumptions

Our forecasts show MCD achieving high-single-digit EPS growth while throwing off significant cash flow, much of which it will return to shareholders. We view this very much as a cash flow story, given the mature nature of the brand and more mature market mix compared to the other major peer in our coverage universe, YUM. Please note that we have adjusted our numbers to remove Chipotle, reflecting the exchange offer in October. This had minimal impact to EPS as the reduction in shares (approximately 18 million) largely offset the reduction in EBIT (\$10 million in 2006 and \$60 million in 2007).

Our 2006E EPS forecast of \$2.41 reflects the following assumptions:

- Worldwide net revenues of \$22.03 billion, +7.7% (+8.8% ex. impact of CMG exchange)
 - Worldwide net restaurant growth of 357 (ex. impact of CMG exchange), or close to 1%, driven by 6.3% growth APMEA co-operated restaurants and 1.9% growth in U.S. co-owned restaurants.
 - Co-owned comparable store sales growth of 5.5%, driven by 4.6% U.S. growth, 5.8% Europe growth, and 5.7% APMEA growth.
- Worldwide EBIT growth of 14.6%, well ahead of the company's long-term target of 6%-7%, on strong sales growth and EBIT margin expansion of 130bp to 20.8%. This reflects a 110bp improvement in restaurant margin to 15.7% and modest leverage on the G&A line. Europe and APMEA represent significant drivers of margin improvement, as France and Germany continue to perform well and the U.K. recovers, and as Australia and China continue to show strong sales and margin improvement.
- 12.1% growth in interest expense as higher interest rates offset debt reductions of at least \$1.4 billion.

- A 3% decline in average shares outstanding, reflecting \$2 billion in share repurchase. Total expected cash returned to shareholders this year is \$3.2 billion, or 127% of operating cash flow after capital expenditure. The company expects to return at least \$10 billion in cash to shareholders between 2006 and 2008.

Our 2007E EPS forecast of \$2.55 reflects the following key assumptions:

- Worldwide net revenues of \$22.71 billion, +3.1% (+7.9% ex. impact of CMG exchange), within MCD's long-term 3-5% growth target
 - Worldwide net restaurant growth of 315, or 1.0%, driven by 4.1% growth in APMEA co-operated restaurants and 1.6% growth in U.S. co-owned restaurants.
 - Co-owned comparable store sales growth of 3.6%, driven by 2.6% U.S. growth, 3.7% Europe growth, and 4.8% APMEA growth.
- Worldwide EBIT growth of 5.7% (+6.7% ex. impact of CMG exchange), on steady sales growth and EBIT margin expansion of 50bp to 21.3%. This reflects a 60bp improvement in restaurant margin to 16.3%.
- A 5% decline in average shares outstanding, reflecting \$1.8 billion in share repurchase. Total expected cash returned to shareholders this year is \$3.3 billion, or 131% of operating cash flow after capital expenditure.

Valuation

Rediscovering the mean

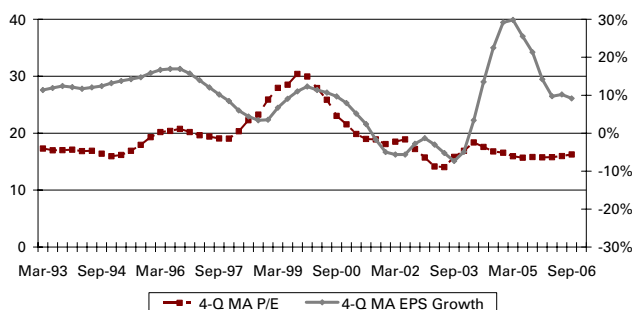
Following a period of elevated sales and valuation in the late 1990s and several years of financial difficulty, MCD's valuation measures appear to be reaching around, trying to find the mean again. Sales and EPS growth have trended above historical averages in recent quarters, but the market is telling us that it doesn't believe it will get much better and in fact, may slow down since the last few years have been recovery years. We concur, given a relatively mature brand and modest international upside given less favorable country mix vs. its close competitor YUM. Our analysis of various valuation methodologies suggests a fair value for MCD of \$43, offering a total return of only 4-5%. We, therefore, see only modest upside from the current price and rate the stock a Hold.

Figure 77: Valuation methodology summary (\$)

Methodology	Multiple	Value
TEV/EBITDA	9.5X	42
P/E	17X	43
ROIC Spread vs. TEV/EBITDA	9.5x	42
DCF	NA	44
 Final Target Price		 43
 Upside		 1.3%
Total Return		4.2%

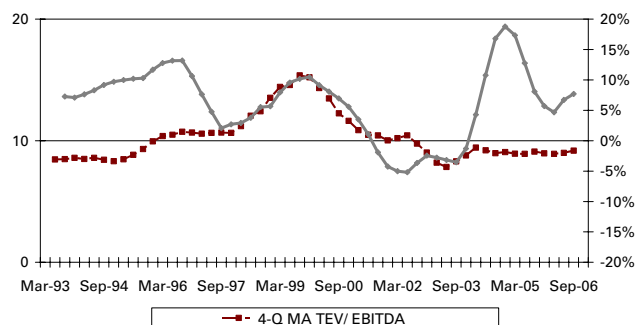
Source: Deutsche Bank

Figure 78: MCD P/E vs. EPS growth



Source: Deutsche Bank, Factset

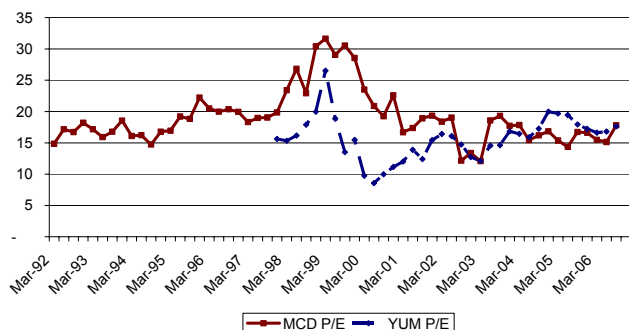
Figure 79: MCD EV/EBITDA vs. EBITDA growth



Source: Deutsche Bank, Factset

EPS growth has averaged 9.4% over the last 15 years and MCD's P/E has averaged 19x. However, over the last five years, EPS has grown at an average of 7% to 8% and the stock has traded at an average P/E of 16.5x.

Figure 80: MCD vs. YUM P/E



Source: Deutsche Bank, Factset, Reuters, Company Info

Figure 81: MCD vs. YUM key metrics

	MCD	YUM
Forward 3-year Sales growth	5.2%	3.9%
Forward 3-year EBIT growth	5.9%	7.2%
Forward 3-year EPS growth	8.6%	13.6%
2006E ROIC Spread	11.8%	12.0%
2007E ROIC Spread	11.7%	13.2%
% EBIT International	43.4%	50.2%

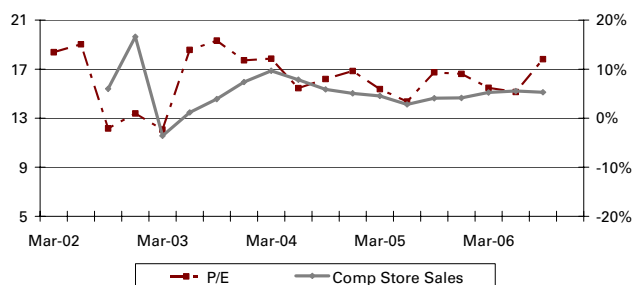
Source: Deutsche Bank, Factset, Reuters, Company Info

We expect EPS growth to average between 8% and 9% (slightly ahead of recent 5-year mean) over the next three years. Since MCD's P/E averaged 16x-17x over the last five years and around 16-17x in the early 90s when EPS growth was steady at 11% to 12%, we believe 17x is fair. The run-up in valuation in the late 1990s appears related to the bubble in consumer confidence and demand. 17x looks like a more normalized mean. A 17x multiple applied to our 2007 EPS forecast of \$2.55, equates to a share value of \$43.

Notice also that while MCD consistently traded ahead of YUM in recent years, this has reversed since early 2004, possibly as YUM's earnings growth has become more consistent, and international expansion has picked up steam. We expect this to continue as we are forecasting modestly better EPS growth and ROIC spread to a market average cost of capital over the next three years, not to mention that YUM's international presence is more skewed to growth markets such as China.

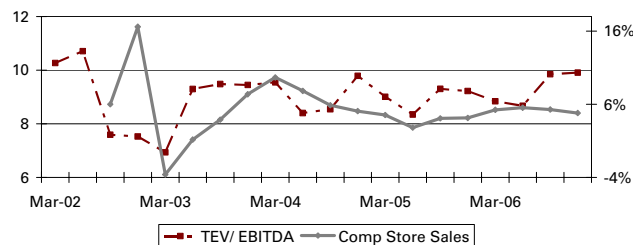
From an EBITDA standpoint, growth has trended lower at 6.2% over the last 15 years. We are forecasting average annual EBITDA growth of approximately 6% for the next three years. Since this is right below the mean, we expect TEV/EBITDA to trend toward 9.5x, just below the historical average of 10x. This equates to a share price of \$42 when applied to our 2007 forecast.

Figure 82: P/E vs. comparable store sales



Source: Deutsche Bank, Factset, Company Info

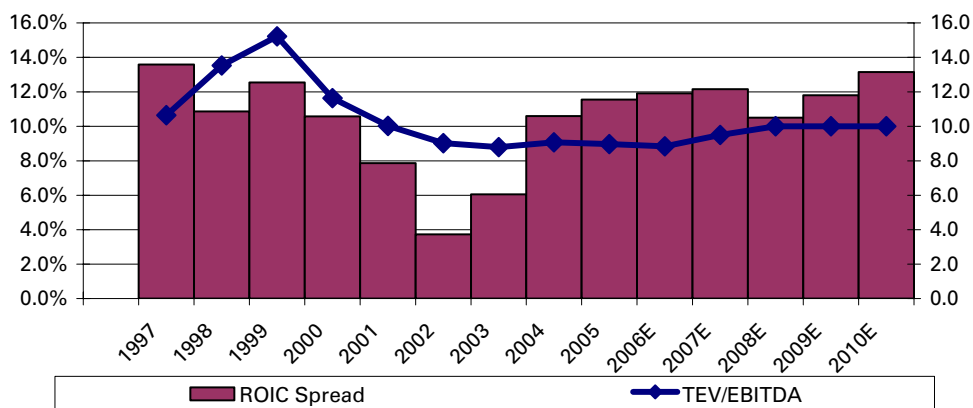
Figure 83: EV/EBITDA vs. comparable store sales



Source: Deutsche Bank, Factset, Company Info

Comparable store sales charted with both TEV/EBITDA and P/E ratios also suggest little upside to valuation. The market appears unwilling to take the P/E much higher than 17x or the TEV/EBITDA much higher than 10x on a sustainable basis. We suspect this reflects concern on the part of investors regarding the sustainability of comparable store sales growth, particularly in the U.S. Indeed, we expect this measure to moderate from over 5% in 2006 to just over 3% in 2007.

Figure 84: TEV/EBITDA vs. ROIC spread



Source: Deutsche Bank, Factset, Company Info

Returns, in our view, are the ultimate measure of shareholder value creation. MCD stacks up high with some of the highest returning businesses, despite the dip between 2001 and 2003. Outside of that period, ROIC spread has held steady between 10% and 12%. Accordingly, average TEV/EBITDA has hovered between 9x and 10x. We believe it's reasonable to expect that as return spread trend upward, TEV/EBITDA could climb toward 10x, at a gradual pace. If we apply an expected 9.5x multiple to our 2007 forecasts, this equates to \$42.

Figure 85: Discounted cash flow

	2002	2003	2004	2005	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E
EBIT*(1-t)	1,261	1,820	2,519	2,827	3,010	3,242	3,416	3,652	3,802	3,931	4,070	4,198	4,320	4,447	4,558
D&A	1,051	1,148	1,201	1,250	1,262	1,335	1,334	1,396	1,460	1,517	1,576	1,635	1,694	1,754	1,807
EBITDA	2,312	2,969	3,720	4,077	4,272	4,577	4,750	5,047	5,262	5,448	5,646	5,833	6,013	6,201	6,365
Chgs in Oper. W/C	892	(89)	190	412	83	57	68	44	73	66	68	68	68	70	70
Capex	2,004	1,307	1,419	1,607	1,800	1,920	1,905	1,994	2,086	2,167	2,251	2,335	2,419	2,506	2,556
FCF	1,200	1,572	2,491	2,882	2,554	2,713	2,913	3,097	3,250	3,347	3,463	3,566	3,662	3,765	3,879

Discount Rate	6.9%															\$40,416
PV of FCF, 2005-2015	\$23,114															
PV of Terminal Value	\$40,416															
Corporate Value	\$63,531															
Less: Debt	\$8,740															
Equity Value	\$54,791															
Share Count (Millions)	1,237															
Equity Value/Share	\$44															

2006 Valuation	2004	2005	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E
Year				1	2	3	4	5	6	7	8	10	10
Factor				1.07	1.14	1.22	1.31	1.40	1.49	1.60	1.71	1.95	1.95
PV of FCF				\$2,538	\$2,548	\$2,534	\$2,487	\$2,396	\$2,318	\$2,233	\$2,145	\$1,929	\$1,987
Cumulative				\$2,538	\$5,086	\$7,620	\$10,107	\$12,502	\$14,821	\$17,053	\$19,198	\$21,127	\$23,114

Cost of Debt	4.5%
Rf	4.7%
Beta	0.82
Market risk premium	5.4%
Required Return on Equity	9.2%
Net Debt / Net Capital	36.8%
Tax Rate	32.3%
Required Return on Investment	6.9%
LT Growth Rate	2.0%
FCF Multiple	20.3

Source: Deutsche Bank, Bloomberg, Company Info

Last but not least, we come to our discussion on cash flows. MCD is clearly a cash generator, throwing off over \$2.5 billion in free cash flow per year and returning over 130% of its operating cash after capital expenditure to shareholders. We believe the company's tendency to raise its dividend and buy back shares will support valuation.

Our discounted cash flow model assumes a 10-year EPS CAGR of 4.2% (below MCD's "long-term" target of 6% to 7%), required return on equity of 9.2%, and a cost of debt of 4.5%, resulting in a share value of \$44.

