

Arcos Dorados (NYSE:ARCO)

General Meeting Buy Pitch

Consumer/Retail Group

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Business Overview



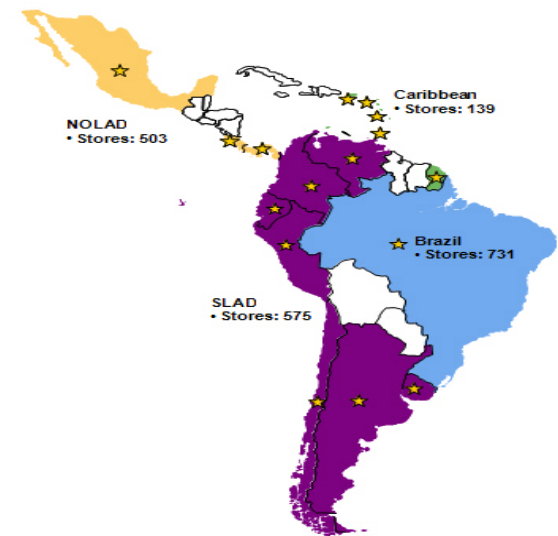
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Arcos Dorados

Business Overview

Arcos Dorados has exclusive rights to McDonalds in Latin America (“LATAM”)

- Signed a Master Franchising Agreement (“MFA”) in 2007 giving it exclusive rights to own, operate, and grant franchises of McDonalds Restaurants in 20 Latin America and Caribbean countries for 20 years
- Under MFA, Arcos Dorados is responsible for brand building in LATAM
 - Net of brand building adjustment, Arcos Dorados must pay royalty fee to McDonalds totalling 5% of USD gross sales
- Current portfolio of 1,948 restaurants
 - 74.6% Company-owned versus 25.4% franchised
 - 7.0% of all McDonalds restaurants worldwide
- In 2012, Company-owned restaurants contributed 95.7% of revenue



Investment Thesis

Arcos Dorados

Investment Thesis

Opportunity to buy in to McDonald's fastest growing segment at a discount



Arcos Dorados

Basic Metrics

Ticker	ARCO
Current Price	\$11.40
% of 52-Week High	73%
% of 52-Week Low	109%
Market Capitalization	\$2,475 M
Enterprise Value	\$3,804 M
LTM Revenue	\$3,997 M
LTM EBITDA	\$331.4 M

- High organic growth extremely undervalued due to temporary foreign exchange fluctuations and June 2013 Brazil Protests
 - Value investors do not care about short-term FX movements
- McDonald's aspirational brand provides a significant economic moat and margin of safety
 - Hugely popular with growing LATAM middle class
 - 3x larger than closest competitor
- Highly scalable business model will result in margin expansion
- CEO Woods Staton owns ~38% of equity after engineering spin-off in 2007 and IPO in 2011
 - 20+ years of experience as McDonalds executive in LATAM
 - Closely aligned interests

Internal Analysis

Arcos Dorados

Franchised Stores Revenue Streams

Recurring

- Rental Income
 - % of sales or flat rate
 - Increases as sales grow
 - Able to charge franchisors a higher rental cost than ARCO's lease expense
 - As of FY2012, ARCO owns land for 513/1,948 of their restaurants and owns the buildings for all but 12 stand-alone restaurants
- Royalty income
 - Collects spread between royalties collected from franchisors and royalties paid to McDonalds

One-Time

- Arcos Dorados collects 50% of the initial franchise fee
 - Not substantial

Arcos Dorados

Growth Opportunity

McDonald's is hugely popular with Latin America's growing middle class

- Excluding currency movements, organic revenues grew 14.2% in 2012 year-over-year
 - System-wide comparable sales rose 9.2% in 2012, fuelled by increased traffic, growth in average check size and change in product mix
- Potential for substantial margin improvements through scale
 - Increased bargaining power with suppliers and stabilizing G&A structure
- Largest QSR in LATAM, commanding a 10.4% market share
 - 3x closest competitor
- FY12 spent \$295 MM in opening new stores, reimagining and brand extensions.

