

MCDONALDS CORP
Form 10-Q
August 05, 2010
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2010

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission File Number 1-5231

McDONALD S CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

| | |
|---|--|
| Delaware (State or Other Jurisdiction of Incorporation or Organization) | 36-2361282 (I.R.S. Employer Identification No.) |
| One McDonald s Plaza Oak Brook, Illinois (Address of Principal Executive Offices) | 60523 (Zip Code) |
| (630) 623-3000 | |

(Registrant s Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject

Edgar Filing: MCDONALDS CORP - Form 10-Q

to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer

Non-accelerated filer (do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

1,064,338,416

(Number of shares of common stock

outstanding as of June 30, 2010)

Table of Contents

McDONALD S CORPORATION

INDEX

| | Page Reference |
|---|----------------|
| Part I. Financial Information | |
| Item 1 <u>Financial Statements</u> | |
| <u>Condensed consolidated balance sheet, June 30, 2010 (unaudited) and December 31, 2009</u> | 3 |
| <u>Condensed consolidated statement of income (unaudited), quarters and six months ended June 30, 2010 and 2009</u> | 4 |
| <u>Condensed consolidated statement of cash flows (unaudited), quarters and six months ended June 30, 2010 and 2009</u> | 5 |
| <u>Notes to condensed consolidated financial statements (unaudited)</u> | 6 |
| Item 2 <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 12 |
| Item 3 <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 28 |
| Item 4 <u>Controls and Procedures</u> | 28 |
| Part II. Other Information | |
| Item 1 <u>Legal Proceedings</u> | 29 |
| Item 1A <u>Risk Factors</u> | 29 |
| Item 2 <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 29 |
| Item 6 <u>Exhibits</u> | 30 |
| <u>Signature</u> | 33 |

All trademarks used herein are the property of their respective owners and are used with permission.

Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****CONDENSED CONSOLIDATED BALANCE SHEET**

| | (unaudited) | |
|---|--------------------|--------------------|
| | June 30, | December 31, |
| | 2010 | 2009 |
| In millions, except per share data | | |
| Assets | | |
| Current assets | | |
| Cash and equivalents | \$ 1,665.5 | \$ 1,796.0 |
| Accounts and notes receivable | 964.1 | 1,060.4 |
| Inventories, at cost, not in excess of market | 94.4 | 106.2 |
| Prepaid expenses and other current assets | 442.5 | 453.7 |
| Total current assets | 3,166.5 | 3,416.3 |
| Other assets | | |
| Investments in and advances to affiliates | 1,212.5 | 1,212.7 |
| Goodwill | 2,413.9 | 2,425.2 |
| Miscellaneous | 1,589.5 | 1,639.2 |
| Total other assets | 5,215.9 | 5,277.1 |
| Property and equipment | | |
| Property and equipment, at cost | 31,897.2 | 33,440.5 |
| Accumulated depreciation and amortization | (11,604.2) | (11,909.0) |
| Net property and equipment | 20,293.0 | 21,531.5 |
| Total assets | \$ 28,675.4 | \$ 30,224.9 |
| Liabilities and shareholders' equity | | |
| Current liabilities | | |
| Accounts payable | \$ 578.0 | \$ 636.0 |
| Income taxes | 27.0 | 202.4 |
| Other taxes | 246.2 | 277.4 |
| Accrued interest | 150.5 | 195.8 |
| Accrued payroll and other liabilities | 1,246.2 | 1,659.0 |
| Current maturities of long-term debt | 334.9 | 18.1 |
| Total current liabilities | 2,582.8 | 2,988.7 |
| Long-term debt | 10,291.3 | 10,560.3 |
| Other long-term liabilities | 1,424.8 | 1,363.1 |
| Deferred income taxes | 1,244.7 | 1,278.9 |
| Shareholders' equity | | |
| Preferred stock, no par value; authorized 165.0 million shares; issued none | | |
| Common stock, \$.01 par value; authorized 3.5 billion shares; issued 1,660.6 million shares | 16.6 | 16.6 |
| Additional paid-in capital | 5,028.7 | 4,853.9 |
| Retained earnings | 32,406.7 | 31,270.8 |
| Accumulated other comprehensive income (loss) | (278.9) | 747.4 |
| Common stock in treasury, at cost; 596.3 and 583.9 million shares | (24,041.3) | (22,854.8) |

Edgar Filing: MCDONALDS CORP - Form 10-Q

| | | |
|---|--------------------|-------------|
| Total shareholders' equity | 13,131.8 | 14,033.9 |
| Total liabilities and shareholders' equity | \$ 28,675.4 | \$ 30,224.9 |

See Notes to condensed consolidated financial statements.