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Figure 86: MCD Income statement (\$mn)

	2004	1Q05	2Q05	3Q05	4Q05	2005	1Q06	2Q06	3Q06	4Q06E	2006E	1Q07E	2Q07E	3Q07E	4Q07E	2007E
Net Revenues																
Company-operated restaurants	14,224	3,600	3,811	4,001	3,940	15,352	3,856	4,200	4,416	4,142	16,614	3,949	4,246	4,467	4,433	17,095
Franchised and affiliated restaurants	4,841	1,203	1,285	1,326	1,294	5,109	1,245	1,372	1,404	1,395	5,416	1,301	1,424	1,454	1,437	5,616
Total Net Revenues	19,065	4,803	5,096	5,327	5,235	20,460	5,101	5,572	5,820	5,537	22,030	5,250	5,670	5,921	5,870	22,711
Food & paper	4,853	1,227	1,296	1,360	1,324	5,207	1,292	1,390	1,457	1,367	5,506	1,303	1,393	1,470	1,463	5,628
Payroll & employee benefits	3,726	957	1,006	1,028	1,047	4,039	1,018	1,096	1,113	1,089	4,316	1,031	1,104	1,121	1,148	4,404
Occupancy & other operating expenses	3,521	911	945	980	1,032	3,868	979	1,037	1,069	1,069	4,154	1,003	1,061	1,077	1,139	4,280
Company-operated rest. expenses	12,100	3,109	3,263	3,390	3,353	13,114	3,303	3,537	3,639	3,525	14,003	3,337	3,558	3,667	3,750	14,313
Franchised rest.-occupancy expenses	1,003	257	254	257	255	1,022	252	260	267	268	1,047	255	271	276	273	1,075
SG&A	1,980	520	538	547	616	2,221	550	596	583	646	2,375	565	605	591	684	2,445
Other operating expenses, net	151	7	25	(27)	105	110	(14)	18	10	15	29	10	10	10	10	40
Total operating expenses	15,234	3,893	4,079	4,167	4,328	16,467	4,091	4,411	4,498	4,454	17,454	4,167	4,444	4,545	4,717	17,873
Impairment and other charges (credits), net	290	24		(53)		(28)	86	22	20		128					-
Operating Income	3,541	910	993	1,160	960	4,022	924	1,139	1,302	1,083	4,448	1,083	1,227	1,376	1,152	4,838
Operating income Excl. - charges	3,831	910	1,017	1,160	907	3,993	1,010	1,162	1,322	1,083	4,576	1,083	1,227	1,376	1,152	4,838
Interest expense	358	90	88	87	91	356	102	98	99	100	399	100	100	99	99	398
Non operating expense	(20)	(10)	7	(13)	(6)	(36)	(64)	(220)	(30)	(15)	(350)	(12)	(10)	(8)	(5)	(35)
Pretax Income	3,202	830	911	1,086	874	3,702	906	1,262	1,233	998	4,398	995	1,137	1,285	1,058	4,475
Taxes	924	102	405	350	242	1,099	281	428	394	319	1,422	328	375	424	349	1,477
Net Income - Continuing Operations	2,279	728	506	735	633	2,602	625	834	838	678	2,976	667	762	861	709	2,998
Cumulative effect of accounting change	-					-										
Net Income	2,279	728	506	735	633	2,602	625	834	838	678	2,976	667	762	861	709	2,998
Net Income Excl.-Charges	2,480	728	520	735	595	2,578	685	718	852	678	2,933	667	762	861	709	2,998
Average Shares Outstanding - Basic	1,260	1,269	1,260	1,254	1,260	1,260	1,254	1,254	1,244	1,234	1,247	1,224	1,215	1,207	1,199	1,211
Basic EPS	\$1.81	\$0.57	\$0.40	\$0.59	\$0.50	\$2.06	\$0.50	\$0.67	\$0.67	\$0.55	\$2.39	\$0.54	\$0.63	\$0.71	\$0.59	\$2.48
Average Shares Outstanding - Diluted	1,274	1,289	1,270	1,272	1,274	1,274	1,271	1,248	1,233	1,196	1,237	1,186	1,177	1,169	1,161	1,174
Diluted EPS	\$1.79	\$0.56	\$0.40	\$0.58	\$0.50	\$2.04	\$0.49	\$0.67	\$0.68	\$0.57	\$2.41	\$0.56	\$0.65	\$0.74	\$0.61	\$2.55
Average Shares Outstanding - Diluted	1,274	1,289	1,270	1,272	1,274	1,274	1,271	1,248	1,233	1,196	1,237	1,186	1,177	1,169	1,161	1,174
Diluted EPS ex. Charges	\$1.79	\$0.56	\$0.41	\$0.58	\$0.50	\$2.04	\$0.54	\$0.58	\$0.69	\$0.57	\$2.37	\$0.56	\$0.65	\$0.74	\$0.61	\$2.55
Dividend	\$0.55					\$0.67					\$1.00					\$1.24
payout ratio	30%					32%					42%					50%

	2004	1Q05	2Q05	3Q05	4Q05	2005	1Q06	2Q06	3Q06E	4Q06E	2006E	1Q07E	2Q07E	3Q07E	4Q07E	2007E
Margin Structure*																
Food & paper	34.1%	34.1%	34.0%	34.0%	33.6%	33.9%	33.5%	33.1%	33.0%	33.0%	33.1%	33.0%	32.8%	32.9%	33.0%	32.9%
Payroll & employee benefits	26.2%	26.6%	26.4%	25.7%	26.6%	26.3%	26.4%	26.1%	25.2%	26.3%	26.0%	26.1%	26.0%	25.1%	25.9%	25.8%
Occupancy & other operating expenses	24.8%	25.3%	24.8%	24.5%	26.2%	25.2%	25.4%	24.7%	24.2%	25.8%	25.0%	25.4%	25.0%	24.1%	25.7%	25.0%
Restaurant Margin	14.9%	13.6%	14.4%	15.3%	14.9%	14.6%	14.3%	15.8%	17.6%	14.9%	15.7%	15.5%	16.2%	17.9%	15.4%	16.3%
Franchised-occupancy expenses % franchised sales	20.7%	21.4%	19.8%	19.3%	19.7%	20.0%	20.2%	19.0%	19.0%	19.2%	19.3%	19.6%	19.0%	19.0%	19.0%	19.1%
SG&A	10.4%	10.8%	10.6%	10.3%	11.8%	10.9%	10.8%	10.7%	10.0%	11.7%	10.8%	10.8%	10.7%	10.0%	11.7%	10.8%
Operating Margin	20.1%	18.9%	20.0%	21.8%	17.3%	19.5%	19.8%	20.8%	22.7%	19.6%	20.8%	20.6%	21.6%	23.2%	19.6%	21.3%
EBITDA Margin	26.4%	25.5%	26.0%	27.6%	23.4%	25.6%	25.8%	26.5%	28.2%	25.4%	26.5%	26.8%	27.5%	28.9%	25.5%	27.2%
SG&A/revenue	10.4%	10.8%	10.6%	10.3%	11.8%	10.9%	10.8%	10.7%	10.0%	11.7%	10.8%	10.8%	10.7%	10.0%	11.7%	10.8%
Tax Rate	28.9%	12.3%	44.4%	32.3%	27.7%	29.7%	31.0%	33.9%	32.0%	32.0%	32.3%	33.0%	33.0%	33.0%	33.0%	33.0%
Net Margin	12.0%	15.2%	9.9%	13.8%	12.1%	12.7%	12.3%	15.0%	14.4%	12.3%	13.5%	12.7%	13.4%	14.5%	12.1%	13.2%

	2004	1Q05	2Q05	3Q05	4Q05	2005	1Q06	2Q06	3Q06E	4Q06E	2006E	1Q07E	2Q07E	3Q07E	4Q07E	2007E
Growth Leverage*																
Company operated- Revenues	11.2%	9.6%	8.5%	9.2%	4.7%	7.9%	7.1%	10.2%	10.4%	5.1%	8.2%	2.4%	1.1%	1.2%	7.0%	2.9%
Franchised and affiliated - Revenues	11.4%	7.8%	5.5%	5.2%	3.9%	5.5%	3.5%	6.8%	5.9%	7.7%	6.0%	4.5%	3.8%	3.6%	3.0%	3.7%
Net Revenues	11.2%	9.2%	7.8%	8.1%	4.5%	7.3%	6.2%	9.4%	9.3%	5.8%	7.7%	2.9%	1.8%	1.7%	6.0%	3.1%
SG&A	8.0%	13.7%	8.3%	15.3%	11.6%	12.2%	5.8%	10.8%	6.5%	5.0%	7.0%	2.7%	1.6%	1.4%	5.8%	2.9%
Operating Income	18.2%	6.0%	5.3%	5.5%	-0.1%	4.2%	11.0%	14.3%	14.0%	19.3%	14.6%	7.2%	5.6%	4.1%	6.5%	5.7%
EBITDA	14.7%	6.1%	5.2%	5.5%	-0.2%	4.2%	7.3%	11.6%	11.7%	14.7%	11.4%	7.0%	5.4%	4.2%	6.6%	5.7%
Net Income	54.9%	42.3%	-14.3%	-5.5%	59.0%	14.2%	-14.1%	64.8%	14.0%	7.2%	14.4%	6.6%	-8.7%	2.7%	4.5%	2.2%
Diluted EPS	55.2%	40.8%	-14.4%	-5.8%	58.9%	14.2%	-12.9%	67.6%	17.6%	14.2%	17.8%	14.2%	-3.2%	8.3%	7.7%	6.2%

	2004	1Q05	2Q05	3Q05	4Q05	2005	1Q06	2Q06	3Q06E	4Q06E	2006E	1Q07E	2Q07E	3Q07E	4Q07E	2007E
Cashflow Points																
Operating Income	3,541	910	993	1,160	960	4,022	924	1,139	1,302	1,083	4,448	1,083	1,227	1,376	1,152	4,838
Depreciation & Amortization	1,201	317	307	310	317	1,250	305	315	320	322	1,262	325	330	335	345	1,335
EBITDA	4,742	1,226	1,299	1,469	1,277	5,271	1,229	1,454	1,622	1,405	5,710	1,408	1,557	1,711	1,497	6,173
Capex	1,419	242	360	372	632	1,607	289	450	500	561	1,800	320	490	535	575	1,920
Dividends	695					842					1,247					1,499

Source: Deutsche Bank, company data

Figure 87: MCD metrics

No. of Restaurants	2004	1Q05	2Q05	3Q05	4Q05	2005	1Q06	2Q06	3Q06E	4Q06E	2006E	1Q07E	2Q07E	3Q07E	4Q07E	2007E
Company-operated Restaurants																
US	2,002	2,028	2,047	2,094	2,097	2,097	2,111	2,099	2,134	2,137	2,137	2,161	2,139	2,169	2,172	2,172
Europe	2,358	2,366	2,364	2,373	2,382	2,382	2,371	2,315	2,363	2,372	2,372	2,381	2,330	2,383	2,392	2,392
APMEA	2,264	2,124	2,136	2,069	2,073	2,073	2,245	2,240	2,174	2,203	2,203	2,325	2,325	2,259	2,293	2,293
Latin America	1,081	1,100	1,110	1,120	1,122	1,122	1,115	1,111	1,130	1,157	1,157	1,135	1,136	1,155	1,182	1,182
Canada	474	473	474	474	489	489	502	499	499	519	519	527	519	504	534	534
Other	1,033	1,051	1,066	1,083	1,110	1,110	1,124	1,133	1,153	629	629	590	591	580	689	689
Total Company-operated	9,212	9,142	9,197	9,213	9,283	9,283	9,468	9,397	9,443	9,017	9,017	9,119	9,040	9,050	9,262	9,262
Franchised & Affil. Restaurants																
US	11,671	11,636	11,644	11,600	11,630	11,630	11,609	11,615	11,570	11,610	11,610	11,589	11,590	11,545	11,586	11,586
Europe	3,929	3,926	3,932	3,935	3,970	3,970	3,968	4,040	4,015	4,080	4,080	4,003	4,070	4,040	4,100	4,100
APMEA	5,303	5,444	5,463	5,554	5,619	5,619	5,456	5,495	5,584	5,654	5,654	5,476	5,530	5,644	5,709	5,709
Latin America	526	508	499	493	495	495	502	521	498	500	500	511	526	503	505	505
Canada	888	903	902	901	879	879	891	890	891	894	894	896	900	906	909	909
Other	32	34	10	10	10	10	10	15	7	7	7	7	7	12	6	6
Total Franchised and Affil.	22,349	22,451	22,450	22,493	22,603	22,603	22,443	22,571	22,573	22,745	22,745	22,482	22,623	22,650	22,815	22,815
Total Restaurants	31,561	31,593	31,647	31,706	31,886	31,886	31,911	31,968	32,016	31,762	31,762	31,601	31,663	31,700	32,077	32,077

# growth in Restaurants	2004	1Q05	2Q05	3Q05	4Q05	2005	1Q06	2Q06	3Q06E	4Q06E	2006E	1Q07E	2Q07E	3Q07E	4Q07E	2007E
Company-operated Restaurants																
US	(32)	23	66	101	95	95	83	52	40	40	40	50	40	35	35	35
Europe	51	64	51	40	24	24	5	(49)	(10)	(10)	(10)	10	15	20	20	20
APMEA	19	(117)	(101)	(170)	(191)	(191)	121	104	105	130	130	80	85	85	90	90
Latin America	100	110	86	85	41	41	15	1	10	35	35	20	20	25	25	25
Canada	2	(13)	(16)	(16)	25	25	29	25	15	20	20	25	20	15	15	15
Other	104	93	82	78	77	77	73	67	70	(481)	(481)	(534)	(542)	(573)	60	60
Total new Company-operated	253	160	168	118	71	71	326	200	230	(266)	(266)	(349)	(357)	(393)	245	245
Franchised & Affil. Restaurants																
US	96	27	2	(54)	(41)	(41)	(27)	(29)	(30)	(20)	(20)	(20)	(25)	(25)	(24)	(24)
Europe	50	42	35	28	41	41	42	108	80	110	110	35	30	25	20	20
APMEA	73	229	231	289	316	316	12	32	30	35	35	20	35	60	55	55
Latin America	(80)	(83)	(66)	(64)	(31)	(31)	1	22	5	5	5	2	5	5	5	5
Canada	21	43	42	37	(9)	(9)	(12)	(12)	(10)	15	15	5	10	15	15	15
Other	19	21	(9)	(16)	(22)	(22)	(24)	-	5	(3)	(3)	(3)	(3)	(3)	(1)	(1)
Total new Franchised and Affil.	179	279	235	230	254	254	(8)	121	80	142	142	39	52	77	70	70
Total new restaurants	432	439	403	348	325	325	318	321	310	(124)	(124)	(310)	(305)	(316)	315	315

Restaurants (% growth)	2004	1Q05	2Q05	3Q05	4Q05	2005	1Q06	2Q06	3Q06E	4Q06E	2006E	1Q07E	2Q07E	3Q07E	4Q07E	2007E
Company-operated Restaurants																
US	-1.6%	1.1%	3.3%	5.1%	4.7%	4.7%	4.1%	2.5%	1.9%	1.9%	1.9%	2.4%	1.9%	1.6%	1.6%	1.6%
Europe	2.2%	2.8%	2.2%	1.7%	1.0%	1.0%	0.2%	-2.1%	-0.4%	-0.4%	-0.4%	0.4%	0.6%	0.8%	0.8%	0.8%
APMEA	0.8%	-5.2%	-4.5%	-7.6%	-8.4%	-8.4%	5.7%	4.9%	5.1%	6.3%	6.3%	3.6%	3.8%	3.6%	4.1%	4.1%
Latin America	11.2%	11.1%	8.4%	8.2%	3.8%	3.8%	1.4%	0.1%	0.9%	3.1%	3.1%	1.8%	2.3%	2.2%	2.2%	2.2%
Canada	0.4%	-2.7%	-3.3%	-3.3%	5.3%	5.3%	6.1%	5.3%	3.2%	4.0%	4.0%	5.0%	4.0%	3.1%	2.9%	2.9%
Other	11.2%	9.7%	8.3%	7.8%	7.5%	7.5%	6.9%	6.3%	6.5%	-43.3%	-43.3%	-47.5%	-47.8%	-49.7%	9.5%	9.5%
Total Company-operated	2.8%	1.8%	1.3%	1.3%	0.8%	0.8%	3.6%	2.2%	2.5%	-2.9%	-2.9%	-3.7%	-3.8%	-4.2%	2.7%	2.7%
Franchised & Affil. Restaurants																
US	0.8%	0.2%	0.0%	-0.5%	-0.4%	-0.4%	-0.2%	-0.2%	-0.3%	-0.2%	-0.2%	-0.2%	-0.2%	-0.2%	-0.2%	-0.2%
Europe	1.3%	1.1%	0.9%	0.7%	1.0%	1.0%	1.1%	2.7%	2.0%	2.8%	2.8%	0.9%	0.7%	0.6%	0.5%	0.5%
APMEA	1.4%	4.4%	4.4%	5.7%	6.0%	6.0%	0.2%	0.6%	0.5%	0.6%	0.6%	0.4%	0.6%	1.1%	1.0%	1.0%
Latin America	-13.2%	-14.0%	-11.7%	-11.5%	-5.9%	-5.9%	0.2%	4.4%	1.0%	1.0%	1.0%	0.4%	1.0%	1.0%	1.0%	1.0%
Canada	2.4%	5.0%	4.9%	4.3%	-1.0%	-1.0%	-1.3%	-1.3%	-1.1%	1.7%	1.7%	0.6%	1.1%	1.7%	1.7%	1.7%
Other	146.2%	161.5%	-47.4%	-61.5%	-68.8%	-68.8%	-70.6%	0.0%	50.0%	-30.0%	-30.0%	-30.0%	-30.0%	-20.0%	-14.3%	-14.3%
Total Franchised and Affil.	0.8%	1.3%	1.1%	1.0%	1.1%	1.1%	0.0%	0.5%	0.4%	0.6%	0.6%	0.2%	0.2%	0.3%	0.3%	0.3%
Total	1.4%	1.4%	1.3%	1.1%	1.0%	1.0%	1.0%	1.0%	1.0%	-0.4%	-0.4%	-1.0%	-1.0%	-1.0%	1.0%	1.0%