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Growth Opportunity

Illustration of Growth Potential

**Current LATAM
penetration**

1,948
restaurants

US penetration

1 McDonalds / 22,285 people

LATAM population

~580 million

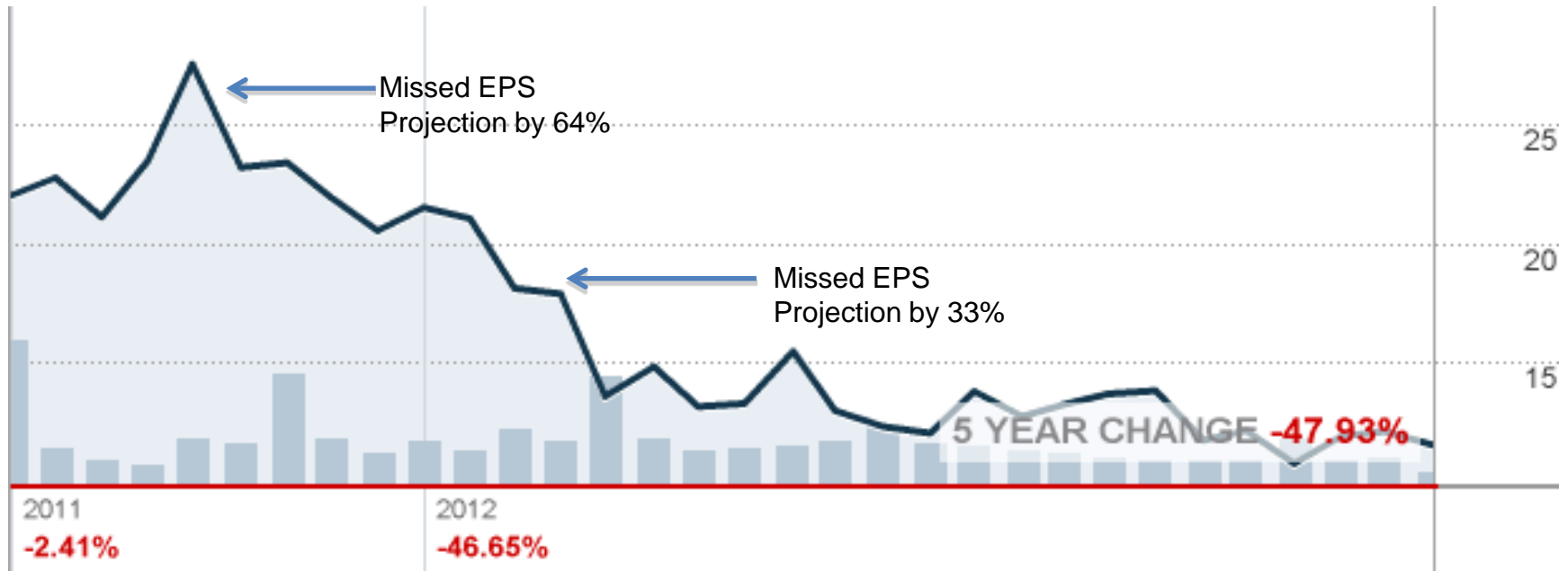
LATAM potential

26,000
restaurants

Arcos Dorados

Performance since IPO

ARCO is down (~47.93%) since IPO due to short-term FX fluctuations



- Went public in April 2011 at \$21.00/share after 4 years of private ownership
- Business fundamentals remain extremely strong
- Creates a pure play value investment opportunity
 - High organic growth mispriced due to short-term headwinds

Arcos Dorados

Recent Developments

Reported 3rd quarter 2013 financial results on November 5th

- Comparable sales grew 12.6% year-over-year
- Excluding FX fluctuations, EBITDA grew 25.8% year-over-year
 - Signs of achieving scale and improving margins