Table of Contents**CONDENSED CONSOLIDATED STATEMENT OF INCOME (UNAUDITED)**

| In millions, except per share data | Quarters Ended | | Six Months Ended | |
|--|-------------------|-------------------|-------------------|-------------------|
| | June 30, | | June 30, | |
| | 2010 | 2009 | 2010 | 2009 |
| Revenues | | | | |
| Sales by Company-operated restaurants | \$ 4,013.4 | \$ 3,850.2 | \$ 7,816.5 | \$ 7,334.9 |
| Revenues from franchised restaurants | 1,932.1 | 1,797.0 | 3,739.1 | 3,389.7 |
| Total revenues | 5,945.5 | 5,647.2 | 11,555.6 | 10,724.6 |
| Operating costs and expenses | | | | |
| Company-operated restaurant expenses | 3,214.8 | 3,159.3 | 6,325.7 | 6,079.8 |
| Franchised restaurants occupancy expenses | 334.3 | 318.0 | 673.6 | 614.7 |
| Selling, general & administrative expenses | 564.9 | 531.5 | 1,111.2 | 1,028.8 |
| Impairment and other charges (credits), net | 6.8 | 1.2 | 37.6 | 2.4 |
| Other operating (income) expense, net | (20.6) | (44.3) | (111.9) | (83.0) |
| Total operating costs and expenses | 4,100.2 | 3,965.7 | 8,036.2 | 7,642.7 |
| Operating income | 1,845.3 | 1,681.5 | 3,519.4 | 3,081.9 |
| Interest expense | 108.1 | 119.3 | 219.1 | 240.2 |
| Nonoperating (income) expense, net | 1.9 | (12.0) | 8.1 | (28.4) |
| Gain on sale of investment | | (17.8) | | (94.3) |
| Income before provision for income taxes | 1,735.3 | 1,592.0 | 3,292.2 | 2,964.4 |
| Provision for income taxes | 509.5 | 498.3 | 976.6 | 891.2 |
| Net income | \$ 1,225.8 | \$ 1,093.7 | \$ 2,315.6 | \$ 2,073.2 |
| Earnings per common share basic: | \$ 1.14 | \$ 1.00 | \$ 2.16 | \$ 1.88 |
| Earnings per common share diluted: | \$ 1.13 | \$ 0.98 | \$ 2.13 | \$ 1.85 |
| Dividends declared per common share | \$ 0.55 | \$ 0.50 | \$ 1.10 | \$ 1.00 |
| Weighted-average shares outstanding basic | 1,072.1 | 1,097.3 | 1,074.1 | 1,103.4 |
| Weighted-average shares outstanding diluted | 1,085.9 | 1,111.4 | 1,088.1 | 1,118.2 |

See Notes to condensed consolidated financial statements.

Table of Contents**CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS (UNAUDITED)**

| In millions | Quarters Ended | | Six Months Ended | |
|---|--------------------------|-------------------|--------------------------|-------------------|
| | June 30, 2010 | 2009 | June 30, 2010 | 2009 |
| Operating activities | | | | |
| Net income | \$ 1,225.8 | \$ 1,093.7 | \$ 2,315.6 | \$ 2,073.2 |
| Adjustments to reconcile to cash provided by operations | | | | |
| Charges and credits: | | | | |
| Depreciation and amortization | 311.5 | 304.4 | 629.4 | 586.6 |
| Deferred income taxes | (0.3) | 38.8 | (6.6) | 89.1 |
| Gain on sale of investment | | (17.8) | | (94.3) |
| Share-based compensation | 18.8 | 29.6 | 44.7 | 60.0 |
| Impairment and other charges (credits), net | 6.8 | 1.2 | 37.6 | 2.4 |
| Other | 56.2 | (9.2) | 92.4 | 70.6 |
| Changes in working capital items | (370.1) | (20.6) | (441.7) | (236.8) |
| Cash provided by operations | 1,248.7 | 1,420.1 | 2,671.4 | 2,550.8 |
| Investing activities | | | | |
| Property and equipment expenditures | (394.5) | (434.4) | (796.3) | (848.1) |
| Purchases and sales of restaurant businesses and property sales | 35.9 | 24.2 | 70.7 | 78.3 |
| Proceeds on sale of investment, net | | 125.3 | | 135.1 |
| Other | (32.1) | (18.0) | (55.5) | (36.8) |
| Cash used for investing activities | (390.7) | (302.9) | (781.1) | (671.5) |
| Financing activities | | | | |
| Notes payable and long-term financing issuances and repayments, net | 224.0 | 276.9 | 273.2 | 744.0 |
| Treasury stock purchases | (881.2) | (792.5) | (1,358.4) | (1,605.0) |
| Common stock dividends | (589.1) | (547.8) | (1,181.1) | (1,101.2) |
| Proceeds from stock option exercises | 95.2 | 79.6 | 255.9 | 117.1 |
| Excess tax benefit on share-based compensation | 22.8 | 12.4 | 63.7 | 27.9 |
| Other | 6.0 | (34.5) | 16.0 | (8.4) |
| Cash used for financing activities | (1,122.3) | (1,005.9) | (1,930.7) | (1,825.6) |
| Effect of exchange rates on cash and cash equivalents | (77.5) | 70.6) | (90.1) | 43.5) |
| Cash and equivalents increase (decrease) | (341.8) | 181.9 | (130.5) | 97.2 |
| Cash and equivalents at beginning of period | 2,007.3 | 1,978.7 | 1,796.0 | 2,063.4 |
| Cash and equivalents at end of period | \$ 1,665.5 | \$ 2,160.6 | \$ 1,665.5 | \$ 2,160.6 |

See Notes to condensed consolidated financial statements.

Table of Contents**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****Basis of Presentation**

The accompanying condensed consolidated financial statements should be read in conjunction with the consolidated financial statements contained in the Company's December 31, 2009 Annual Report on Form 10-K. In the opinion of management, all adjustments (consisting of normal recurring accruals) necessary for a fair presentation have been included. The results for the quarter and six months ended June 30, 2010 do not necessarily indicate the results that may be expected for the full year.

The results of operations of McDonald's restaurant businesses purchased and sold were not material, on either an individual or aggregate basis, to the condensed consolidated financial statements for periods prior to purchase and sale.