Comparable sales growth	2004	1Q05	2Q05	3Q05	4Q05	2005	1Q06	2Q06	3Q06E	4Q06E	2006E	1Q07E	2Q07E	3Q07E	4Q07E	2007E
Company-operated																
US	9.6%	5.2%	4.8%	3.7%	4.1%	4.4%	6.6%	4.2%	4.1%	3.5%	4.6%	2.2%	2.4%	2.6%	3.2%	2.6%
Europe	2.4%	2.9%	-0.3%	5.1%	2.7%	2.6%	2.0%	6.3%	7.6%	7.2%	5.8%	5.0%	3.0%	2.8%	4.1%	3.7%
APMEA	5.6%	5.5%	1.2%	3.9%	5.8%	4.0%	4.1%	7.2%	6.1%	5.8%	5.7%	5.8%	3.8%	4.0%	5.8%	4.8%
Latin America	13.0%	14.6%	11.4%	11.6%	8.8%	11.6%	15.3%	13.1%	9.0%	10.0%	11.9%	9.0%	8.0%	6.0%	5.0%	7.0%
Canada	5.4%	-2.7%	-0.1%	-1.1%	5.1%	0.3%	8.5%	3.3%	4.5%	2.0%	4.6%	1.5%	2.5%	1.5%	2.0%	1.9%
McDonald Restaurants	6.9%	4.6%	2.8%	4.1%	4.1%	3.9%	5.2%	5.5%	5.8%	5.5%	5.5%	4.4%	3.3%	3.1%	3.8%	3.6%

Balance Factor inc. Currency	2004	1Q05	2Q05	3Q05	4Q05	2005	1Q06	2Q06	3Q06E	4Q06E	2006E	1Q07E	2Q07E	3Q07E	4Q07E	2007E
Company-operated																
US	-1.5%	-0.2%	-0.2%	-1.6%	-2.0%	-2.1%	-0.4%	0.6%	0.8%	0.7%	1.0%	-1.0%	-1.0%	-1.0%	-0.7%	-0.7%
Europe	10.4%	5.3%	5.3%	0.5%	-5.7%	2.0%	-4.9%	3.9%	4.0%	1.5%	1.0%	1.5%	0.5%	0.8%	1.0%	0.7%
APMEA	4.3%	6.6%	4.7%	7.3%	1.9%	7.1%	-6.5%	-2.7%	-1.5%	-3.5%	-4.3%	-1.0%	-1.0%	0.5%	1.0%	-0.4%
Latin America	-3.7%	2.3%	12.6%	17.4%	19.6%	17.2%	18.3%	12.6%	8.0%	9.0%	9.6%	7.0%	6.0%	5.0%	5.0%	5.5%
Canada	9.7%	7.5%	8.6%	8.7%	-3.2%	-0.8%	4.3%	10.4%	9.0%	11.0%	9.2%	2.0%	0.5%	0.5%	0.0%	1.5%
Other	-8.6%	2.1%	7.0%	9.3%	4.9%	6.7%	10.7%	4.8%	2.0%	5.0%	NM	1.0%	1.5%	1.4%	1.0%	NM
Total Company-operated	1.4%	3.3%	3.9%	3.8%	-0.2%											

Figure 88: MCD segment P&L (\$mn)

	2004	1Q05	2Q05	3Q05	4Q05	2005	1Q06	2Q06	3Q06E	4Q06E	2006E	1Q07E	2Q07E	3Q07E	4Q07E	2007E
Revenues																
Company operated																
US	3,828	930	1,047	1,067	1,055	4,098	1,025	1,124	1,139	1,119	4,407	1,061	1,161	1,176	1,165	4,563
Europe	5,174	1,322	1,369	1,413	1,362	5,465	1,286	1,480	1,571	1,474	5,810	1,375	1,541	1,641	1,562	6,119
APMEA	2,390	617	594	645	598	2,453	637	649	708	647	2,641	690	692	767	716	2,865
Latin America	933	263	283	330	361	1,237	355	356	389	441	1,541	418	414	440	494	1,767
Canada	730	166	190	205	203	765	198	227	239	238	901	214	242	251	250	958
Other	1,169	302	328	341	362	1,334	356	365	370	223	1,314	190	196	191	247	824
Total Company operated	14,224	3,600	3,811	4,001	3,941	15,352	3,856	4,200	4,416	4,142	16,614	3,949	4,246	4,467	4,433	17,095
Franchised and affiliated revenues																
US	2,697	657	727	738	735	2,857	713	773	788	792	3,066	740	804	814	814	3,172
Europe	1,563	396	400	420	392	1,607	370	429	437	422	1,657	388	438	447	429	1,702
APMEA	331	89	89	93	92	362	91	91	96	97	375	93	94	99	100	386
Latin America	75	21	21	23	25	90	25	26	25	27	103	28	29	28	31	116
Canada	168	40	46	50	47	183	44	50	54	51	199	47	54	58	55	213
Other	7	2	2	2	3	9	3	3	5	5	16	5	5	8	9	27
Total Franchised and affiliated revenues	4,841	1,203	1,285	1,326	1,294	5,108	1,245	1,372	1,404	1,395	5,416	1,301	1,424	1,454	1,437	5,616
Total Revenues	19,065	4,803	5,096	5,327	5,234	20,460	5,101	5,572	5,820	5,537	22,030	5,250	5,670	5,921	5,870	22,711
Operating income																
Company operated																
US	731	166	201	199	201	768	187	222	211	207	827	195	232	219	217	863
Europe	807	179	196	227	214	817	175	237	254	233	900	190	250	269	248	957
APMEA	264	67	61	80	59	267	79	78	90	68	314	87	89	100	94	370
Latin America	89	32	28	38	43	141	47	43	49	57	195	56	58	62	68	244
Canada	112	19	27	32	28	106	27	38	38	33	137	30	41	40	35	146
Other																
Total Company operated	2,003	462	514	577	546	2,099	515	618	642	598	2,373	558	670	689	663	2,580
Franchised and affiliated																
US	2,177	527	595	604	600	2,326	581	640	646	650	2,517	604	667	667	668	2,606
Europe	1,195	299	307	328	302	1,235	280	333	334	323	1,269	293	341	343	329	1,306
APMEA	284	76	76	81	81	314	79	79	84	86	328	81	82	87	87	337
Latin America	45	14	15	16	18	62	18	18	18	20	73	20	21	20	22	83
Canada	131	30	36	39	36	141	33	39	148	106	327	27	36	130	134	327
Other																
Total Franchised and affiliated	3,832	945	1,029	1,068	1,037	4,078	990	1,110	1,230	1,184	4,514	1,025	1,147	1,247	1,240	4,659
Other		(498)	(526)	(485)	(676)	(2,184)	(495)	(566)	(550)	(700)	(2,311)	(500)	(590)	(560)	(750)	(2,400)
Total Company		910	1,017	1,160	907	3,993	1,010	1,162	1,322	1,083	4,576	1,083	1,227	1,376	1,152	4,838
Operating margins																
Company operated																
US	19.1%	17.9%	19.2%	18.7%	19.1%	18.7%	18.3%	19.8%	18.5%	18.5%	18.8%	18.4%	20.0%	18.6%	18.6%	18.9%
Europe	15.6%	13.5%	14.4%	16.1%	15.7%	14.9%	13.6%	16.0%	16.2%	15.8%	15.5%	13.8%	16.2%	16.4%	15.9%	15.6%
APMEA	11.0%	10.8%	10.3%	12.4%	9.9%	10.9%	12.4%	11.9%	12.7%	10.5%	11.9%	12.6%	12.8%	13.0%	13.2%	12.9%
Latin America	9.5%	12.0%	9.9%	11.6%	12.0%	11.4%	13.2%	12.0%	12.5%	13.0%	12.7%	13.5%	14.0%	14.0%	13.8%	13.8%
Canada	15.3%	11.2%	14.2%	15.7%	13.8%	13.9%	13.8%	16.9%	16.0%	14.0%	15.2%	13.9%	17.0%	16.0%	14.0%	15.3%
Total Company operated	15.3%	14.0%	14.8%	15.8%	15.3%	15.0%	14.7%	16.1%	15.9%	15.3%	15.5%	14.9%	16.5%	16.1%	15.8%	15.9%
Franchised and affiliated																
US	80.7%	80.2%	81.9%	81.8%	81.6%	81.4%	81.5%	82.8%	82.0%	82.0%	82.1%	81.6%	83.0%	82.0%	82.0%	82.2%
Europe	76.5%	75.5%	76.7%	78.1%	77.0%	76.9%	75.6%	77.6%	76.5%	76.5%	76.6%	75.5%	77.7%	76.7%	76.8%	76.7%
APMEA	85.8%	85.6%	86.3%	87.3%	87.6%	86.7%	87.1%	87.0%	87.5%	88.0%	87.4%	87.2%	87.2%	88.0%	87.0%	87.4%
Latin America	60.0%	64.8%	70.1%	68.0%	72.1%	68.9%	70.5%	72.2%	70.5%	72.0%	71.3%	71.0%	72.0%	71.0%	72.2%	71.6%
Canada	78.0%	74.8%	77.6%	78.0%	77.4%	77.0%	76.2%	77.8%	274.2%	209.8%	164.4%	57.1%	67.5%	222.8%	245.5%	153.1%
Total Franchised and affiliated	79.3%	78.6%	80.2%	80.6%	80.3%	80.0%	79.7%	81.0%	87.9%	85.2%	83.6%	79.1%	80.8%	86.2%	86.8%	83.3%

Source: Deutsche Bank, company data

Figure 89: MCD Balance sheet (\$mn)

	2004	1Q05	2Q05	3Q05	4Q05	2005	1Q06	2Q06	3Q06	4Q06E	2006E	1Q07E	2Q07E	3Q07E	4Q07E	2007E
Cash/Marketable Securities	1,380	1357	1561	2297	4260	4,260	3,803	3,290			2892					1280
Accounts and notes receivables	746	686	757	755	796	796	742	858			881					908
Inventory	148	138	139	142	147	147	139	142			176					159
Prepaid and other current assets	585	617	585	608	646	646	584	571			661					681
Total Current Assets	2,858	2,798	3,042	3,802	5,850	5,850	5,268	4,861	-	-	4,610	-	-	-	-	3,029
Equity and other investments	1,110	1137	1074	1050	1,035	1,035	1,018	1,040			1,102					1,181
Goodwill	1,828	1816	1828	1935	1,951	1,951	2,043	2,126			2,036					2,156
Other assets	1,338	1301	1309	1306	1,245	1,245	1,208	1,207			661					681
Plant & Equipment, Net	20,703	20183	19729	19752	19,908	19,908	20,064	20,539			20,446					21,031
Total Assets	27,838	27,234	26,980	27,844	29,989	29,989	29,601	29,773	-	-	28,854	-	-	-	-	28,078
Notes Payable	-	0	0	0	544	544	529	553			550					550
Accounts Payable	714	495	529	524	689	689	586	557			770					787
Dividend Payable				843	-	-					-					-
Taxes	576	445	528	743	801	801	574	191			881					908
Accrued interest	179	169	168	159	159	159	167	132			154					182
Accrued Payroll & Other liab.	1,188	1056	1057	1151	1,185	1,185	1,168	1,304			1,234					1,249
Current portion of LT debt	862	504	793	715	659	659	673	602			673					673
Total Current Liabilities	3,521	2,669	3,075	4,135	4,036	4,036	3,697	3,338	-	-	4,263	-	-	-	-	4,350
Long-term Debt	8,357	8155	7764	7350	8,937	8,937	8,709	8,351			7,517					7,017
Other Long-term Liabilities	977	926	854	904	892	892	1,064	1,167			991					908
Deferred Tax	782	846	927	939	977	977	965	1,024			1,102					1,022
Total Liabilities	13,636	12,596	12,620	13,327	14,843	14,843	14,434	13,881	-	-	13,872	-	-	-	-	13,297
Common Stock	17	17	17	17	17	17	17	17			17					17
Additional Paid in Capital	2,186	2,391	2463	2662	2,798	2,798	2,977	3,089			2,977					3,277
Unearned ESOP's	(83)	(83)	-84	-82	(77)	(77)	(75)	(73)			(75)					(75)
Retained Earnings	21,756	22,484	23015	22908	23,516	23,516	24,142	24,976			25,246					26,745
Accumulated Other Comprehensive income	(96)	(302)	(624)	(592)	(733)	(733)	(637)	(36)			(132)					(332)
Treasury Shares	(9,578)	(9,869)	(10,427)	(10,396)	(10,374)	(10,374)	(11,256)	(12,004)			(13,050)					(14,850)
Total Shareholders' Equity	14,202	14,638	14,361	14,516	15,146	15,146	15,167	15,969	-	-	14,982	-	-	-	-	14,781
Total Liabilities & Shareholders' Equity	27,838	27,234	26,980	27,844	29,989	29,989	29,601	29,850	-	-	28,854	-	-	-	-	28,078

Source: Deutsche Bank, company data

Figure 90: MCD cash flows (\$mn)

	2000	2001	2002	2003	2004	2005	2006E	2007E
Operating Cash Flows								
Net income	1,977	1,637	894	1,471	2,279	2,602	2,976	2,998
Depreciation and amortization	1,011	1,086	1,051	1,148	1,201	1,250	1,262	1,335
Other	61	(88)	54	738	234	73	100	100
Net change in working capital	(297)	53	892	(89)	190	412	83	57
Net Operating Cash Flows	2,752	2,688	2,890	3,269	3,904	4,337	4,421	4,490
Capex	(1,945)	(1,906)	(2,004)	(1,307)	(1,419)	(1,607)	(1,800)	(1,920)
Dividends	(281)	(288)	(297)	(504)	(695)	(842)	(1,247)	(1,499)
FCF	1,053	1,128	1,200	1,572	2,491	2,882	2,554	2,713
Investing Cash Flows								
Acquisitions	(123)	44	(179)	15	157	(84)		
Equity investments							(66)	(79)
Other	(145)	(206)	(284)	(77)	(120)	(127)	499	(140)
Net Investing Cash Flows	(268)	(162)	(463)	(62)	36	(211)	433	(220)
Financing Cash Flows								
Debt issuances / (payments)	1,679	527	146	(892)	(816)	1,612	(1,400)	(500)
Share issuances / (repurchases)	(2,023)	(1,068)	(475)	(220)	(41)	(434)	(2,000)	(1,800)
Other	89	205	116	(122)	(83)	25	224	(162)
Net Financing Cash Flows	(256)	(336)	(214)	(1,233)	(939)	1,204	(3,176)	(2,462)
Net increase/ (decrease) in cash	2	(4)	(88)	162	887	2,881	(1,369)	(1,611)
Cash and equivalents beginning of year	420	422	418	330	493	1,380	4,260	2,892
Cash and equivalents end of year	422	418	330	493	1,380	4,260	2,892	1,280

Source: Deutsche Bank, company data

Figure 91: MCD EVA (\$mn)