JPMorgan updated rating to a buy on October 29th

- Target price of \$14.00
 - Stock price jumped 5.0%+ on news

On October 7th, ARCO issued \$375 MM of senior unsecured notes due in 2023

- Allowing ARCO to prepay 2019 USD dominated notes
- Lower interest payments while fueling future store growth

Management announced commitment to the growth of McCafe's and product mix evolution to higher margin items

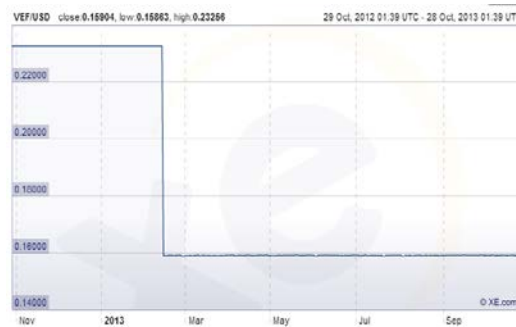
- Implementing local suppliers and products to match consumer preferences
- 340 McCafe's and continuing to expand

External Analysis

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Venezuela Currency Devaluation

Hugo Chavez Devalues Bolivar in February

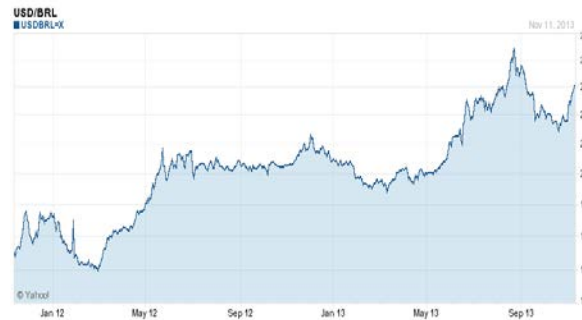


- In February of 2013, Hugo Chavez ordered the devaluation of the Bolivar in order to meet foreign debt payments and increase oil exports
- Hugo Chavez has now passed, with the new president vehemently stating that no future devaluation will occur
 - Devaluation was a one-time macroeconomic event which won't affect the long-term fundamentals and growth prospects of ARCO

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Brazil Protests

Currency Falls as Deficit Widens









- Protests occurred in Brazil through 2013 due to issues regarding the high costs of public services (transportation, health, etc.) and rising cost of living
- Brazilian Real fell due to concern over a widening deficit as government pledged 50 billion Reals to improve conditions
 - Will have a positive long-term effect on economic growth
- Upcoming Election in 2014 suspected to provide political stability
 - USD / BRL has improved since the height of the protests in the summer

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Industry Analysis

QSRs in LATAM

Company	Brand	Number of Stores	Key Notes
Arcos Dorados	 Arcos Dorados	1,948	LATAM Franchisee
Burger King		1,398	Aggressive store growth, weak sales
Subway		1,302	Actively recruiting franchisees
YUM Brands		930 KFC, 755 P.H.	Most restaurants operated by partners
Brazil Fast Food		983	YUM brands franchisee in Brazil
Habib's		300	Privately held