Restaurant Information

The following table presents restaurant information by ownership type:

| Restaurants at June 30, | 2010 | 2009 |
|--------------------------------|---------------|-------------|
| Conventional franchised | 19,059 | 18,645 |
| Developmental licensed | 3,327 | 3,084 |
| Affiliated | 3,823 | 4,072 |
| Total Franchised | 26,209 | 25,801 |
| Company-operated | 6,257 | 6,357 |
| Systemwide restaurants | 32,466 | 32,158 |
| Comprehensive Income | | |

The following table presents the components of comprehensive income for the quarters and six months ended June 30, 2010 and 2009:

| In millions | Quarters Ended | | Six Months Ended | |
|--|-----------------------|-------------|-------------------------|-------------|
| | June 30, | | June 30, | |
| | 2010 | 2009 | 2010 | 2009 |
| Net income | \$ 1,225.8 | \$ 1,093.7 | \$ 2,315.6 | \$ 2,073.2 |
| Other comprehensive income (loss): | | | | |
| Foreign currency translation adjustments | (806.1) | 715.6 | (1,048.9) | 317.2 |
| Deferred hedging adjustments | 14.3 | (17.5) | 21.8 | (24.3) |
| Pension liability adjustment | | 0.7 | 0.8 | 1.0 |
| Total other comprehensive income (loss) | (791.8) | 698.8 | (1,026.3) | 293.9 |
| Total comprehensive income | \$ 434.0 | \$ 1,792.5 | \$ 1,289.3 | \$ 2,367.1 |
| Per Common Share Information | | | | |

Diluted earnings per common share is calculated using net income divided by diluted weighted-average shares. Diluted weighted-average shares include weighted-average shares outstanding plus the dilutive effect of share-based compensation calculated using the treasury stock method, of 13.8 million shares and 14.1 million shares for the second quarter 2010 and 2009, respectively, and 14.0 million shares and 14.8 million shares for the six months ended June 30, 2010 and 2009, respectively. Stock options that were not included in diluted weighted-average shares because they would have been antidilutive were 10.2 million shares and 10.3 million shares for the second quarter and six months ended June 30, 2009, respectively.

Table of Contents**Fair Value Measurements**

The Company measures certain financial assets and liabilities at fair value on a recurring basis, and certain non-financial assets and liabilities on a nonrecurring basis. The guidance provided by the Financial Accounting Standards Board (FASB) in the Fair Value Measurements and Disclosures Topic of the FASB Accounting Standards Codification (ASC) defines fair value as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market in an orderly transaction between market participants on the measurement date. The guidance also establishes a three-level hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability on the measurement date. The three levels are defined as follows:

Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for an identical asset or liability in an active market.

Level 2 inputs to the valuation methodology include quoted prices for a similar asset or liability in an active market or model-derived valuations in which all significant inputs are observable for substantially the full term of the asset or liability.

Level 3 inputs to the valuation methodology are unobservable and significant to the fair value measurement of the asset or liability. Certain of the Company's derivatives are valued using various pricing models or discounted cash flow analyses that incorporate observable market parameters, such as interest rate yield curves, option volatilities and currency rates, classified as Level 2 within the valuation hierarchy. Derivative valuations incorporate credit risk adjustments that are necessary to reflect the probability of default by the counterparty or the Company.

Certain Financial Assets and Liabilities Measured at Fair Value

The following table presents financial assets and liabilities measured at fair value on a recurring basis as of June 30, 2010 by the valuation hierarchy as defined in the fair value guidance:

| | | | | Carrying |
|--|-----------------|-----------------|---------|-----------------|
| In millions | Level 1 | Level 2 | Level 3 | Value |
| Cash equivalents | \$ 278.3 | | | \$ 278.3 |
| Investments | 114.5* | | | 114.5 |
| Derivative receivables | 84.0* | \$ 147.4 | | 231.4 |
| Total assets at fair value | \$ 476.8 | \$ 147.4 | | \$ 624.2 |
| Derivative payables | | \$ (8.1) | | \$ (8.1) |
| Total liabilities at fair value | | \$ (8.1) | | \$ (8.1) |

* Includes long-term investments and derivatives that hedge market driven changes in liabilities associated with the Company's supplemental benefit plans.

Certain Financial Assets and Liabilities not Measured at Fair Value

At June 30, 2010, the fair value of the Company's debt obligations was estimated at \$11.9 billion, compared to a carrying amount of \$10.6 billion. This fair value was estimated using various pricing models or discounted cash flow analyses that incorporated quoted market prices, and

Edgar Filing: MCDONALDS CORP - Form 10-Q

is similar to Level 2 within the valuation hierarchy. The Company has no current plans to retire a significant amount of its debt prior to maturity. The carrying amount for both cash and equivalents and notes receivable approximate fair value.

Non-Financial Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

Certain assets and liabilities are measured at fair value on a nonrecurring basis; that is, the assets and liabilities are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (e.g., when there is evidence of impairment). At June 30, 2010, no material fair value adjustments or fair value measurements were required for non-financial assets or liabilities.

Financial Instruments and Hedging Activities

The FASB guidance on disclosures in the Derivatives and Hedging Topic of the FASB ASC requires qualitative and quantitative information on how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for, and how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows.

Table of Contents

The Company is exposed to global market risks, including the effect of changes in interest rates and foreign currency fluctuations. The Company uses foreign currency denominated debt and derivative instruments to mitigate the impact of these changes. The Company does not use derivatives with a level of complexity or with a risk higher than the exposures to be hedged and does not hold or issue derivatives for trading purposes.

The Company documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking hedging transactions. The Company's derivatives that are designated as hedging instruments consist mainly of interest rate exchange agreements, forward foreign currency exchange agreements and foreign currency options. Interest rate exchange agreements are entered into to manage the interest rate risk associated with the Company's fixed and floating-rate borrowings. Forward foreign currency exchange agreements and foreign currency options are entered into to mitigate the risk that forecasted foreign currency cash flows (such as royalties denominated in foreign currencies) will be adversely affected by changes in foreign currency exchange rates. Certain foreign currency denominated debt is used, in part, to protect the value of the Company's investments in certain foreign subsidiaries and affiliates from changes in foreign currency exchange rates.