NOPAT	2000	2001	2002	2003	2004	2005	2006E	2007E
Income for Common	\$1,977	\$1,637	\$894	\$1,471	\$2,279	\$2,602	\$2,976	\$2,998
Increase in Deferred taxes								
Goodwill Amortization	-	1,320	239	105	163	122	85	120
Increase in LIFO reserve								
Advertising Expense	595	601	648	597	620	657	991	1,022
Special Charges/Gains								
Increase in Equity Equivalents	595	1,921	887	702	783	779	1,076	1,142
Adjusted Income for Common	2,573	3,558	1,781	2,173	3,061	3,381	4,052	4,140
Interest Expense	430	452	374	388	358	356	399	398
Tax Benefit of Interest Expense	(295)	(318)	(223)	(249)	(255)	(250)	(270)	(267)
Tax Shield	135	135	151	139	103	106	129	131
NOPAT	2,708	3,692	1,931	2,312	3,165	3,487	4,182	4,272
Capital								
Short-term Debt	630	363	276	388	862	1,203	1,223	1,223
Long-term Debt	7,844	8,556	9,704	9,343	8,357	8,937	7,517	7,017
PV of Non-Cap Leases	6,591	6,598	6,703	7,317	7,689	7,636	9,340	9,697
Total Debt & Leases	15,065	15,516	16,683	17,048	16,908	17,777	18,080	17,937
Common Equity	1,442	1,591	1,747	1,838	2,186	2,798	2,977	3,277
Deferred Income Tax								
Capitalized Advertising								
LIFO Reserve								
Accumulated Goodwill Amortization	-	1,320	1,560	1,665	1,828	1,951	2,036	2,156
Restructuring Charge								
Equity Equivalents	-	1,320	1,560	1,665	1,828	1,951	2,036	2,156
Adjusted Common Equity	1,442	2,912	3,307	3,503	4,014	4,748	5,012	5,432
Capital	16,506	18,428	19,990	20,551	20,922	22,525	23,093	23,369
ROIC	16.4%	20.0%	9.7%	11.3%	15.1%	15.5%	18.1%	18.3%
MACC-Mkt. Adjusted Cost of Capital								
Required Rate of Return	11%	11%	11%	11%	11%	11%	11%	11%
Cost of Debt	5.5%	5.2%	4.0%	3.9%	3.8%	3.7%	4.2%	4.7%
Forward Relative P/E	93%	71%	53%	49%	65%	84%	80%	87%
% Debt	91%	84%	83%	83%	81%	79%	78%	77%
% Equity	9%	16%	17%	17%	19%	21%	22%	23%
Weighted Cost of Debt	5.0%	4.4%	3.3%	3.3%	3.1%	2.9%	3.3%	3.6%
Weighted Cost of Equity	1.0%	2.4%	3.4%	3.8%	3.3%	2.8%	3.0%	2.9%
Market Adj. Cost of Capital	6.0%	6.8%	6.7%	7.1%	6.3%	5.7%	6.3%	6.5%
Spread								
ROIC	16.4%	20.0%	9.7%	11.3%	15.1%	15.5%	18.1%	18.3%
MACC	6.0%	6.8%	6.7%	7.1%	6.3%	5.7%	6.3%	6.5%
Spread	10.4%	13.2%	3.0%	4.1%	8.8%	9.8%	11.8%	11.7%

Source: Deutsche Bank, company data

North America United States
Consumer Restaurants

18 October 2006

Chipotle Mexican Grill

Reuters: **CMG.N** Bloomberg: **CMG US**

Initiate at Hold, great story priced in

Initiate with Hold rating & \$57 price target

Chipotle is the simplest but fastest-growing chain in our coverage group. Its store concept aligns well with consumer trends, which supports strong unit and comps growth. We believe CMG's high forecasted growth (31% EPS CAGR through 2010) deserves premium valuation, but at 43x 2007 EPS, valuation appears fair.

Attractive value proposition

CMG offers a highly relevant concept, built around a simple menu (burritos, tacos) using fresh, high-quality ingredients and served in a unique and energetic store setting. CMG's concept caters to the ongoing secular shift toward variety (customizable menu creates choice) and healthier, more natural food ingredients. We believe the company's focus on through-put improvement supports improving efficiency, and even stronger growth.

Substantial store growth opportunity drives 25%+ forward EPS growth rates

Operating in only 23 states and absent from numerous tier 1-2 cities, CMG has a long road of expansion ahead. We expect growth from just over 500 stores at present to over 1,500 by 2015. Coupled with high rates of comparable store sales growth, this drives 20-25% top-line growth. Although operating leverage is limited, and CMG has higher ingredient cost and labor intensity than most other chains, we see this flowing through to 25%+ EPS growth.

Looking for better entry point

CMG's high growth profile deserves premium valuation, but we prefer to buy at a level below 40x P/E and 1.5x PEG. Our \$57 TP reflects a combination of methodologies (P/E, TEV/EBITDA, DCF) and in particular, 42x P/E or 1.75x PEG. A better entry may result from negative industry headlines or signs of accelerating growth. Key risks include changes in pace of store openings and comps as well as ingredient sourcing/costs and the cost impact of separation from McDonald's. (Please see also page 22 and pages 32-34.)

Forecasts and ratios

Year End Dec 31	2005A	2006E	2007E
1Q EPS ¹	0.10	0.26A	0.30
2Q EPS	0.98	0.33A	0.40
3Q EPS	0.19	0.25	0.34
4Q EPS	0.16	0.21	0.28
FY EPS (USD)	1.43	1.05	1.33
EV/EBITDA (x)	-	18.9	14.6
ROE (%)	13.2	8.8	9.0

Source: Deutsche Bank estimates, company data

¹ Includes the impact of FAS123R requiring the expensing of stock options.

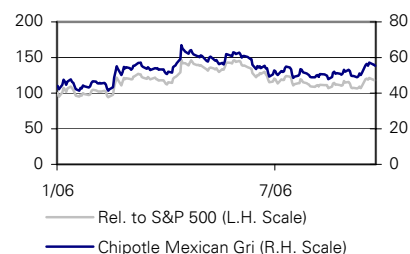
Hold

Price at 17 Oct 2006 (USD)	55.49
Price Target	57.00
52-week range	67.05 - 41.46

Key changes

Rating	No Recommendation to Hold	↑	-
Price Target	- to 57.00	↑	-
EPS (USD)	- to 1.06	↑	-
Revenue (USDm)	0 to 837	↑	-

Price/price relative



Performance (%)	1m	3m	12m
Absolute	8.4	0.0	-
S&P 500	3.3	10.5	14.6

Stock data

Market Cap (USD)	1,784.6
Shares outstanding (m)	32.2
Free float (%)	-
Volume	613,100
S&P 500	1,364.05

Key indicators

ROE (%)	8.8
ROA (%)	7.4
Net debt/equity (x)	-32.9
Book value/share (USD)	14.38
Price/book (x)	3.9
Net interest cover (x)	-
EBIT margin (%)	6.1

Model updated: 16 October 2006

Running the Numbers

North America

US

Restaurants

Chipotle Mexican Grill, Inc.

Reuters: CMG.N

Bloomberg: CMG US

Hold

Price as of 17 October US\$ 55.49

Target price US\$ 57.00

Company website

http://www.chipotle.com

Company description

CMG is a fast-casual Mexican restaurant operator, currently operating about 500 restaurants in 23 states. CMG does not franchise, and emphasizes fresh high-quality ingredients and simple menu options. CMG has operated as a subsidiary of McDonald's since 1998.

Research Team

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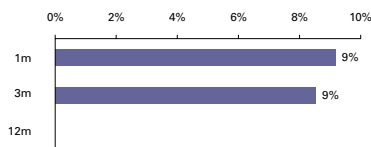
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Absolute Price Return (%)



52-week Range: US\$ 41.46 - 67.05

Market Cap (m) USD 1,785

EUR 1,423

Company identifiers

Cusip

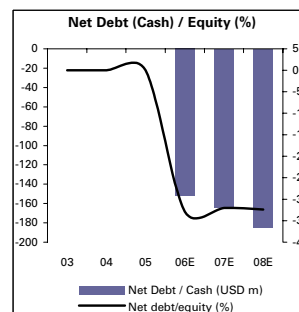
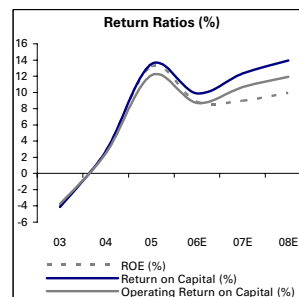
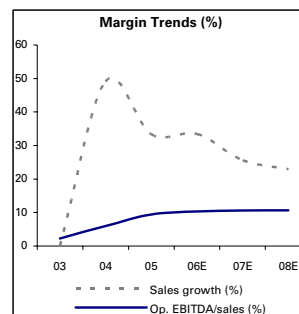
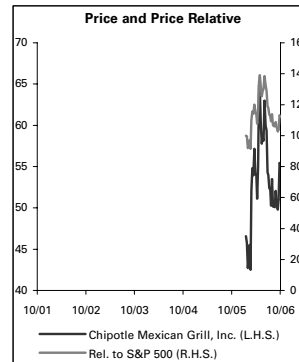
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Source: Company data, Deutsche Bank estimates

Year Ending 31 December	2003	2004	2005	2006E	2007E	2008E
SUMMARY						
Headline EPS (US\$)	-0.34	0.24	1.43	1.05	1.33	1.63
P/E ratio Headline (x)	na	na	na	52.9	41.8	34.1
Headline EPS growth (%)	na	nm	495.4	-26.6	26.4	22.8
EPS FD (US\$)	-0.34	0.24	1.43	1.05	1.33	1.63
P/E ratio FD (x)	na	na	na	52.9	41.8	34.1
Operating CFPS (US\$)	0.99	1.56	2.97	3.10	3.07	3.46
Free CFPS (US\$)	-2.86	-2.20	-0.19	0.24	0.04	0.28
P/CFPS (x)	na	na	na	17.9	18.1	16.0
DPS (US\$)	0.00	0.00	0.00	0.00	0.00	0.00
Dividend Yield (%)	na	na	na	0.0	0.0	0.0
BV/Share (US\$)	8.56	10.32	11.77	14.38	15.49	17.27
Price/BV (x)	na	na	na	3.86	3.58	3.21
Weighted average shares (m)	22.4	25.5	26.3	32.2	33.0	33.0
Average market cap (USD m)	na	na	na	1,785	1,785	1,785
Enterprise value (USD m)	na	na	na	1,632	1,621	1,600
EV/Sales	na	na	na	1.95	1.54	1.24
EV/EBITDA	na	na	na	18.9	14.6	11.6
EV/EBIT	na	na	na	32.1	24.0	18.8
EV/Operating Capital	na	na	na	4.6	4.0	3.5
INCOME STATEMENT (USD m)						
Sales revenue	316	471	628	837	1,051	1,292
Operating EBITDA	7	28	59	87	111	138
Depreciation	15	22	28	36	44	53
Amortisation	0	0	0	0	0	0
EBIT	-8	6	31	51	68	85
Net interest income(expense)	0	0	-1	6	5	4
Associates/affiliates	0	0	0	0	0	0
Investment/other income(expense)	0	0	0	0	0	0
Exceptionals/extraordinaries	0	0	0	0	0	0
Income tax expense	0	0	-7	22	29	36
Minorities/preference dividends	0	0	0	0	0	0
Net income	-8	6	38	34	44	54
CASH FLOW (USD m)						
Cash flow from operations	22	40	78	100	101	114
Movement in net working capital	10	9	15	16	9	2
Capex	-86	-96	-83	-92	-100	-105
Free cash flow	-64	-56	-5	8	1	9
Other investing activities	0	0	0	25	10	12
Equity raised(bought back)	38	65	0	91	0	0
Dividends paid	0	0	0	0	0	0
Net inc(dec) in borrowings	0	0	0	0	0	0
Other financing cash flows	26	-9	6	28	0	0
Total cash flows from financing	64	56	6	119	0	0
Net cash flow	0	0	1	152	12	21
Movement in net debt(cash)	0	0	-1	-152	-12	-21
BALANCE SHEET (USD m)						
Cash and other liquid assets	0	0	0	152	164	185
Tangible fixed assets	212	290	341	397	453	505
Goodwill	26	26	18	18	18	18
Other intangible assets	0	0	0	0	0	0
Associates/investments	0	0	0	0	0	0
Other assets	11	14	34	22	28	34
Total assets	249	330	392	588	663	742
Interest bearing debt	0	0	0	0	0	0
Other liabilities	58	67	83	126	152	172
Total liabilities	58	67	83	126	152	172
Shareholders' equity	192	263	309	463	511	570
Minorities	0	0	0	0	0	0
Total shareholders' equity	192	263	309	463	511	570
Net working capital	-30	-28	-24	-40	-49	-51
Net debt(cash)	0	0	0	-152	-164	-185
Capital	192	263	309	310	347	385
RATIO ANALYSIS						
Sales growth (%)	na	49.2	33.3	33.4	25.5	23.0
Op. EBITDA/sales (%)	2.3	5.9	9.4	10.3	10.6	10.7
EBIT/sales (%)	-2.5	1.3	4.9	6.1	6.4	6.6
Payout ratio (%)	nm	0.0	0.0	0.0	0.0	0.0
ROE (%)	-4.0	2.7	13.2	8.8	9.0	9.9
Return on Capital (%)	-4.1	2.7	13.5	9.9	12.3	14.0
Operating Return on Capital (%)	-3.8	2.4	12.1	8.7	10.7	11.9
Capex/sales (%)	27.3	20.3	13.2	11.0	9.5	8.1
Capex/depreciation (x)	5.7	4.4	3.0	2.6	2.3	2.0
Net debt/equity (%)	0.0	0.0	0.0	-32.9	-32.1	-32.4
Net interest cover (x)	nm	nm	41.1	nm	nm	nm



Investment thesis

Outlook

Chipotle Mexican Grill is the simplest but fastest growing restaurant concept in our universe. Following its IPO earlier this year and separating completely from MCD (\$42.12, Hold) at the beginning of October, CMG is now a high-growth stand-alone concept with a tilt towards key consumer growth trends. CMG is a young and energetic organization, offering an attractive value proposition – fresh, high-quality customizable Mexican food from a simple menu. CMG serves it in casual, hip restaurants with an emphasis on friendly and well-trained staff. Its appeal is simple but widely relevant in our view – the menu caters to consumer trends toward healthier food (more organic and locally-sourced ingredients), the ongoing secular trade-up in restaurant food and consumer interest in choice through customization.

Expect store expansion to drive CMG's growth. CMG possesses substantial penetration opportunities, operating in only 23 states with over 500 stores, less than any other company in our universe. Expanding in a hub and spoke format, CMG has yet to tap regions in New England, NW and major Tier 1-2 cities such as Philadelphia and Boston. We expect a major expansion of new stores, with 90 new openings expected in 2006, and a surge to about 1,000 stores by 2010. Beyond unit expansion, increasing brand awareness should support some of the highest comparable store sales growth in the industry (15% expected for 2006).

We expect CMG to generate average EBIT growth of 28% over the next three years, ahead of both SBUX (forecasted +22% average 3-year EBIT growth) and PNRA (forecasted +24%). From a margin standpoint, store opening costs could drag given the time needed to ramp up new stores to run-rate sales levels. Modest operating leverage could resume next year, but higher-cost ingredients than most chains and a more labor intensive model given fresh ingredient inputs (chopped and prepared every morning) and customized customer orders could limit this benefit.

Valuation

We believe CMG's growth potential deserves a premium valuation, but at well over 40x our 2007 EPS estimate, the stock appears fairly valued. Our \$57 TP is based on an averaging of valuations from four methodologies (EV/EBITDA, P/E, ROIC spread, DCF). Our target 17x TEV/EBITDA falls just below our SBUX target of 18.5x, reflecting smaller size and untested track record as a public entity. P/E target of 41x reflects 1.75x PEG on our 23% 3-year sales growth forecast. ROIC spread expansion forecasts to mid-single digits suggest 16x TEV/EBITDA. DCF methodology is based on 20% 10-year EBIT growth, 12.0% WACC–0.82 beta, 4.7% Rf rate, 5.4% market premium, 11.8% K-equity, 5% long-term growth (assumes slower industry growth vs. recent 4% and CMG above industry over the long term). The best opportunity to get involved may come on an overdone reaction to negative restaurant industry headlines or indications that growth is trending ahead of our forecasts.