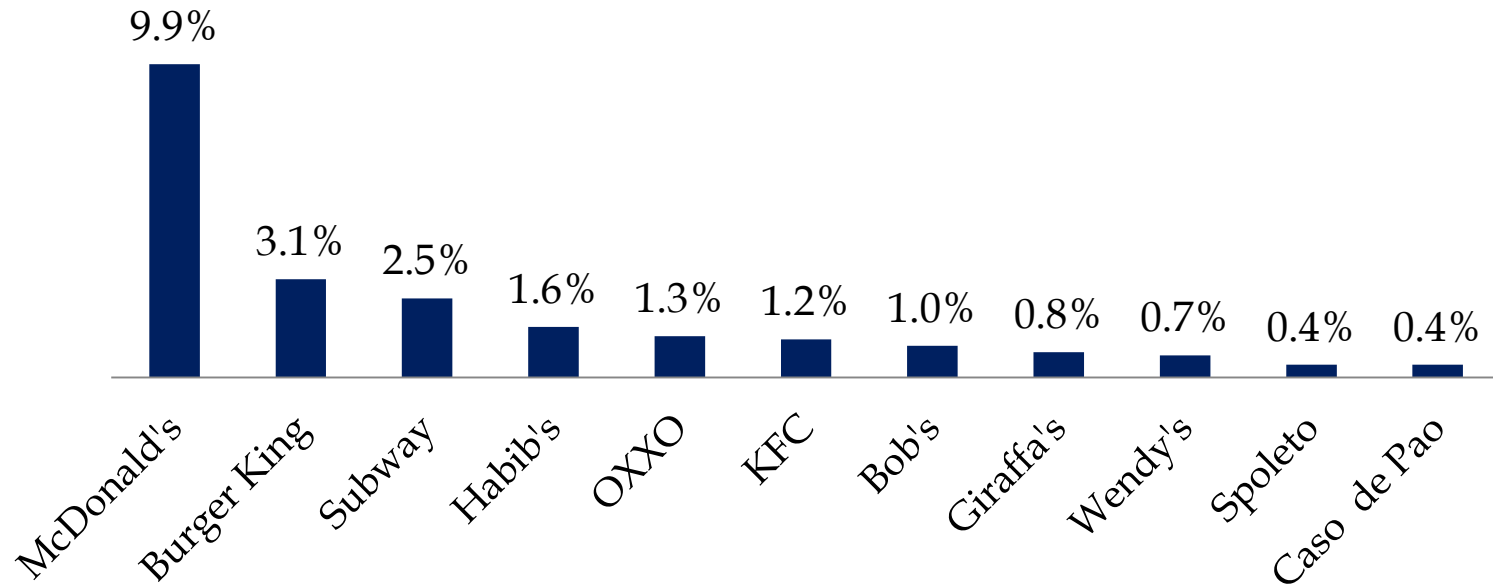
- QSRs aggressively growing footprint in LATAM to capitalize on the growing middle class and rise in disposable income

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Industry Analysis

McDonalds (Arcos Dorados) dominates LATAM QSR market

LATAM Market Share



- ARCO is monetizing investments in and store growth in LATAM at a much higher rate than peers

Valuation

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Comparables Analysis

Comparable Analysis

(All figures in \$ millions except per share amounts)

Company	Market Capitalization	Enterprise Value	Sales Growth	Average Store Sales	Same-Store Sales Growth	Price / LTM Earnings	EV / LTM EBITDA	EV / LTM EBITDAR
McDonald's Corporation	\$98,632	\$109,575	2.1%	\$0.8	3.3%	17.7x	10.6x	10.2x
Starbucks Corporation	\$63,560	\$62,685	13.7%	\$0.8	7.0%	39.8x	23.7x	20.1x
Yum! Brands	\$31,997	\$34,242	8.2%	\$0.3	5.0%	28.9x	14.2x	12.9x
Chipotle	\$16,946	\$16,638	20.3%	\$2.2	7.1%	54.8x	27.8x	23.8x
Burger King	\$7,683	\$9,963	(15.8%)	\$0.1	3.2%	35.7x	17.8x	15.7x
Average	\$43,764	\$46,621	5.7%	\$0.8	5.1%	35.4x	18.8x	16.5x
Arcos Dorados - Nominal	\$2,475	\$3,804	8.4%	\$2.1	9.2%	37.5x	11.5x	10.2x
Arcos Dorados - CC						23.2x	10.2x	9.5x

- Arcos is heavily undervalued on both a P/E and EV/EBITDA basis
- Excluding the impact of short-term foreign exchange fluctuations, Arcos should be trading more in line with high growth peers like Starbucks