The Company also enters into certain derivatives that are not designated as hedging instruments. The Company has entered into derivative contracts to hedge market-driven changes in certain of its supplemental benefit plan liabilities. Changes in the fair value of these derivatives are recorded in selling, general & administrative expenses together with the changes in the supplemental benefit plan liabilities. In addition, the Company uses forward foreign currency exchange agreements and foreign currency exchange agreements to mitigate the change in fair value of certain foreign currency denominated assets and liabilities. Since these derivatives are not designated as hedging instruments, the changes in the fair value of these hedges are recognized immediately in nonoperating (income) expense together with the translation gain or loss from the hedged balance sheet position. A portion of the Company's foreign currency options (more fully described in the Cash Flow Hedging Strategy section) are undesignated as hedging instruments as the underlying foreign currency royalties are earned.

All derivative instruments designated as hedging instruments are classified as fair value, cash flow or net investment hedges. All derivatives (including those not designated as hedging instruments) are recognized on the Consolidated balance sheet at fair value and classified based on the instruments' maturity date. Changes in the fair value measurements of the derivative instruments are reflected as adjustments to other comprehensive income (OCI) and/or current earnings.

The following table presents the fair values of derivative instruments included on the Consolidated balance sheet:

| In millions | Asset Derivatives | | | Liability Derivatives | | |
|---|---|------------------|----------------------|---------------------------------------|------------------|----------------------|
| | Balance Sheet | | | Balance Sheet | | |
| | Classification | June 30, 2010 | December 31, 2009 | Classification | June 30, 2010 | December 31, 2009 |
| Derivatives designated as hedging instruments | | | | | | |
| Foreign currency options | Prepaid expenses and other current assets | \$ 33.7 | \$ 13.2 | Accrued payroll and other liabilities | \$ (1.1) | |
| Interest rate exchange agreements | Prepaid expenses and other current assets | 0.5 | 1.4 | Accrued payroll and other liabilities | (0.8) | |
| Forward foreign currency exchange agreements | Prepaid expenses and other current assets | 3.7 | 0.3 | Accrued payroll and other liabilities | (1.9) | (0.1) |
| Foreign currency options | Miscellaneous other assets | 4.1 | 5.4 | Other long-term liabilities | | |
| Interest rate exchange agreements | Miscellaneous other assets | 80.6 | 67.3 | Other long-term liabilities | | (3.4) |
| Total derivatives designated as hedging instruments | | \$ 122.6 | \$ 87.6 | | \$ (3.8) | \$ (3.5) |

Edgar Filing: MCDONALDS CORP - Form 10-Q

Derivatives not designated as hedging instruments

| | | | | | | |
|---|---|----------|----------|---------------------------------------|----------|----------|
| Forward foreign currency exchange agreements | Prepaid expenses and other current assets | \$ 25.2 | \$ 9.3 | Accrued payroll and other liabilities | \$ (4.7) | \$ (5.4) |
| Derivatives hedging supplemental benefit plan liabilities | Miscellaneous other assets | 84.0 | 79.6 | Other long-term liabilities | | |
| Foreign currency exchange agreements | Miscellaneous other assets | | | Other long-term liabilities | | (0.5) |
| Total derivatives not designated as hedging instruments | | \$ 109.2 | \$ 88.9 | | \$ (4.7) | \$ (5.9) |
| Total derivatives ⁽¹⁾ | | \$ 231.8 | \$ 176.5 | | \$ (8.5) | \$ (9.4) |

(1) The fair value of derivatives is presented on a gross basis. Accordingly, the total asset and liability fair values at June 30, 2010 do not agree with the values provided in the Fair Value Measurements note, because that disclosure reflects netting adjustments of \$0.4 million.

Table of Contents

The following table presents the pretax amounts affecting income and OCI for the six months ended June 30, 2010 and 2009, respectively:

In millions

| Derivatives in Fair Value | (Gain) Loss Recognized in Income on Derivative | | Hedged Items in Fair Value | | (Gain) Loss Recognized in Income on Related Hedged Items | |
|--|--|----------|-------------------------------|----------|--|---------|
| Hedging Relationships | 2010 | 2009 | Hedging Relationships | | 2010 | 2009 |
| Interest rate exchange agreements | \$(15.1) | \$9.5 | Fixed-rate debt | | \$15.1 | \$(9.5) |
| | (Gain) Loss | | (Gain) Loss | | (Gain) Loss | |
| | Recognized in Accumulated | | Reclassified from | | Recognized in Income on | |
| Derivatives in | OCI on Derivative | | Accumulated OCI into | | Derivative (Amount Excluded | |
| Cash Flow | (Effective Portion) | | Income (Effective Portion) | | and Ineffective Portion) | |
| Hedging Relationships | 2010 | 2009 | 2010 | 2009 | 2010 | 2009 |
| Foreign currency options | \$(30.7) | \$1.0 | \$(6.5) | \$(32.0) | \$15.0 | \$16.4 |
| Interest rate exchange agreements ⁽¹⁾ | | (1.4) | (0.3) | (1.1) | 0.4 | |
| Forward foreign currency exchange agreements | (10.0) | 0.9 | 0.1 | (4.3) | 0.4 | |
| Total | \$(40.7) | \$0.5 | \$(6.7) | \$(37.4) | \$15.8 | \$16.4 |
| | (Gain) Loss | | Recognized in Accumulated | | Recognized in Income on | |
| Derivatives in | OCI on Derivative | | OCI on Derivative | | Derivative (Amount Excluded | |
| Net Investment | (Effective Portion) | | Income (Effective Portion) | | and Ineffective Portion) | |
| Hedging Relationships | 2010 | 2009 | | | | |
| Foreign currency denominated debt | \$(225.7) | \$(46.2) | | | | |
| Forward foreign currency exchange agreements | 4.3 | | | | | |
| Total | \$(221.4) | \$(46.2) | | | | |
| | (Gain) Loss | | Recognized in Income | | Recognized in Income on | |
| Derivatives Not Designated | on Derivative | | on Derivative | | Derivative (Amount Excluded | |
| as | (Effective Portion) | | Income (Effective Portion) | | and Ineffective Portion) | |
| Hedging Instruments | 2010 | 2009 | | | | |
| Forward foreign currency exchange agreements | \$(13.0) | \$26.5 | | | | |
| Derivatives hedging supplemental benefit plan liabilities ⁽²⁾ | (5.5) | 5.3 | | | | |

Edgar Filing: MCDONALDS CORP - Form 10-Q

| | | |
|--------------------------------------|----------|--------|
| Foreign currency options | (0.8) | (0.1) |
| Foreign currency exchange agreements | (0.5) | |
| Total | \$(19.8) | \$31.7 |

(Gains) losses recognized in income on derivatives are recorded in nonoperating (income) expense unless otherwise noted.