Risks

Most significant risks to our forecasts are the rate of store openings and same store sales, which drive our growth outlook. On an operational front, the most prominent issues are ingredient sourcing, since CMG uses local suppliers and higher quality ingredients and does not engage in significant cost hedging, and is therefore more vulnerable to supply disruption or cost spikes, we believe. The pending full separation from McDonald's may also elevate costs or cause short-term operational disruptions.

Great story priced in

There's value in simplicity

Chipotle Mexican Grill is the simplest, yet fastest growing restaurant concept in our universe. It's young. It's relevant. It carries a certain energy throughout the organization. And it offers a conceptual value proposition to consumers—fresh, customizable food in a casual, fun atmosphere—which we believe can grow rapidly for several years to come. Not just because it seems like a great idea. It *is* a great idea based on a history of success; i.e. 56% average annual sales growth for the five years ending 2005. We expect sales and EBIT growth to average 23% and 29%, respectively over the next three years, ahead of both SBUX and PNRA. We believe this deserves a premium valuation, but at 54x and 43x our 2006 and 2007 EPS estimates, respectively, the stock appears fairly valued. We prefer to buy the stock at a P/E below 40x on our 2007 forecast at a 1.5x PEG or better.

Figure 92: PEG ratios

	P/E	Forward 3-Year Sales Growth	PEG	Forward 3-Year EBIT Growth	PEG
PNRA	28	22.6%	1.2	24.4%	1.1
CMG	43	23.0%	1.9	28.4%	1.5
SBUX	42	21.0%	2.0	21.9%	1.9

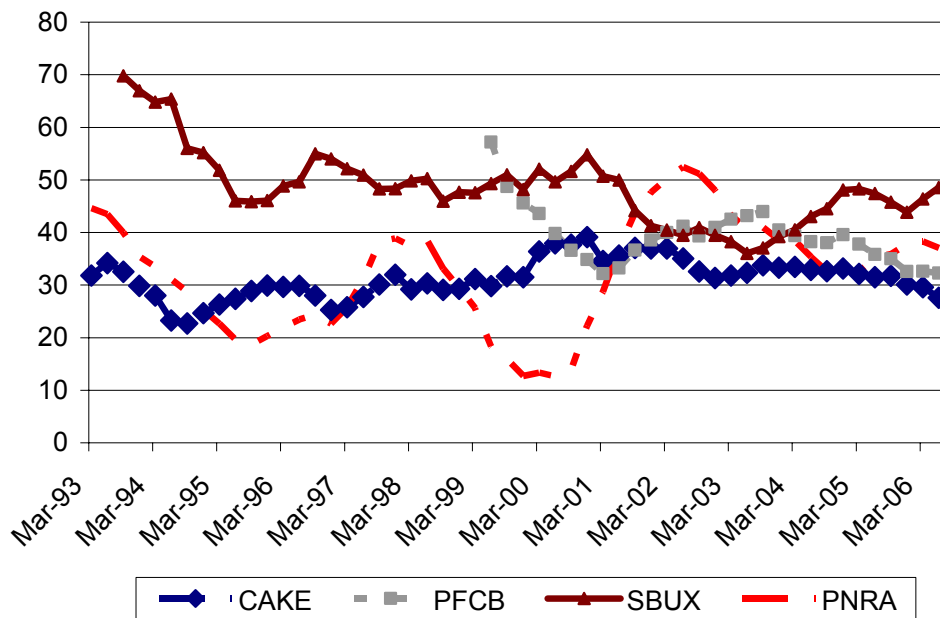
Source: Deutsche Bank, company data

Not your average burrito

- A simple yet widely relevant concept.** Steve Ellis, a professionally trained chef and founder of CMG, has seasoned this organization with his personal style and interest in great food. Fresh ingredients, freshly prepared to order, in a burrito, taco, or burrito bowl to suit the consumer's taste. It's a concept that can go anywhere in the U.S. and find interest from many types of consumers. It's also relevant to a number of broad consumer trends: 1) the health movement shuns anything processed or raised with chemicals and CMG plays right into this trend with fresh produce and naturally raised meats; 2) the secular consumer tendency to trade up in quality across many categories caters to CMG's strengths as a company intensely focused on food quality and integrity; and 3) the desire for choice—CMG's menu can be customized whichever way you please, unlike most QSR restaurants that typically have a standardized menu format.
- Low level of penetration suggests long growth curve.** A 23 state penetration doesn't even get to half the U.S., and many major regions are untapped, such as parts of New England, the Northwest, parts of the Midatlantic and the South. We expect CMG to end the third quarter with 546 stores. This compares to PNRA at just under 1,000 and SBUX at just over 8,000 U.S. stores. This is a company at the beginning of its life cycle, with a strong concept (both from a food and people standpoint). We expect high levels of growth for several years to come.

We believe this is a high-growth potential concept, and while the high cost of ingredients and potential cost bumps related to the separation from MCD could cause a little noise, the market generally recognizes the opportunity here. Figure 93 shows the progression of restaurant growth concept valuations over the last thirteen years. P/E's have ranged on average between 30x and 50x over the last five years, with most stocks in the 30x to 40x range. As a high growth story, we believe CMG deserves a valuation at the high end of the range. But even 42x our 2007 EPS estimate suggests \$56 per share, close to the current price. Other valuation methodologies (i.e. DCF, TEV/EBITDA) suggest prices in the high \$50s to \$60.

Figure 93: Peer group P/E history



Source: Deutsche Bank, Factset, Reuters, Company Info

The crux: great company, not so great entry point

Following a rash of buzz around the IPO in January, valuation is in the process of settling. Sales growth trends continue to look strong but could come up on some tougher comps. Expansion of brand equity and new store openings should continue to fuel growth, but we’re looking for an opportunity to get involved, whether it be an overdone reaction to typical negative restaurant industry headlines (food contamination, obesity issues, consumer slowdown fears) or an indication that growth is trending ahead of our forecasts. Believe us, we’ll be looking.

CMG financial drivers

Plenty of room for expansion

Chipotle Mexican Grill is a unique concept within the growing fast casual segment. It's fresh and highly focused on food quality. It offers variety within a relatively simple menu by allowing consumers to create their own meal. And it caters to several key consumer growth trends – healthier lifestyles, growth in Hispanic demographic, and trading up to affordable food luxuries. Operating in only 23 states, we see plenty of room for additional growth through unit expansion, not to mention the growth in brand awareness post-IPO. In short, we are confident that CMG can exceed its 25% EBIT growth target over the next few years.

Top line drivers

Strong store growth opportunity from untapped markets

CMG operates a total of 518 stores, most of which are company-owned. New store openings represent the biggest component of growth. The company has not provided explicit long-term store growth targets, but plans an aggressive expansion over at least the next three years. We believe the number of untapped markets available to CMG supports long-term store growth. For instance, many major metropolitan cities remain untapped, such as Philadelphia, Boston, St Louis, and Pittsburgh—the company is looking to enter these markets late this year or in 2007.

CMG's expansion strategy is a hub and spoke format, whereby it targets major metro locations and then expands outward as brand recognition builds into suburban areas. Initial locations in a new market tend to be stylized free-standing stores, chosen to increase prominence of the brand. As brand recognition grows in each local market, efficiency of marketing spend for follow-on openings increases and the sales gap between start-ups and legacy stores narrows.

Selection criteria for new markets targets urban and suburban areas. CMG has progressively refined its new location search criteria using proprietary tools from MCD, but target locations are primarily evaluated according to population density, income, thresholds for daytime population (given CMG's peak lunch hours), and subjective evaluations of consumer sophistication. Other gating factors to new store growth include the potential employee pool in each market and suitable real estate.

CMG's current footprint shows an opportunity to significantly increase the number of Tier 1 and Tier 2 cities served. Management believes the ultimate size of the footprint could number into the thousands as it continues growing into undeveloped markets. This seems reasonable, given just over 500 stores in under half the states in the U.S. And not every market is yet saturated.

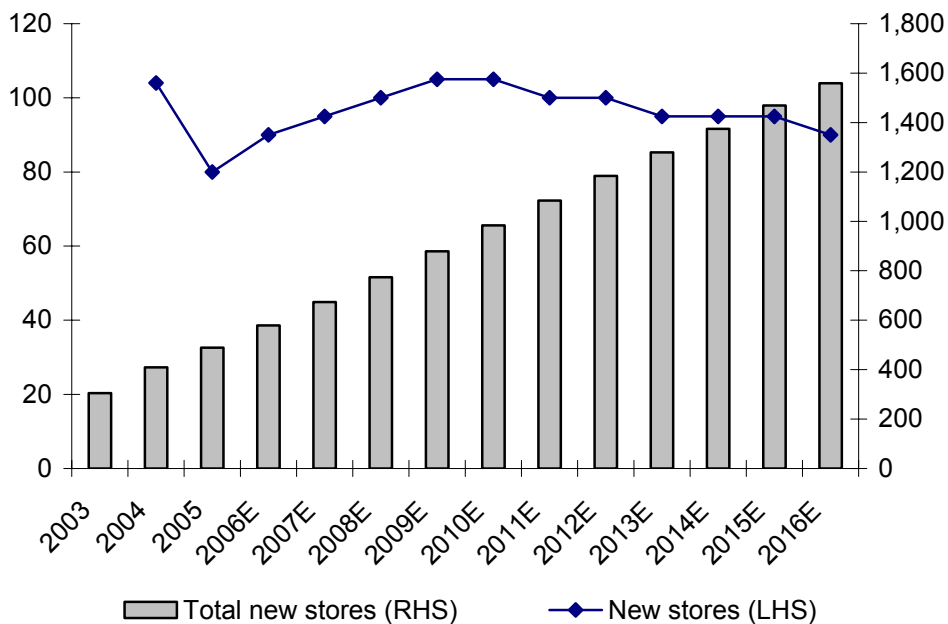
Figure 94: CMG store footprint



Source: Company Info

Most of the 80-90 new stores planned for this year will open in CMG’s existing markets. We expect the company to come in at the upper end of FY06 guidance at 90 stores, and project 95-105 new adds per year over the next five years. We base this on the still relatively small size of the current footprint and ability to manage growth vs. a large availability of new markets and progressive maturation of legacy stores. We believe the bias for trends in new store openings is firmly on the upside, constrained primarily by management’s ability to balance growth vs. execution in the existing base. Through-put is a significant initiative in this regard, which we will touch on later in this report. We estimate a long-term store base of just over 1,500 by 2016E, nearly tripling the current base.

Figure 95: Projected store growth



Source: Deutsche Bank, Company Info

Although we believe CMG has room to substantially expand the size of its store base, a crucial driver of the speed of expansion will be the impact on same store sales. As brand recognition matures, the use of end-cap and in-line stores is expected to increase, and although these carry lower opening costs, they increasingly stack up comparatively well to free-standing stores from a revenue standpoint. We therefore expect to see less emphasis on free standing stores in the future, which should cut down on capital costs.

Same store sales growth driven by transactions & order processing efficiency

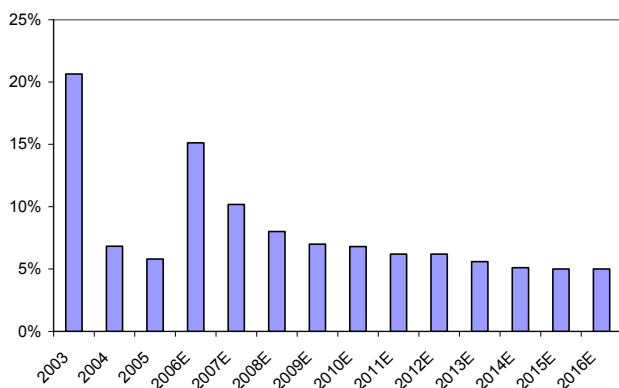
The second key leg of CMG’s top-line growth is comp store sales. This is an important measure given the relative immaturity and rapid sales growth of most CMG stores, and leverage on lease/rent expense commitments.

Same store sales growth (stores open at least 12 months) is currently heavily weighted towards growth of transactions. CMG tends to take pricing on a selective basis, for example with the launch of natural chicken or beef in a given market. This allows the company to offer the customer greater value for the higher price and retain loyalty. Regardless, pricing power has proven to be fairly strong, as customers absorbed recent price increases with minimal impact to sales. We expect several key factors to drive transaction growth:

- **Growth in brand awareness.** Following the company’s IPO in January 2006, comparable store sales picked up as the company garnered attention in the media, both in the financial and foodie community. CMG is one of the few chain restaurants to gain favorable reviews, or any review at all, in major food publications such as the New York Time’s Dining section.
- **Continued growth in dinner day-part business.** This has grown to just over half the company’s business. The food and atmosphere translate well to a dinner business, as the company serves alcohol and offers a relaxed, festive atmosphere.
- **Through-put improvements.** Once proud of its long lines, CMG now looks to improve its efficiency in order to drive sales. Our grassroots research inside CMG stores confirms that long lines do turn customers away. Many die-hards are willing to wait; others are not, and potential sales walk out the door. This is of particular note during peak lunch hours. CMG has put a number of initiatives in place, from more employees on the line to a fax order system. The new “Restaurateur” program, which provides performance incentives to specially selected managers, is designed to enhance the employee and therefore the customer experience.

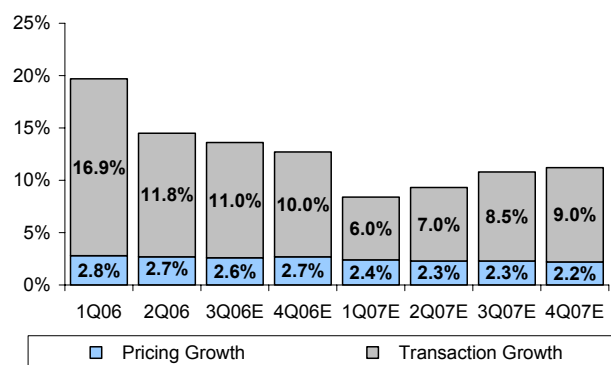
We expect transaction growth of 12% in 2006, however, as the number of mature stores grows, we expect this to slow down toward the mid to high single-digits over the next few years. CMG pricing increases have historically been fairly restrained, and we believe that pricing will continue to be used to offset gross margin pressure and more expensive (i.e. organic) ingredients. Our forecasts assume pricing increases of 1-2% per year, allowing CMG to maintain stable long-term gross margins.

Figure 96: Comparable store sales growth



Source: Deutsche Bank, Company Info

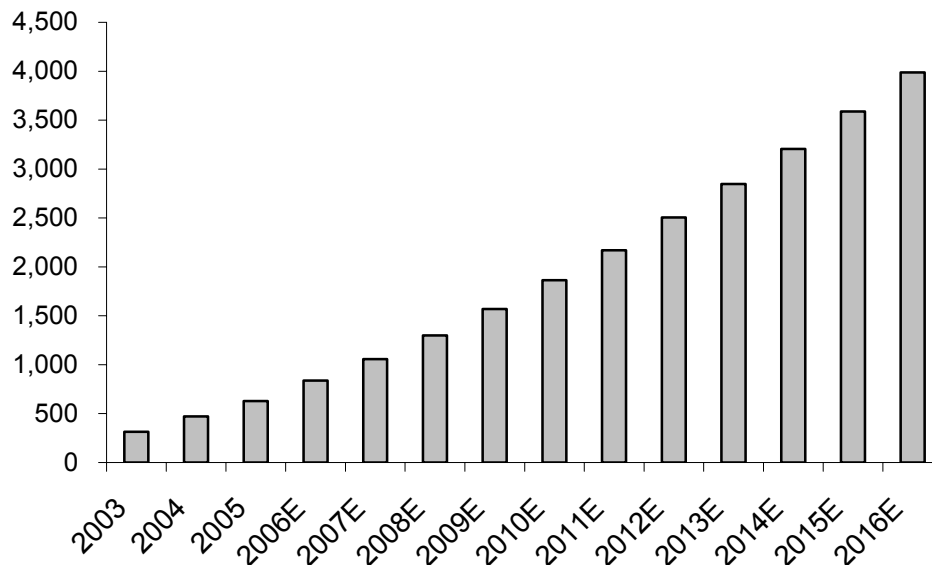
Figure 97: Quarterly same store sales growth



Source: Deutsche Bank, Company Info

The combination of robust restaurant growth and comparable sales growth leads to the robust expected revenue growth in our forecasts. We project top-line growth of 33% in 2006 and 26% in 2007, with long-term growth (2016E) of 11-12%.