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Discounted Cash Flow

Key Value Drivers

- New store openings
 - Increased penetration through unit growth with 745 store openings over 5 years
- Comparable sales growth
 - Higher average ticket size and increased traffic driving same store sales growth
 - Caribbean and SLAD (Argentina, Venezuela, etc.) fastest growing segments at 10% and 13% respectively
- EBITDA margin expansion
 - Increased average ticket sizes, economies of scale, and McCafe penetration into existing restaurants

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Discounted Cash Flow

Output

WACC Calculation	
Target Capital Structure	
Equity-to-Total Capitalization	83.7%
Debt-to-Total Capitalization	16.3%
Risk-free Rate	2.61%
Equity Risk Premium	6.70%
Mid-Cap Premium	2.00%
Adjusted Beta	1.7
Cost of Equity	16.00%
Cost of Debt	5.30%
WACC	14.25%

Enterprise Value	
Cumulative PV of FCF	\$390,979
Terminal Value	
Terminal Year EBITDA (2020E)	\$783,397
Terminal Multiple (EV/EBITDA)	8.50x
Terminal Value	\$6,658,874
Discount Factor	0.51
PV of Terminal Value	\$3,420,005
<i>% of Enterprise Value</i>	89.7%
Enterprise Value	\$3,810,985

Implied Equity Value and Share Price	
Enterprise Value	\$3,810,985
Less: Total Debt	652,170
Less: Preferred Securities	0
Less: Noncontrolling Interest	1,167
Plus: Cash and Cash Equivalent:	184,851
Implied Equity Value	\$3,342,499
Shares Outstanding	210,780
Implied Share Price	\$15.86
Implied Potential Upside	39.47%

- DCF analysis implies potential upside of 39.47% under conservative assumptions
 - Foreign exchange upside
 - Exit multiple lower than McDonald's current EV/EBITDA multiple of 10.6x

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Discounted Cash Flow

Sensitivity

Implied Price/ Share

Terminal Multiple

WACC	Terminal Multiple				
	7.50x	8.00x	8.50x	9.00x	9.50x
12.25%	\$ 15.38	\$ 16.42	\$ 17.46	\$ 18.51	\$ 19.55
13.75%	\$ 14.29	\$ 15.27	\$ 16.25	\$ 17.22	\$ 18.20
14.25%	\$ 13.95	\$ 14.91	\$ 15.86	\$ 16.82	\$ 17.77
14.75%	\$ 13.62	\$ 14.55	\$ 15.49	\$ 16.42	\$ 17.35
15.25%	\$ 13.29	\$ 14.21	\$ 15.12	\$ 16.03	\$ 16.95

- DCF analysis shows significant margin of safety and upside to current trading price

- With varying Terminal Value and WACC, there remains much upside

Implied Upside

Terminal Multiple

WACC	Terminal Multiple				
	7.50x	8.00x	8.50x	9.00x	9.50x
12.25%	35.2%	44.4%	53.6%	62.8%	71.9%
13.75%	25.7%	34.3%	42.9%	51.5%	60.1%
14.25%	22.7%	31.1%	39.5%	47.9%	56.3%
14.75%	19.8%	28.0%	36.2%	44.4%	52.6%
15.25%	16.9%	25.0%	33.0%	41.0%	49.1%

Catalysts and Risks

Arcos Dorados

Catalysts

- 2014 Brazil elections
- 2014 Brazil world cup
 - Bringing attention to Brazil and equities with Brazil exposure
- One-time events driving up LATAM currency or devaluing the US dollar
 - End of QE

Risks

- Foreign exchange fluctuations (short-term) or temporary structural FX issue (i.e. JPY vs USD post-earthquake)
- Supply chain problems
- Unrest in Brazil and Venezuela
- Death of CEO Woods Staton

Recommendation:

Buy shares @ \$11.40

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