- (1) The amount of (gain) loss reclassified from accumulated OCI into income is recorded in interest expense.
- (2) The amount of (gain) loss recognized in income on the derivatives used to hedge the supplemental benefit plan liabilities is recorded in selling, general & administrative expenses.

Fair Value Hedging Strategy

The Company enters into fair value hedges to reduce the exposure to changes in the fair values of certain liabilities. The fair value hedges the Company enters into consist of interest rate exchange agreements which convert a portion of its fixed-rate debt into floating-rate debt. All of the Company's interest rate exchange agreements meet the shortcut method requirements. Accordingly, changes in the fair values of the interest rate exchange agreements are exactly offset by changes in the fair value of the underlying debt. No ineffectiveness has been recorded to net income related to interest rate exchange agreements designated as fair value hedges for the six month period ended June 30, 2010. A total of \$2.0 billion of the Company's outstanding fixed-rate debt was effectively converted to floating-rate debt resulting from the use of interest rate exchange agreements.

Cash Flow Hedging Strategy

The Company enters into cash flow hedges to reduce the exposure to variability in certain expected future cash flows. The types of cash flow hedges the Company enters into include interest rate exchange agreements, forward foreign currency exchange agreements and foreign currency options.

To protect against the reduction in value of forecasted foreign currency cash flows (such as royalties denominated in foreign currencies), the Company uses forward foreign currency exchange agreements and foreign currency options to hedge a portion of anticipated exposures.

Table of Contents

When the U.S. dollar strengthens against foreign currencies, the decline in present value of future foreign denominated royalties is offset by gains in the fair value of the forward foreign currency exchange agreements and/or foreign currency options. Conversely, when the U.S. dollar weakens, the increase in the present value of future foreign denominated royalties is offset by losses in the fair value of the forward foreign currency exchange agreements and/or foreign currency options.

Although the fair value changes in the foreign currency options may fluctuate over the period of the contract, the Company's total loss on a foreign currency option is limited to the upfront premium paid for the contract. However, the potential gains on a foreign currency option are unlimited as the settlement value of the contract is based upon the difference between the exchange rate at inception of the contract and the spot exchange rate at maturity. In limited situations, the Company uses foreign currency option collars, which limit the potential gains and lower the upfront premium paid, to protect against currency movements.

The hedges typically cover the next 12-15 months for certain exposures and are denominated in various currencies. As of June 30, 2010, the Company had derivatives outstanding with an equivalent notional amount of \$527.7 million that were used to hedge a portion of forecasted foreign currency denominated royalties.

The Company excludes the time value of foreign currency options, as well as the discount or premium points on forward foreign currency exchange agreements from its effectiveness assessment on its cash flow hedges. As a result, changes in the fair value of the derivatives due to these components, as well as the ineffectiveness of the hedges, are recognized in earnings currently. The effective portion of the gains or losses on the derivatives is reported in the deferred hedging adjustment component of OCI in shareholders' equity and reclassified into earnings in the same period or periods in which the hedged transaction affects earnings.

The Company recorded after tax adjustments related to cash flow hedges to the deferred hedging adjustment component of accumulated OCI in shareholders' equity. The Company recorded a net increase of \$21.8 million for the six months ended June 30, 2010 and a net decrease of \$24.3 million for the six months ended June 30, 2009. Based on interest rates and foreign currency exchange rates at June 30, 2010, the majority of the \$38.3 million in cumulative deferred hedging gains, after tax, at June 30, 2010, will be recognized in earnings over the next 12 months as the underlying hedged transactions are realized.

Hedge of Net Investment in Foreign Operations Strategy

The Company primarily uses foreign currency denominated debt to hedge its investments in certain foreign subsidiaries and affiliates. Realized and unrealized translation adjustments from these hedges are included in shareholders' equity in the foreign currency translation component of OCI and offset translation adjustments on the underlying net assets of foreign subsidiaries and affiliates, which also are recorded in OCI. As of June 30, 2010, a total of \$3.2 billion of the Company's outstanding foreign currency denominated debt was designated to hedge investments in certain foreign subsidiaries and affiliates.

Credit Risk

The Company is exposed to credit-related losses in the event of non-performance by the counterparties to its hedging instruments. The counterparties to these agreements consist of a diverse group of financial institutions. The Company continually monitors its positions and the credit ratings of its counterparties and adjusts positions as appropriate. The Company did not have significant exposure to any individual counterparty at June 30, 2010 and has master agreements that contain netting arrangements. Some of these agreements also require each party to post collateral if credit ratings fall below, or aggregate exposures exceed, certain contractual limits. At June 30, 2010, neither the Company nor its counterparties were required to post collateral on any derivative position, other than on hedges of certain of the Company's supplemental benefit plan liabilities where our counterparty was required to post collateral on its liability positions.

Impairment and Other Charges (Credits), Net

In the first quarter, McDonald's Japan (a 50%-owned affiliate) announced plans to close approximately 430 restaurants by mid-2011 in conjunction with the strategic review of the market's restaurant portfolio. These actions are designed to enhance the brand image, overall profitability and returns of the market. For the six months 2010, the Company recorded after tax impairment charges of \$35.3 million related to its share of restaurant closing costs in Japan. These charges primarily consist of asset writeoffs and lease termination costs.