Figure 98: CMG revenues (\$mn)



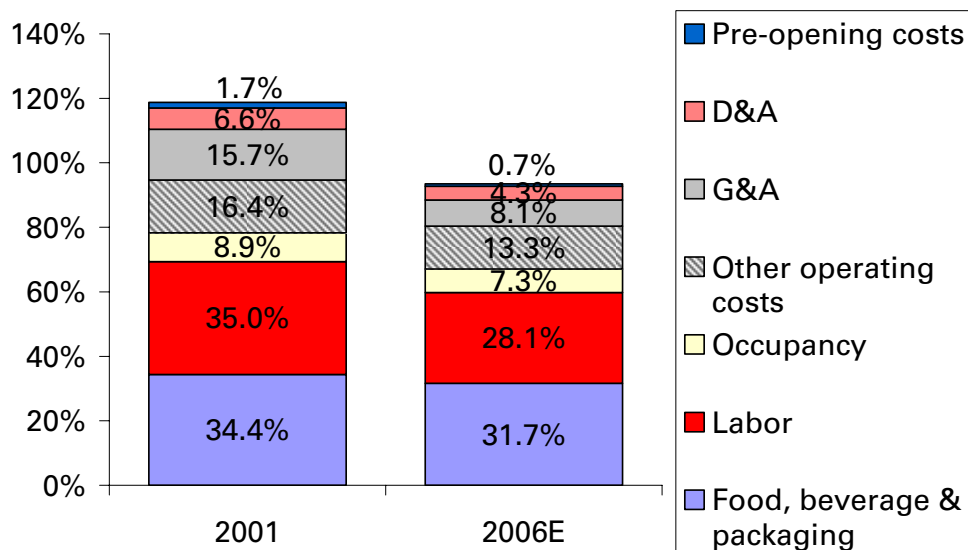
Source: Deutsche Bank, Company Info

Profit drivers

Continued opening of new stores drags on margins – although CMG does not provide revenue numbers for new vs. comp stores, new stores open at about 85% of comp store sales and take about 1.5-2 years to reach comp store levels. Expansion into more suburban areas and deeper penetration of existing markets is likely to widen this gap, somewhat offsetting refinements of store opening procedures. However, given the high level of sales growth and continued focus on efficiency, we expect modest operating leverage to continue.

Margins: Modest operating leverage

Over the last five years, CMG has achieved operating leverage in almost every major expense category. From year to year, fluctuations in key commodities such as cheese, avocados, beef, chicken, and beans can impact margins, but CMG generally has sufficient pricing power in order to offset any sustainable upward pressure. CMG's positioning in the premium end of the market and emphasis on ingredient quality leads to higher ingredient costs vs. its peers (close to 200bps).

Figure 99: Cost structure evolution

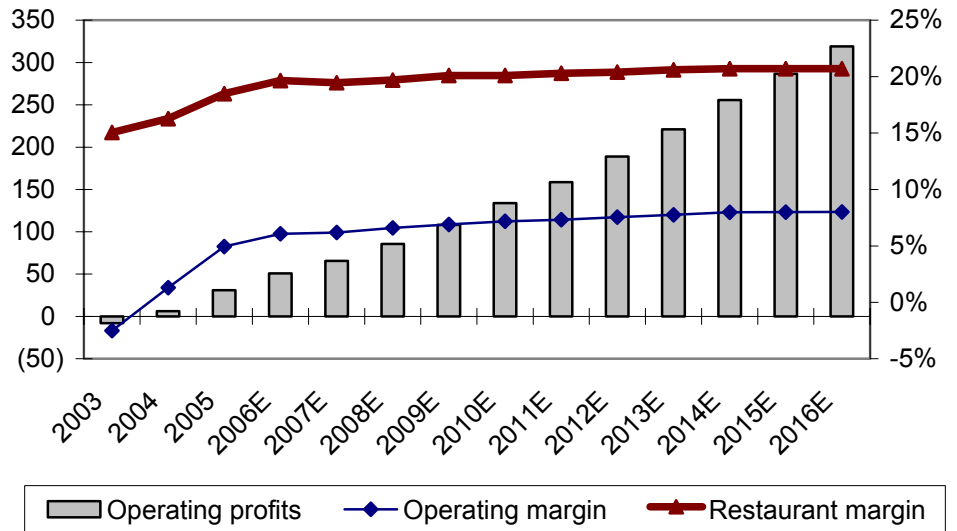
Source: Deutsche Bank, Company Info

Food, Beverage, Packaging. CMG's top input costs are chicken, beef, cheese, avocado and beans. Most ingredients are sourced on a local basis, with end pricing adjusted to maintain targeted gross margins. CMG does not do much hedging of input prices, with only occasional quarter to quarter hedging of top ingredients and some cheese/dairy (cheese prices locked in for 2007). CMG could see modest leverage here over the next few years, but packaging costs could offset this in the near-term, particularly aluminum.

Labor costs. The other major driver of profitability is CMG's labor expense – CMG is more labor intensive than fast food operations given the need to freshly prepare ingredients and the "assembly line" structure for filling orders. Although this is partially offset by a relatively simple menu, and process improvement and training continue to improve employee efficiency, we see only a limited amount of leverage in employee costs, which should generally increase in line with sales growth. We have assumed modest increase in this item as a percentage of revenue to account for a front-end loaded bump in employees costs related to the Restaurateur program. Over time, the efficiency benefits will likely outweigh these costs.

Over the next few years, we expect strong sales growth to drive modest leverage in various other items such as occupancy, utilities, etc. In the near-term through 2007, the separation from McDonald's may also cause some cost disruption. CMG has the same contract with KO as MCD, which is expected to remain the same after the separation, and shared MCD distribution centers are expected to maintain existing structures. Conservatively however, we do factor in some minor cost increases with outside vendors and G&A costs as the McDonald's separation proceeds. We therefore expect flattish EBIT margins of close to 6% through 2007, rising toward the 8-9% range by 2016 as store expansion slows.

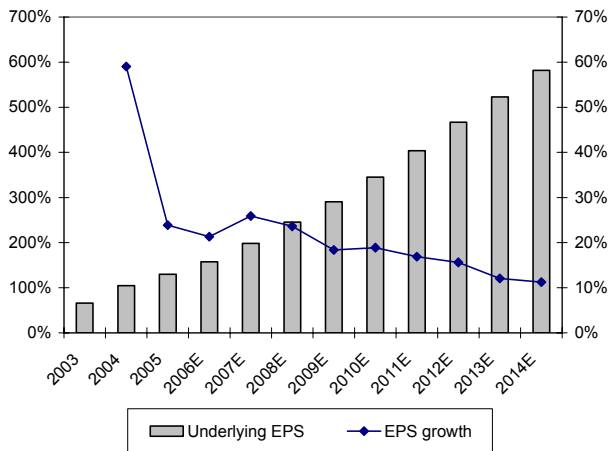
Figure 100: CMG operating profit (\$mn)



Source: Deutsche Bank, Company Info

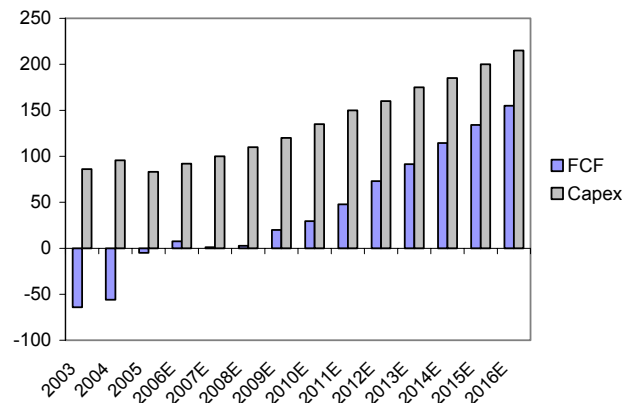
CMG's strong stores and earnings growth should translate into robust long-term FCF growth. Capital expenditures comprise new store opening costs, and we conservatively expect expenditures per new store to steadily increase, assuming gradual inflation of construction costs. Given capital costs per new store currently around \$900k and comp store 12-month sales around \$1.5mn with 11-12% EBITDA margins, recovery of new store investments is a lengthy process. However, progressive enlargement of the mature store base and slowing of new store openings beyond 2010 allows us to forecast a significant long-term expansion of FCF.

Figure 101: EPS growth



Source: Deutsche Bank, Company Info

Figure 102: FCF growth (\$mn)



Source: Deutsche Bank, Company Info

Estimate review

Our 2006 EPS estimate of \$1.05 reflects the following key assumptions:

- Net sales of \$837.3 million, +33.4%, driven by 18% unit growth and 15.1% comparable store sales growth.
- EBIT of \$50.8 million, +64.0%, reflecting sales growth, a 120bp improvement in restaurant level margin to 19.7%, and a 110bp improvement in overall margin to 6.1%.
- \$6 million interest income, 39.8% tax rate.

Our 2007 EPS estimate of \$1.33 reflects the following key assumptions:

- Net sales of \$1.051 billion, +25.5%, driven by 16% unit growth and 9.2% comparable store sales growth.
- EBIT of \$67.5 million, +33%, reflecting sales growth, a flat restaurant level margin at 19.7% to reflect potential labor cost pressure from new manager program, and a 30bp improvement in overall margin to 6.4%.
- \$5.8 million interest income, 40% tax rate.

Our long-term projections through 2010 assume the following:

- 95-105 new stores per year, bringing total stores from 518 to 984 by 2010
- Comparable store sales growth of 9-15% in 2006-07 and 7-8% from 2008-10. We assume comp growth is driven by pricing increases of about 2% per year, with transaction growth slowing from 12% in 2006 to 5% by 2010 as the legacy store base matures
- Revenue growth of 30-35% for 2006-07, slowing to just under 20% by 2010
- Restaurant margin expansion from 19.7% in 2006 to 20.1% by 2010, and total operating margin expansion from 6.1% in 2006 to 7.2% by 2010. We expect average annual EBIT growth of 34% for the five years through 2010, the most attractive growth rate in our universe.
- Given CMG's lack of significant debt obligations or NOLs, non-operating line items are highly transparent, and these flow through to our strong projected EPS growth rates. We estimate that after 2006, CMG will be able to grow EPS by 20-25% p.a. through 2010, with a 29% EPS growth CAGR between 2005 and 2010.

Valuation

Finding a reasonable valuation for a new growth entity

How do you value a brand new public company with outstanding prospects but no measurable valuation track record? We've taken into account the 25%-30% near-term EBIT growth and compared multiples of other restaurant growth stocks. Good news is, plenty of similar growth plays have come before, like Starbucks (SBUX), P.F. Chang's Bistro (PFCB), Panera Bread Company (PNRA) and Cheesecake Factory (CAKE). We will use these companies as helpful proxies, while also considering how CMG growth and return fundamentals come into play.

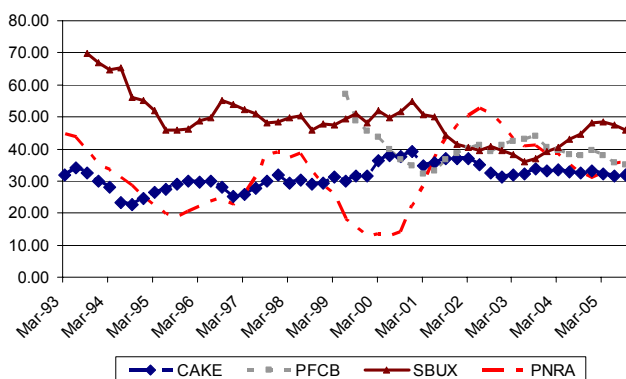
In short, while we are happy to assign a premium valuation to a concept with many years of growth potential, most valuation methodologies suggest only modest upside from current levels. We believe valuation is in the process of settling and the multiple may come down from levels seen over the past few months. We have therefore been somewhat conservative, particularly since CMG has yet to prove itself as a public company. So far so good, but it's still a riskier bet. Our target price of \$57 is in line with the current price. We therefore rate CMG a Hold.

Figure 103: Valuation methodology summary (\$)

Methodology	Multiple	Value
TEV/EBITDA	17x	60
P/E	41X	54
ROIC Spread vs. TEV/EBITDA	16x	58
DCF	NA	59
Final Target Price		57
Upside		2.7%
Total Return		2.7%

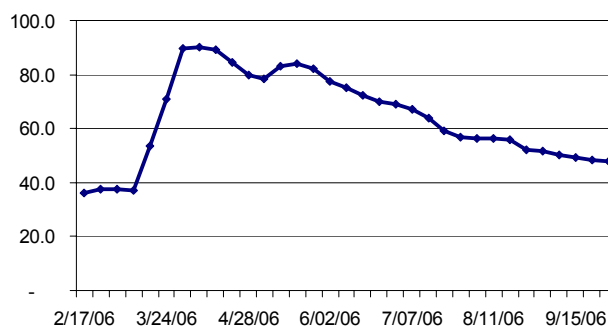
Source: Deutsche Bank, Factset, Reuters, Company Info

Figure 104: Peer group P/E ratios



Source: Deutsche Bank, Factset

Figure 105: CMG 3-day average forward P/E

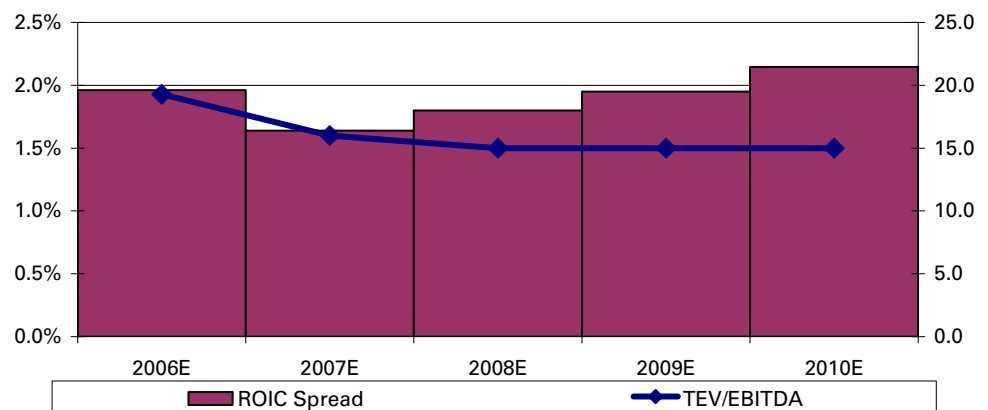


Source: Deutsche Bank, Factset

Most restaurant stocks with growth characteristics similar to CMG have traded at P/E ratios between 30x and 40x over the last 3 to 4 years. SBUX is still trading at a higher ratio, but it appears to be moderating. On average, when compared to sales growth rates over time, these stocks have traded around 1.5x sales growth. We believe this is reasonable given the strong growth characteristics of the concepts involved, and CMG certainly fits into that mold. If we apply a 1.75x multiple to CMG's sales growth forecast for 2007 of 25.5%, we come up with a P/E multiple of approximately 41x. 41x our 2007 EPS forecast of \$1.33 equates to \$54.

