CtW Investment Group

Akira Kawamura
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Dear Mr Kawamura:

We are writing to you as the sole truly independent external director of McDonald's Holding Company (Japan) ("McDonald's Japan".)

In light of both McDonald's Japan's deteriorating performance and the upcoming implementation of amendments to Japan's Corporate Law that establish new standards for corporate governance and board independence, we urge you and your fellow directors to go beyond the recent appointment of two new directors and a new external auditor, and genuinely embrace board independence and accountability. Because these new appointees are all officers of either the company or McDonald's Corporation, the controlling shareholder of McDonald's Japan, we do not believe that they qualify as "outside" directors under the terms of the 2014 amendments to the Corporate Law.

Indeed, the failure to either explain the board's rationale for replacing the departing directors and auditor, or to appoint genuine outsiders to these positions suggests that McDonald's Japan does not recognize the growing gap between investor expectations for accountable governance and the company's actual policies. The severe deterioration in the company's performance over the past five years, and especially since the July 2014 food safety scandal, makes it imperative for this board to quickly announce credible plans to replace incumbent inside directors with qualified, independent, outsiders. In particular, the board should quickly announce the creation of a new committee comprised of at least a majority of independent directors to oversee supply chain operations and compliance with public and corporate food safety standards.

The CtW Investment Group works with pension funds in order to enhance long-term shareholder value through active ownership. These funds invest over $250 billion in the global capital markets and are investors in McDonald's Japan.

McDonald's Japan has underperformed its peers across multiple metrics for many years. From 2010 to 2014, the company has earned a return on equity of only 2.15%, compared to over 12% for the restaurant industry. Unsurprisingly, these low returns have resulted in the company's shares underperforming the Nikkei 225 index by 35% over the past five years, and by more than 60% over the past three years. Since the disclosure of the company's food safety issues in July 2014, the return on equity has fallen further, to -13.7%, while revenue fell nearly 15% compared to 2013 and the company experienced its first annual loss since 2001.

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Worse still, the company's efforts to put the scandal behind it do not appear to have been effective, as a second round of food safety issues came to light early in 2015. Consequently, costumer dissatisfaction with McDonald's Japan has accelerated while the company dithers: same store sales have been at least 10% below the previous year each month since July 2014, and as of January 2015 same store sales had fallen by nearly 40%. We believe that the lack of outside, independent, and accountable directors on the board is at the root of the company's problems, and that a turnaround strategy will only be credible with customers if it includes significant structural changes to the board.

Recent Board Changes are Inadequate.

Instead, McDonald's Japan has responded to its mounting challenges by returning to past practices and appointing new directors exclusively from its own ranks of officers and from those of its controlling shareholder, McDonald's Corporation. We are not surprised that the February 20, 2015 resignations of Chairman Eiko Harada, Sr. VP Takehiko Aoki, and external Auditor Kevin M. Ozan have failed to stem the tide of bad news. These recent developments frustrate shareholders in three respects:

First, and very much against the spirit of the governance-focused amendments to Japan's Corporate Law, the company failed to explain clearly to shareholders why these directors (including the external auditor) were resigning, nor did it explain its rationale in appointing in their stead two more company officers (Atsuo Shimodaira and Kenji Miyashita), and two officers of McDonald's Corporation (director Robert D. Larson and external auditor Michael J. Eraci). One of the central features of Japan's new corporate governance standards is the expectation that board's will communicate its reasoning on issues such as board independence and outside directors, particularly when the board's decisions do not conform to the new standards.

Second, the Corporate Law amendments change the standard by which a director or external auditor is considered an outsider, specifically stating that officers of parent or affiliate companies do not qualify as outsiders. Given the close relationship between McDonald's Japan and the McDonald's corporation, we believe that none of the McDonald's Corporation officers, including proposed external auditor Mr. Eraci, qualify as outsiders under this new standard. It seems especially troubling that a company experiencing an ongoing and even worsening compliance scandal would appoint a new "external" auditor who does not qualify as "external" under the new law.

Third, the company seems intent on missing the opportunity to address long-standing criticisms from corporate governance experts such as Institutional Shareholder Services (ISS), which maintains that controlled companies should have at least two independent directors on its board. Since McDonald's Corporation holds a virtual majority of the company's shares, ISS considers McDonald's Japan a controlled company, and therefore appears likely to recommend that shareholders oppose the re-election of director and CEO Sarah L. Casanova. By acting quickly to appoint an additional, genuinely independent outsider to the board, the company can avoid this further embarrassment.

Conclusion

McDonald's Japan's shareholders have endured considerable pain over the past five years. While the board's failure to ensure that its supply chain met adequate food -safety standards has had a devastating effect on revenue and profits, the company's sales and earnings had already been declining for at least a year before the food-safety scandal hit. This long-term deterioration in both operating performance, as well as in the relative performance of the share price, clearly indicates that the company's problems go beyond the recent scandal. Nevertheless, the board has so far opted to stick with its established practice of elevating company and controlling-shareholder officers to its board, despite the new Corporate Law governance standards that will become legally effective shortly after this year's annual meeting. We urge the board to demonstrate its commitment to improved governance by creating a new committee charged with overseeing supply chain operations comprised of independent, outside directors.

We look forward to your reply.

Sincerely,

Dieter Waizenegger
Executive Director, CtW Investment Group