Table of Contents**Gain on Sale of Investment**

In 2009, the Company sold its minority ownership interest in Redbox Automated Retail, LLC to Coinstar, Inc. (Coinstar), the majority owner, for total consideration of \$139.8 million. In connection with the sale, in first quarter 2009, the Company received initial consideration valued at \$51.6 million consisting of 1.5 million shares of Coinstar common stock at an agreed to value of \$41.6 million and \$10 million in cash with the balance of the purchase price deferred. In second quarter 2009, the Company sold all of its holdings in the Coinstar common stock for \$46.8 million and received \$78.4 million in cash from Coinstar as deferred consideration, and in third quarter 2009, the Company received \$9.8 million in cash from Coinstar as final consideration. As a result of the transaction, the Company recognized a nonoperating pretax gain of \$17.8 million (after tax \$11.1 million or \$0.01 per share) for the second quarter 2009 and \$94.3 million (after tax \$58.5 million or \$0.05 per share) for the six months. For the full year 2009, the Company recognized a cumulative gain of \$94.9 million (after tax \$58.8 million or \$0.05 per share).

Segment Information

The Company franchises and operates McDonald's restaurants in the food service industry. The following table presents the Company's revenues and operating income by geographic segment. The APMEA segment represents operations in Asia/Pacific, Middle East and Africa. Other Countries & Corporate represents operations in Canada and Latin America, as well as Corporate activities.

| In millions | Quarters Ended | | Six Months Ended | |
|-----------------------------|-------------------|-------------------|--------------------|--------------------|
| | June 30, 2010 | 2009 | June 30, 2010 | 2009 |
| Revenues | | | | |
| U.S. | \$ 2,076.9 | \$ 2,044.2 | \$ 3,953.6 | \$ 3,920.6 |
| Europe | 2,326.1 | 2,264.0 | 4,571.5 | 4,212.2 |
| APMEA | 1,211.2 | 1,047.9 | 2,402.5 | 2,057.0 |
| Other Countries & Corporate | 331.3 | 291.1 | 628.0 | 534.8 |
| Total | \$ 5,945.5 | \$ 5,647.2 | \$ 11,555.6 | \$ 10,724.6 |
| Operating income | | | | |
| U.S. | \$ 895.1 | \$ 834.9 | \$ 1,704.5 | \$ 1,560.4 |
| Europe | 673.6 | 618.9 | 1,274.6 | 1,108.8 |
| APMEA | 273.5 | 230.6 | 545.6 | 444.2 |
| Other Countries & Corporate | 3.1 | (2.9) | (5.3) | (31.5) |
| Total | \$ 1,845.3 | \$ 1,681.5 | \$ 3,519.4 | \$ 3,081.9 |

Variable Interest Entities and Consolidation

In June 2009, the FASB issued amendments to the guidance on variable interest entities and consolidation, codified primarily in the Consolidation Topic of the FASB ASC. This guidance modifies the method for determining whether an entity is a variable interest entity as well as the methods permitted for determining the primary beneficiary of a variable interest entity. In addition, this guidance requires ongoing reassessments of whether a company is the primary beneficiary of a variable interest entity and enhanced disclosures related to a company's involvement with a variable interest entity. The Company adopted this guidance as of January 1, 2010.

The Company evaluates its business relationships such as those with franchisees, joint venture partners, developmental licensees, suppliers, and advertising cooperatives to identify potential variable interest entities. Generally, these businesses qualify for a scope exception under the consolidation guidance. The Company has concluded that consolidation of any such entities is not appropriate for the periods presented. As a result, the adoption did not have any impact on our consolidated financial statements.

Subsequent Events

The Company evaluated subsequent events through the date the financial statements were issued and filed with the Securities and Exchange Commission. In August 2010, the Company issued \$450 million of 10-year U.S. Dollar-denominated notes at a coupon rate of 3.5% and \$300 million of 30-year U.S. Dollar-denominated bonds at a coupon rate of 4.875%. There were no other subsequent events that required recognition or disclosure.

Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

The Company franchises and operates McDonald's restaurants. Of the 32,466 restaurants in 117 countries at June 30, 2010, 26,209 were operated by franchisees (including 19,059 operated by conventional franchisees, 3,327 operated by developmental licensees and 3,823 operated by foreign affiliated markets (affiliates) primarily in Japan) and 6,257 were operated by the Company. Under our conventional franchise arrangement, franchisees provide a portion of the capital required by initially investing in the equipment, signs, seating and décor of their restaurant businesses, and by reinvesting in the business over time. The Company owns the land and building or secures long-term leases for both Company-operated and conventional franchised restaurant sites. This maintains long-term occupancy rights, helps control related costs and assists in alignment with franchisees. In certain circumstances, the Company participates in reinvestment for conventional franchised restaurants. Under our developmental license arrangement, licensees provide capital for the entire business, including the real estate interest, and the Company has no capital invested. In addition, the Company has an equity investment in a limited number of affiliates that invest in real estate and operate or franchise restaurants within a market.

We view ourselves primarily as a franchisor and believe franchising is important to delivering great, locally-relevant customer experiences and driving profitability. However, directly operating restaurants is paramount to being a credible franchisor and is essential to providing Company personnel with restaurant operations experience. In our Company-operated restaurants, and in collaboration with franchisees, we further develop and refine operating standards, marketing concepts and product and pricing strategies, so that only those that we believe are most beneficial are introduced Systemwide. Accordingly, we continually review our mix of Company-operated and franchised restaurants to help maximize overall performance.