Compared to its peer group, 25-30% sales and profit growth is at the high end (PNRA just under 25%, SBUX just above 20%). We therefore view a top-end multiple just over 40x as reasonable, particularly given the somewhat slower consumer environment relative to the late 90s/early 2000s. Several stocks traded up toward 50x in the past, but the group seems to have established a range between 30x and 40x over the last few years.

Figure 106: TEV/EBITDA vs. ROIC spread



Source: Deutsche Bank

From an EBITDA standpoint, we would use PNRA and SBUX as good proxies, which trade at 17x and 18x, respectively. We believe PNRA — as another fast casual play with similar EBIT growth outlook of 20%+ — is the closest proxy, and therefore assign a 17x multiple to CMG shares, which offers the most optimistic share value at \$60.

On the other hand, the company's total ROIC spread to a market average cost of capital is fairly low, although new investments are coming in at a much higher return, which should push this measure up over time. If we assume TEV/EBITDA settles from the initial high teens/low 20s level to around 17x or \$60.

Figure 107: Discounted cash flow

	2002	2003	2004	2005	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	
EBIT*(1-t)			4	19	31	41	51	65	80	95	113	132	152	171	190	
D&A			22	28	36	44	53	64	74	86	102	116	127	143	159	
EBITDA	-	-	25	47	66	84	104	128	154	181	215	248	280	314	349	
Chgs in Oper. W/C			9	15	16	9	2	5	4	10	11	11	12	13	13	
Capex	-	-	96	83	92	100	105	110	110	106	106	101	101	101	95	
FCF	-	-	(61)	(21)	(10)	(7)	2	23	48	85	120	159	191	226	267	
% Growth																
Discount Rate																11.8%
PV of FCF, 2005-2015																\$473
PV of Terminal Value																\$1,278
Corporate Value																\$1,751
Less: Debt, net + Leases																(152.21)
Equity Value																\$1,903
Share Count (Millions)																32
Equity Value/Share																\$59

2006 Valuation	2004	2005	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E
Year				1	2	3	4	5	6	7	8	9	10
Factor				1.12	1.25	1.40	1.56	1.75	1.96	2.19	2.45	2.73	3.06
PV of FCF				(\$6)	\$1	\$17	\$31	\$49	\$61	\$73	\$78	\$83	\$87
Cumulative				(\$6)	(\$5)	\$12	\$42	\$91	\$152	\$225	\$303	\$386	\$473

Cost of Debt	7.5%
Rf	4.7%
Beta	1.31
Market risk premium	5.4%
Required Return on Equity	11.8%
Net Debt / Net Capital	0.0%
Tax Rate	40.0%
Required Return on Investment	11.8%
LT Growth Rate	5.0%
FCF Multiple	14.6

Source: Deutsche Bank

Our discounted cash flow model assumes a 10-year EPS CAGR of 20.1%, required return on equity of 11.8%, and a cost of debt of 7.5%. We have assumed a long-term growth rate of 5%, in line with comparable growth peers like CMG and SBUX and higher than the 2%-2.5% we've assigned to more traditional, mature QSR restaurant companies.

The author of this report wishes to acknowledge the contribution made by Zarvan Tatfi, an employee of Progeon, a third-party provider to Deutsche Bank of offshore research support services.

Figure 108: CMG Income Statement

	2004	1Q05	2Q05	3Q05	4Q05	2005	1Q06	2Q06	3Q06E	4Q06E	2006E	1Q07E	2Q07E	3Q07E	4Q07E	2007E
Restaurant sales	468.6	132.9	155.7	164.0	172.5	625.1	186.4	204.2	217.0	226.7	834.3	229.5	254.0	276.8	287.5	1,047.8
Franchise royalties & fees	2.1	0.5	0.6	0.7	0.8	2.6	0.6	0.7	0.8	0.9	3.0	0.7	0.8	0.9	1.0	3.3
Revenue	470.7	133.4	156.3	164.7	173.3	627.7	187.0	204.9	217.8	227.6	837.3	230.2	254.8	277.6	288.5	1,051.1
Food, beverage & packaging	154.1	43.1	50.4	53.4	55.4	202.3	59.2	63.3	70.1	72.4	265.1	72.7	78.5	89.1	91.5	331.8
Labor	139.5	39.7	43.5	46.5	49.0	178.7	52.9	56.9	61.2	64.4	235.5	65.4	71.1	78.0	81.6	296.1
Occupancy	36.2	10.5	11.8	12.1	13.1	47.6	13.9	14.3	15.9	17.1	61.2	16.8	17.8	20.0	21.3	76.0
Other operating costs	64.3	17.3	19.5	22.6	23.6	83.0	23.2	25.9	30.3	31.6	111.0	29.4	32.5	38.6	40.1	140.6
G&A	44.8	11.2	13.7	12.3	14.8	52.0	15.3	17.6	16.1	19.1	68.1	18.6	21.7	20.3	23.9	84.5
D&A	21.8	6.5	6.7	7.2	7.6	28.0	8.0	8.3	9.4	10.0	35.7	9.7	10.2	11.4	12.4	43.6
Pre-opening costs	2.2	0.5	0.4	0.4	0.7	2.0	1.1	1.5	1.5	1.8	6.0	1.3	1.6	1.8	2.2	6.9
Asset disposals	1.7	0.3	0.8	0.7	1.3	3.1	0.6	1.1	1.0	1.2	3.9	1.0	1.0	1.0	1.0	4.0
Special charges	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Operating income	6.1	4.4	9.3	9.5	7.7	31.0	12.7	15.9	12.3	10.0	50.8	15.3	20.4	17.4	14.4	67.5
Special charges	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Underlying operating income	6.1	4.4	9.3	9.5	7.7	31.0	12.7	15.9	12.3	10.0	50.8	15.3	20.4	17.4	14.4	67.5
Interest income	0.2	0.0	0.0	0.0	0.0	0.0	1.0	1.6	1.7	1.7	6.0	1.6	1.5	1.4	1.3	5.8
Interest expense	(0.2)	(0.1)	(0.3)	(0.2)	(0.1)	(0.8)	(0.1)	(0.1)	(0.1)	(0.1)	(0.3)	(0.1)	(0.1)	(0.1)	(0.1)	(0.4)
Net interest	0.0	(0.1)	(0.3)	(0.2)	(0.1)	(0.8)	0.9	1.6	1.6	1.6	5.7	1.5	1.4	1.3	1.2	5.4
Pre-tax income	6.1	4.4	9.0	9.3	7.6	30.2	13.6	17.4	13.9	11.6	56.6	16.8	21.8	18.7	15.6	72.9
Taxes	-	(1.8)	16.7	(4.2)	(3.4)	7.5	(5.7)	(6.6)	(5.6)	(4.6)	(22.5)	(6.7)	(8.7)	(7.5)	(6.2)	(29.2)
Net income	6.1	2.6	25.7	5.1	4.3	37.7	8.0	10.8	8.4	7.0	34.1	10.1	13.1	11.2	9.4	43.8
Special charges	-	-	(20.3)	-	-	(20.3)	-	-	-	-	-	-	-	-	-	-
Underlying net income	6.1	2.6	5.4	5.1	4.3	17.4	8.0	10.8	8.4	7.0	34.1	10.1	13.1	11.2	9.4	43.8
Shares outstanding - Basic	25.5	26.3	26.3	26.3	26.3	26.3	30.7	32.5	32.5	33.0	32.2	33.0	33.0	33.0	33.0	33.0
EPS - basic	0.24	0.10	0.98	0.19	0.16	1.43	0.26	0.33	0.26	0.21	1.06	0.30	0.40	0.34	0.28	1.33
Shares outstanding - Diluted	25.5	26.3	26.3	26.3	26.4	26.4	31.1	32.9	33.0	33.0	32.5	33.0	33.0	33.0	33.0	33.0
EPS - Diluted	0.24	0.10	0.98	0.19	0.16	1.43	0.26	0.33	0.25	0.21	1.05	0.30	0.40	0.34	0.28	1.33
Underlying EPS - Diluted	0.24	0.10	0.21	0.19	0.16	0.66	0.26	0.33	0.25	0.21	1.05	0.30	0.40	0.34	0.28	1.33

	2,004.0	1Q05	2Q05	3Q05	4Q05	2,005.0	1Q06	2Q06	3Q06E	4Q06E	2006E	1Q07E	2Q07E	3Q07E	4Q07E	2007E
Margin structure																
Food, beverage & packaging	32.7%	32.3%	32.2%	32.4%	32.0%	32.2%	31.7%	30.9%	32.2%	31.8%	31.7%	31.6%	30.8%	32.1%	31.7%	31.6%
Labor	29.6%	29.7%	27.9%	28.2%	28.3%	28.5%	28.3%	27.8%	28.1%	28.3%	28.1%	28.4%	27.9%	28.1%	28.3%	28.2%
Occupancy	7.7%	7.9%	7.6%	7.4%	7.6%	7.6%	7.4%	7.0%	7.3%	7.5%	7.3%	7.3%	7.0%	7.2%	7.4%	7.2%
Other operating costs	13.7%	13.0%	12.5%	13.7%	13.6%	13.2%	12.4%	12.6%	13.9%	13.9%	13.3%	12.8%	12.8%	13.9%	13.9%	13.4%
G&A	9.5%	8.4%	8.8%	7.5%	8.5%	8.3%	8.2%	8.6%	7.4%	8.4%	8.1%	8.1%	8.5%	7.3%	8.3%	8.0%
D&A	4.6%	4.8%	4.3%	4.4%	4.4%	4.5%	4.3%	4.1%	4.3%	4.4%	4.3%	4.2%	4.0%	4.1%	4.3%	4.2%
Pre-opening costs	0.5%	0.3%	0.3%	0.2%	0.4%	0.3%	0.6%	0.7%	0.7%	0.8%	0.7%	0.6%	0.6%	0.7%	0.8%	0.7%
EBITDA margin	5.9%	8.2%	10.3%	10.1%	8.9%	9.4%	11.1%	11.8%	9.9%	8.8%	10.3%	10.8%	12.0%	10.4%	9.3%	10.6%
Operating margin	1.3%	3.3%	6.0%	5.8%	4.5%	4.9%	6.8%	7.7%	5.6%	4.4%	6.1%	6.6%	8.0%	6.3%	5.0%	6.4%
Restaurant level operating margin	16.3%	17.1%	19.9%	18.2%	18.6%	18.5%	20.2%	21.7%	18.5%	18.5%	19.7%	19.9%	21.5%	18.7%	18.7%	19.7%
Tax rate	0.0%	40.1%	nm	45.1%	44.1%	nm	41.4%	38.1%	40.0%	40.0%	39.8%	40.0%	40.0%	40.0%	40.0%	40.0%
Net income margin	1.3%	2.0%	3.5%	3.1%	2.5%	2.8%	4.3%	5.3%	3.8%	3.1%	4.1%	4.4%	5.1%	4.0%	3.2%	4.2%

	2004	1Q05	2Q05	3Q05	4Q05	2005	1Q06	2Q06	3Q06E	4Q06E	2006E	1Q07E	2Q07E	3Q07E	4Q07E	2007E
Growth leverage																
Revenue	49.2%	31.6%	33.4%	32.2%	35.9%	33.3%	40.2%	31.1%	32.3%	31.3%	33.4%	23.1%	24.3%	27.5%	26.8%	25.5%
COGS	46.9%					31.2%	37.6%	25.7%	31.3%	30.6%	31.0%	22.8%	23.9%	27.1%	26.4%	25.2%
SG&A	44.3%					26.7%	33.6%	30.2%	33.0%	32.4%	32.2%	23.4%	24.3%	26.6%	26.1%	25.2%
Operating income						407.6%	186.8%	70.3%	29.3%	28.7%	64.0%	19.9%	28.7%	41.8%	44.8%	32.8%
Net income						184.0%	204.2%	98.9%	64.3%	63.1%	95.9%	26.0%	21.4%	34.5%	34.7%	28.4%
Diluted EPS						174.8%	157.6%	59.1%	31.2%	30.3%	59.0%	18.6%	21.0%	34.5%	34.7%	26.4%

	2004	1Q05	2Q05	3Q05	4Q05	2005	1Q06	2Q06	3Q06E	4Q06E	2006E	1Q07E	2Q07E	3Q07E	4Q07E	2007E
Cashflow Points																
Operating Income	6.1	4.4	9.3	9.5	7.7	31.0	12.7	15.9	12.3	10.0	50.8	15.3	20.4	17.4	14.4	67.5
D&A	21.8	6.5	6.7	7.2	7.6	28.0	8.0	8.3	9.4	10.0	35.7	9.7	10.2	11.4	12.4	43.6
EBITDA	27.9	10.9	16.1	16.7	15.4	59.0	20.7	24.2	21.7	20.0	86.5	24.9	30.6	28.8	26.8	111.2
Capex	95.6					83.1	14.2	22.8	25.0	30.0	92.0	15	25	30	30	100.0

Source: Deutsche Bank, Company Info

Figure 109: CMG Metrics

	2004	1Q05	2Q05	3Q05	4Q05	2005	1Q06	2Q06	3Q06E	4Q06E	2006E	1Q07E	2Q07E	3Q07E	4Q07E	2007E
Revenues																
Company operated	468.6	132.9	155.7	164.0	172.5	625.1	186.4	204.2	217.0	226.7	834.3	229.5	254.0	276.8	287.5	1047.8
Franchise royalties & fees	2.1	0.5	0.6	0.7	0.8	2.6	0.6	0.7	0.8	0.9	3.0	0.7	0.8	0.9	1.0	3.3
Total Revenues	470.7	133.4	156.3	164.7	173.3	627.7	187.0	204.9	217.8	227.6	837.3	230.2	254.8	277.6	288.5	1051.1
Revenue (% growth)																
Company operated	49%					33%	40%	31%	32%	31%	33%	23%	24%	28%	27%	26%
Franchise royalties & fees	43%					22%	21%	20%	10%	10%	14%	9%	10%	11%	11%	10%
Total Revenue	49%					33%	40%	31%	32%	31%	33%	23%	24%	27%	27%	26%
No. of Stores																
Company operated	401	419	436	453	481	481	496	510	538	571	571	574	592	628	666	666
Franchise operated	8	8	8	8	8	8	8	8	8	8	8	8	8	8	8	8
Total Cafes	409	427	444	461	489	489	504	518	546	579	579	582	600	636	674	674
Stores (% Total)																
Company operated	98%	98%	98%	98%	98%	98%	98%	98%	99%	99%	99%	99%	99%	99%	99%	99%
Franchise operated	2%	2%	2%	2%	2%	2%	2%	2%	1%	1%	1%	1%	1%	1%	1%	1%
Total Cafes	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
# growth in Stores																
Company operated	103	92	83	79	80	80	77	74	85	90	90	78	82	90	95	95
Franchise operated	1	1	1	1	0	0	0	0	0	0	0	0	0	0	0	0
Total Cafes	104	93	84	80	80	80	77	74	85	90	90	78	82	90	95	95
Store (% growth)																
Company operated	34.6%	28.1%	23.5%	21.1%	20.0%	20%	18%	17%	19%	19%	19%	16%	16%	17%	17%	17%
Franchise operated	14.3%	14.3%	14.3%	14.3%	0.0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Total Cafes	34.1%	27.8%	23.3%	21.0%	19.6%	20%	18%	17%	18%	18%	18%	15%	16%	16%	16%	16%
Same Store Sales																
Pricing Growth							2.8%	2.7%	2.6%	2.7%	2.7%	2.4%	2.3%	2.3%	2.2%	2.3%
Transaction Growth							16.9%	11.8%	11.0%	10.0%	12.4%	5.0%	6.0%	8.5%	8.0%	6.9%
Comparable Store Sales Growth	6.8%	4.1%	9.6%	11.5%	14.3%	5.8%	19.7%	14.5%	13.6%	12.7%	15.1%	7.4%	8.3%	10.8%	10.2%	9.2%
Royalties per franchise store (\$000)																
Growth	295	62	73	88	104	327	76	88	97	114	374	82	96	108	127	413
						10.8%	21.0%	19.9%	10.0%	10.0%	14.3%	9.0%	10.0%	11.0%	11.0%	10.4%