The business is managed as distinct geographic segments. Significant reportable segments include the United States (U.S.), Europe, and Asia/Pacific, Middle East and Africa (APMEA). In addition, throughout this report we present Other Countries & Corporate that includes operations in Canada and Latin America, as well as Corporate activities. The U.S., Europe and APMEA segments account for 34%, 40% and 21% of total revenues, respectively.

In 2010, McDonald's Japan (a 50%-owned affiliate) announced plans to close approximately 430 restaurants by mid-2011 in conjunction with the strategic review of the market's restaurant portfolio. These actions are designed to enhance the brand image, overall profitability and returns of the market. For the six months 2010, the Company recorded after tax impairment charges of \$35.3 million related to its share of restaurant closing costs in Japan. The Company does not expect to record significant charges related to these restaurant closings in the second half of 2010.

In 2009, the Company sold its minority ownership interest in Redbox Automated Retail, LLC (Redbox) to Coinstar, Inc., the majority owner, and recognized a nonoperating pretax gain of \$17.8 million for second quarter 2009 and \$94.3 million for the six months. The Company disposed of all non-McDonald's restaurant businesses as of December 31, 2009.

Strategic Direction and Financial Performance

The strength of the alignment between the Company, its franchisees and suppliers (collectively referred to as the System) has been key to McDonald's success over the years. This business model enables McDonald's to consistently deliver locally-relevant restaurant experiences to customers and be an integral part of the communities we serve. In addition, it facilitates our ability to identify, implement and scale innovative ideas that meet customers' changing needs and preferences.

McDonald's customer-focused Plan to Win which is centered around being better, not just bigger provides a common framework for our global business yet allows for local adaptation. Through the execution of multiple initiatives surrounding the five key drivers of exceptional customer experiences People, Products, Place, Price and Promotion we have enhanced the restaurant experience for customers worldwide and grown sales and customer visits in each of the last six years. This Plan, coupled with financial discipline, has delivered strong results for shareholders.

The Company is pursuing initiatives in three key areas: service enhancement, restaurant reimagining and menu innovation. These initiatives include leveraging technology to make it easier for restaurant staff to quickly and accurately serve customers, accelerating our interior and exterior reimagining efforts and innovating at every tier of our menu to deliver great taste and value to customers. These efforts successfully resonated with consumers driving increases in sales and customer visits in many countries despite challenging global economies and a flat informal eating-out market. As a result, every area of the world contributed to global comparable sales, which increased 4.8% for the second quarter and 4.5% for the six months.

Table of Contents

The U.S. business continued to deliver results by maintaining its commitment to high-quality food at a great value. U.S. operating income increased 7% for the second quarter and 9% for the six months as sales were driven by the beverage line-up, featuring the popular new Frappés and value-based beverages, as well as classic core menu favorites and the everyday affordability of the Dollar Menu. Ongoing U.S. strategies include strengthening the core menu and value offerings; aggressively pursuing new growth opportunities in beverages, breakfast, chicken and snacking options; elevating the brand experience by updating technology with a new point of sale system; enhancing restaurant employee retention and productivity; and initiating a multi-year program to contemporize the interiors and exteriors of our restaurants through reimagining.

For both the quarter and six months, Europe delivered strong comparable sales of 5.2% and a constant currency operating income increase of 14%. Europe's focus on contemporary and inviting décors, signature menu options and unique marketing promotions contributed to these results. Europe's strategic priorities include upgrading the customer and employee experience, enhancing local relevance and building brand transparency.

APMEA's emphasis on everyday affordability, daypart expansion and core menu extensions contributed to a constant currency operating income increase of 9% for the second quarter and six months. APMEA will continue to execute initiatives that best support the goal to be customers' first choice for eating out: convenience, core menu, branded affordability, improved operations and reimagining.

Operating Highlights Included:

Global comparable sales increased 4.8% for the quarter and 4.5% for the six months

Consolidated operating income increased 10% (10% in constant currencies) for the quarter and 14% (11% in constant currencies) for the six months

Diluted earnings per share were \$1.13 for the quarter and \$2.13 for the six months, up 15% (15% in constant currencies) and 15% (12% in constant currencies), respectively. Foreign currency translation had no impact on diluted earnings per share for the quarter and a positive impact of \$0.05 per share for the six months

For the six months ended June 30, 2010, the Company repurchased 20.8 million shares for \$1.4 billion and paid total dividends of \$1.10 per share or nearly \$1.2 billion

Outlook

While the Company does not provide specific guidance on earnings per share, the following information is provided to assist in forecasting the Company's future results.

Changes in Systemwide sales are driven by comparable sales and net restaurant unit expansion. The Company expects net restaurant additions to add 1.5 to 2 percentage points to 2010 Systemwide sales growth (in constant currencies), most of which will be due to the 609 net traditional restaurants added in 2009.

The Company does not generally provide specific guidance on changes in comparable sales. However, as a perspective, assuming no change in cost structure, a 1 percentage point increase in comparable sales for either the U.S. or Europe would increase annual diluted earnings per share by about 3 cents.

With about 75% of McDonald's grocery bill comprised of 10 different commodities, a basket of goods approach is the most comprehensive way to look at the Company's commodity costs. For the full year 2010, the total basket of goods cost is expected to decrease 3-4% in the U.S. and to decrease 1-2% in Europe. Some volatility may be experienced between quarters in the normal

Edgar Filing: MCDONALDS CORP - Form 10-Q

course of business, with more favorable comparisons in the first half of this year.

The Company expects full year 2010 selling, general & administrative expenses to increase slightly, in constant currencies, although fluctuations will be experienced between quarters due to certain items in 2010 such as the Vancouver Winter Olympics in February and the biennial Worldwide Owner/Operator Convention in April.

Based on current interest and foreign currency exchange rates, the Company expects interest expense for full year 2010 to decrease 3-5% compared with 2009.