Source: Deutsche Bank, Company Info

Figure 110: CMG balance sheet

Balance sheet	2004	1Q05	2Q05	3Q05	4Q05	2005	1Q06	2Q06	3Q06E	4Q06E	2006E	1Q07E	2Q07E	3Q07E	4Q07E	2007E
Cash	-					0.1	133.5	142.0			152.2					164.0
Accounts receivable	2.5					1.9	2.8	2.0			3.3					5.3
Inventory	2.3					2.6	3.0	3.0			3.7					4.3
Prepaid expense	4.9					8.6	7.0	6.7			11.0					14.7
Other	0.7					4.6	1.0	1.3			1.5					2.0
Current assets	10.3					17.8	147.3	155.1			171.7					190.2
PP&E	289.9					340.7	345.8	359.6			397.0					453.4
Goodwill	26.2					17.7	17.7	17.7			17.7					17.7
Other	3.2					16.2	2.7	2.6			2.0					2.0
Total assets	329.7					392.5	513.6	535.1			588.5					663.3
Accounts payable	11.8					13.2	9.3	11.7			17.0					21.6
Accrued payroll	7.3					9.7	10.8	10.6			12.2					15.7
Accrued liabilities	9.4					15.7	14.7	14.2			21.8					27.3
Other	10.1					3.4	9.2	7.4			8.4					10.5
Current liabilities	38.7					42.0	44.0	43.9			59.4					75.1
Deferred rent	28.2					37.1	38.7	40.8			45.9					56.2
Debt	-					-	-	-			-					-
Other	0.2					4.1	23.0	20.7			20.7					20.7
Total liabilities	67.1					83.1	105.7	105.4			125.9					152.0
Common stock	0.3					0.3	0.3	0.3			0.3					0.3
Paid-in capital	384.4					375.7	464.4	466.6			466.6					466.6
Tax receivable	(46.0)					(28.2)	(26.4)	(17.6)			0.0					0.0
Accumulated other	(76.1)					(38.4)	(30.5)	(19.7)			(4.4)					44.4
Equity	262.6					309.4	407.9	429.7			462.6					511.3
Total Liabilities & Shareholders' Equity	329.7	-	-	-	-	392.5	513.6	535.1	-	-	588.5	-	-	-	-	663.3
Balance sheet ratios																
Receivables/sales	0.5%					0.3%					0.4%					0.5%
Turnover	189.0					324.7					250.0					200.0
Days	1.9					1.1					1.5					1.8
Inventory/COGS	1.5%					1.3%					1.4%					1.3%
Turnover	68.3					77.1					71.4					76.9
Days	5.3					4.7					5.1					4.7
Prepaid expense/opex	1.0%					1.5%					1.4%					1.5%
Current ratio	0.3					0.4					2.9					2.5
Asset turnover	1.4					1.6					1.4					1.6
Payables/COGS	7.7%					6.5%					6.4%					6.5%
Turnover	13.1					15.4					15.7					15.4
Days	27.8					23.8					23.3					23.7
Accrued payroll/labor	5.2%					5.4%					5.2%					5.3%
Accrued liabilities/sales	2.0%					2.5%					2.6%					2.6%
Other liabilities/sales	2.2%					0.5%					1.0%					1.0%
Deferred rent/occupancy	78.0%					77.9%					75.0%					74.0%
Net working capital						(24)					(40)					(49)
Change in working capital																
ROA	1.9%					4.4%					5.8%					6.6%
ROE	2.3%					5.6%					7.4%					8.6%
ROC	2.3%					5.6%					7.4%					8.6%
Cash/share											\$4.68					\$4.97

Source: Deutsche Bank, Company Info

Figure 111: CMG cash flows

	2002	2003	2004	2005	2006E	2007E
Operating Cash Flows						
Net income	(17)	(8)	6	38	34	44
Depreciation and amortization	11	15	22	28	36	44
Other	1	4	3	(3)	14	5
Net change in working capital	<u>11</u>	<u>10</u>	<u>9</u>	<u>15</u>	<u>16</u>	<u>9</u>
Net Operating Cash Flows	6	22	40	78	100	101
Capex	(49)	(86)	(96)	(83)	(92)	(100)
Dividends	-	-	-	-	-	-
FCF	(43)	(64)	(56)	(5)	8	1
Investing Cash Flows						
Acquisitions	-	-	-	-	-	-
Equity investments	-	-	-	-	-	-
Other	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>25</u>	<u>10</u>
Net Investing Cash Flows	-	-	-	-	25	10
Financing Cash Flows						
Debt issuances / (payments)	-	-	-	-	-	-
Share issuances / (repurchases)	55	38	65	-	91	-
Other	<u>(12)</u>	<u>26</u>	<u>(9)</u>	<u>6</u>	<u>28</u>	<u>-</u>
Net Financing Cash Flows	43	64	56	6	119	-
Net increase/ (decrease) in cash	-	-	-	0.7	152	12
Cash and equivalents beginning of year	-	-	-	-	0	152
Cash and equivalents end of year	-	-	-	0	152	164

Source: Deutsche Bank, Company Info

Figure 112: CMG EVA

CMG (\$mn)	2004	2005	2006E	2007E
Income for Common	6.1	37.7	34.1	43.8
Deferred tax				
Goodwill Amortization	-	(8.51)	-	-
Increase in LIFO reserve				
Advertising Expense	8.7	10.7	14.3	18.0
Special Charges/Gains				
Adjusted Income for Comi	14.8	39.9	48.4	61.8
Interest Expense	0.19	0.79	0.26	0.40
Interest on non-cap. Leases	31.9	40.9	52.5	65.2
Adjusted interest expense	32.0	41.7	52.7	65.6
Tax Benefit of Interest Expens	(19.2)	(25.0)	(31.6)	(39.3)
Tax Shield	12.8	16.7	21.1	26.2
NOPAT	27.7	56.6	69.5	88.0
Debt	-	-	-	-
PV of Capital Leases	410.8	445.3	577.3	716.9
Total Debt & Leases	410.8	445.3	577.3	716.9
Common Equity	262.6	309.4	462.6	511.3
Deferred Income Tax	-	-	-	-
Capitalized Advertising	-	-	-	-
LIFO Reserve	-	-	-	-
Accumulated Goodwill Amort	26.2	17.7	17.7	17.7
Restructuring Charge				
Equity Equivalents	26.24	17.74	17.74	17.74
Capital	699.6	772.4	1,057.6	1,246.0
ROIC	4.0%	7.3%	6.6%	7.1%
Required Rate of Return	11.0%	11.0%	11.0%	11.0%
Cost of Debt	5.7%	5.8%	6.2%	7.0%
Forward Relative P/E	406%	406%	406%	350%
% Debt	58.7%	57.7%	54.6%	57.5%
% Equity	41.3%	42.3%	45.4%	42.5%
Weighted Cost of Debt	3.4%	3.3%	3.4%	4.0%
Weighted Cost of Equity		1.1%	1.2%	1.3%
Market Adj. Cost of Capital		4.5%	4.6%	5.4%
ROIC		7.3%	6.6%	7.1%
MACC		4.5%	4.6%	5.4%
Spread		2.8%	2.0%	1.7%

Source: Deutsche Bank, Company Info

Appendix 1

Important Disclosures

Additional information available upon request

Disclosure checklist			
Company	Ticker	Recent price*	Disclosure
Chipotle Mexican Grill, Inc.	CMG.N	56.05 (USD) 16 Oct 06	2,6,8,14
McDonald's	MCD.N	42.12 (USD) 16 Oct 06	2,6,8,14
Panera Bread Co	PNRA.OQ	67.03 (USD) 16 Oct 06	2,6
Starbucks Corporation	SBUX.OQ	37.86 (USD) 17 Oct 06	2,6
YUM Brands, Inc.	YUM.N	57.90 (USD) 16 Oct 06	2,6,7

*Prices are sourced from local exchanges via Reuters, Bloomberg and other vendors. Data is sourced from Deutsche Bank and subject companies.

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Historical recommendations and target price: Chipotle Mexican Grill, Inc. (CMG.N)

(as of 17/10/06)



Previous Recommendations

- Strong Buy
- Buy
- Market Perform
- Underperform
- Not Rated
- Suspended Rating

Current Recommendations

- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

*New Recommendation Structure as of September 9, 2002

1. 10/16/2006: Hold, Target Price Change USD57.00

2.

Historical recommendations and target price: McDonald's (MCD.N)

(as of 17/10/06)



Previous Recommendations

- Strong Buy
- Buy
- Market Perform
- Underperform
- Not Rated
- Suspended Rating

Current Recommendations

- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

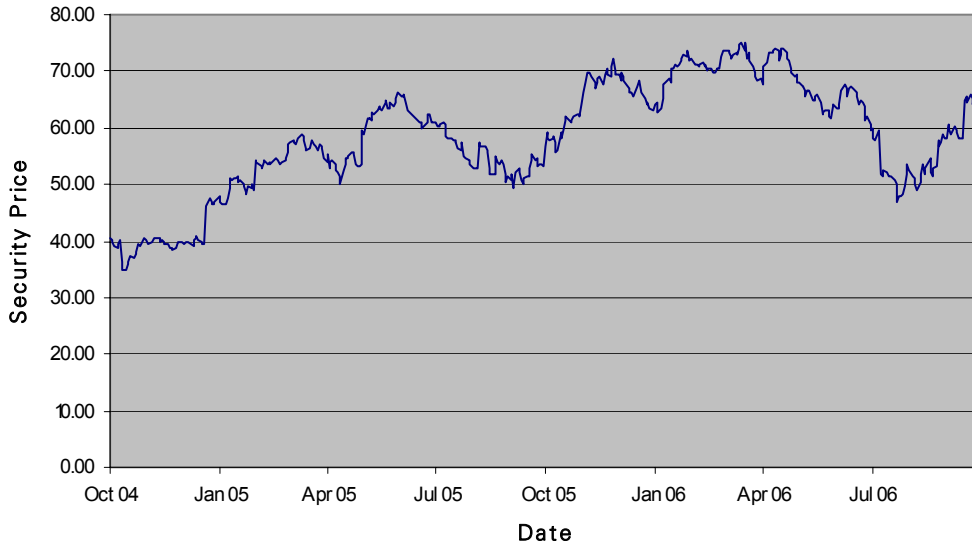
*New Recommendation Structure as of September 9, 2002

3. 10/16/2006: Hold, Target Price Change USD43.00

4.

Historical recommendations and target price: Panera Bread Co (PNRA.OQ)

(as of 17/10/06)



Previous Recommendations

- Strong Buy
- Buy
- Market Perform
- Underperform
- Not Rated
- Suspended Rating

Current Recommendations

- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

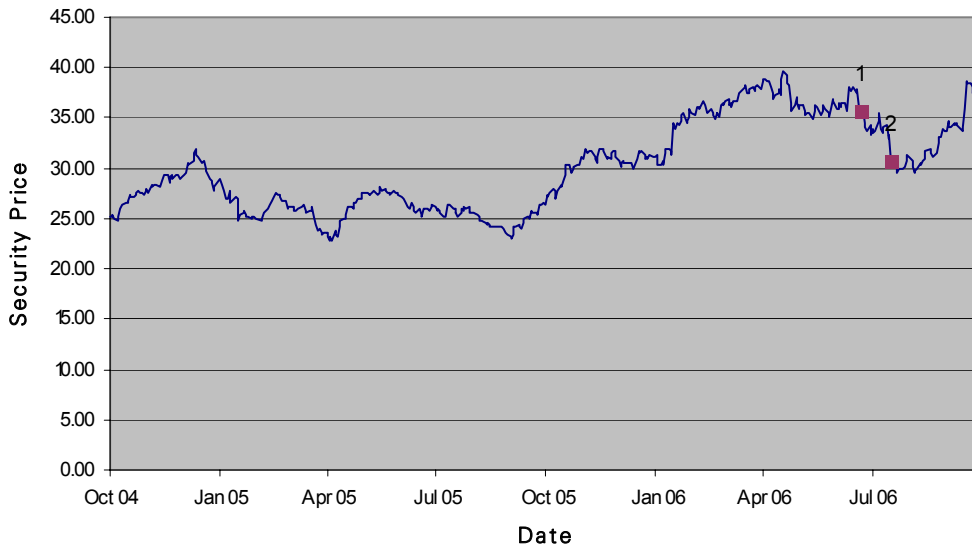
*New Recommendation Structure as of September 9, 2002

5. 10/16/2006: Buy, Target Price Change USD81.00

6.

Historical recommendations and target price: Starbucks Corporation (SBUX.OQ)

(as of 17/10/06)



Previous Recommendations

- Strong Buy
- Buy
- Market Perform
- Underperform
- Not Rated
- Suspended Rating

Current Recommendations

- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

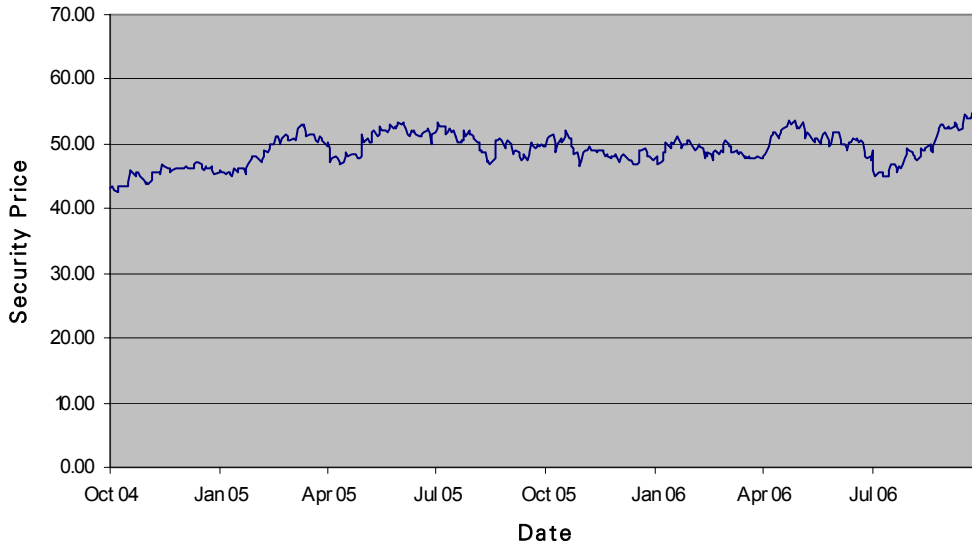
*New Recommendation Structure as of September 9, 2002

7. 7/10/2006: Hold, Target Price Change USD38.00

8. 8/3/2006: Hold, Target Price Change USD37.00

Historical recommendations and target price: YUM Brands, Inc. (YUM.N)

(as of 17/10/06)



Previous Recommendations

- Strong Buy
- Buy
- Market Perform
- Underperform
- Not Rated
- Suspended Rating

Current Recommendations

- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

*New Recommendation Structure as of September 9, 2002

1. 10/16/2006: Buy, Target Price Change USD66.00

2.

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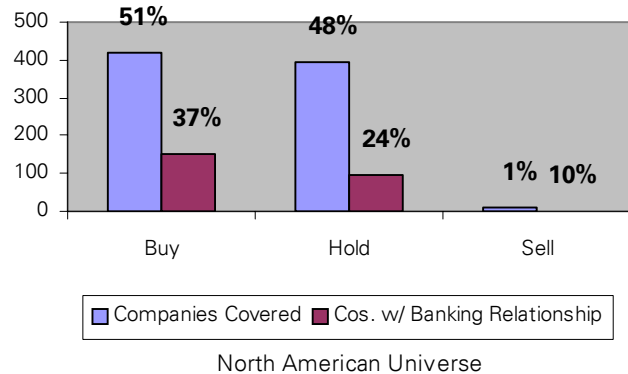
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