A significant part of the Company's operating income is generated outside the U.S., and about 40% of its total debt is denominated in foreign currencies. Accordingly, earnings are affected by changes in foreign currency exchange rates, particularly the Euro, British Pound, Australian Dollar and Canadian Dollar. Collectively, these currencies represent approximately 70% of the Company's operating income outside the U.S. If all four of these currencies moved by 10% in the same direction compared with 2009, the Company's annual diluted earnings per share would change by about 17 to 19 cents. At current foreign currency rates, the Company expects foreign currency translation to negatively impact full year diluted earnings per share.

The Company expects the effective income tax rate for the full year 2010 to be approximately 29% to 31%. Some volatility may be experienced between the quarters resulting in a quarterly tax rate that is outside the annual range.

Table of Contents

The Company expects capital expenditures for the full year 2010 to be approximately \$2.4 billion. About half of this amount will be reinvested in existing restaurants, including the reimagining of over 2,000 locations worldwide. The rest will primarily be used to open new restaurants. The Company expects to open 1,000 restaurants including about 350 restaurants in affiliated and developmental licensed markets, such as Japan and Latin America, where the Company does not fund any capital expenditures. The Company expects net additions of about 325 restaurants, which reflects the strategic closing of restaurants by McDonald's Japan.

The Following Definitions Apply to These Terms as Used Throughout This Form 10-Q:

Constant currency results exclude the effects of foreign currency translation and are calculated by translating current year results at prior year average exchange rates. Management reviews and analyzes business results in constant currencies and bases certain incentive compensation plans on these results because they believe this better represents the Company's underlying business trends.

Systemwide sales include sales at all restaurants, whether operated by the Company or by franchisees. While franchised sales are not recorded as revenues by the Company, management believes the information is important in understanding the Company's financial performance because these sales are the basis on which the Company calculates and records franchised revenues and are indicative of the financial health of the franchisee base.

Comparable sales represent sales at all restaurants and comparable guest counts represent the number of transactions at all restaurants, including those operated by the Company or by franchisees, in operation at least thirteen months including those temporarily closed. Some of the reasons restaurants may be temporarily closed include reimagining or remodeling, rebuilding, road construction and natural disasters. Comparable sales exclude the impact of currency translation. Management reviews the increase or decrease in comparable sales and comparable guest counts compared with the same period in the prior year to assess business trends. The number of weekdays and weekend days, referred to as the calendar shift/trading day adjustment, can impact comparable sales and guest counts. In addition, the timing of holidays can also impact comparable sales and guest counts.

Table of Contents**CONSOLIDATED OPERATING RESULTS**

| Dollars in millions, except per share data | Quarter Ended June 30, 2010 | | Six Months Ended June 30, 2010 | |
|---|--|----------------------------|---|----------------------------|
| | Amount | % Increase / (Decrease) | Amount | % Increase / (Decrease) |
| Revenues | | | | |
| Sales by Company-operated restaurants | \$ 4,013.4 | 4 | \$ 7,816.5 | 7 |
| Revenues from franchised restaurants | 1,932.1 | 8 | 3,739.1 | 10 |
| Total revenues | 5,945.5 | 5 | 11,555.6 | 8 |
| Operating costs and expenses | | | | |
| Company-operated restaurant expenses | 3,214.8 | 2 | 6,325.7 | 4 |
| Franchised restaurants occupancy expenses | 334.3 | 5 | 673.6 | 10 |
| Selling, general & administrative expenses | 564.9 | 6 | 1,111.2 | 8 |
| Impairment and other charges (credits), net | 6.8 | n/m | 37.6 | n/m |
| Other operating (income) expense, net | (20.6) | 53 | (111.9) | (35) |
| Total operating costs and expenses | 4,100.2 | 3 | 8,036.2 | 5 |
| Operating income | 1,845.3 | 10 | 3,519.4 | 14 |
| Interest expense | 108.1 | (9) | 219.1 | (9) |
| Nonoperating (income) expense, net | 1.9 | n/m | 8.1 | n/m |
| Gain on sale of investment | | n/m | | n/m |
| Income before provision for income taxes | 1,735.3 | 9 | 3,292.2 | 11 |
| Provision for income taxes | 509.5 | 2 | 976.6 | 10 |
| Net income | \$ 1,225.8 | 12 | \$ 2,315.6 | 12 |
| Earnings per common share basic: | \$ 1.14 | 14 | \$ 2.16 | 15 |
| Earnings per common share diluted: | \$ 1.13 | 15 | \$ 2.13 | 15 |

n/m Not meaningful

Table of Contents**Impact of Foreign Currency Translation**

While changes in foreign currency exchange rates affect reported results, McDonald's mitigates exposures, where practical, by financing in local currencies, hedging certain foreign-denominated cash flows, and purchasing goods and services in local currencies. Management reviews and analyzes business results excluding the effect of foreign currency translation and bases certain incentive compensation plans on these results because they believe this better represents the Company's underlying business trends. Results excluding the effect of foreign currency translation (also referred to as constant currency) are calculated by translating current year results at prior year average exchange rates.

IMPACT OF FOREIGN CURRENCY TRANSLATION

In millions, except per share data

| | | | Currency Translation Benefit / (Cost) |
|--|-------------|------------|--|
| Quarters Ended June 30, | 2010 | 2009 | 2010 |
| Revenues | \$ 5,945.5 | \$ 5,647.2 | \$ 20.8 |
| Company-operated margins | 798.6 | 690.9 | 6.5 |
| Franchised margins | 1,597.8 | 1,479.0 | (8.9) |
| Selling, general & administrative expenses | 564.9 | 531.5 | (0.2) |
| Operating income | 1,845.3 | 1,681.5 | (1.6) |
| Net income | 1,225.8 | 1,093.7 | (0.6) |
| Earnings per common share diluted | 1.13 | 0.98 | |

IMPACT OF FOREIGN CURRENCY TRANSLATION

In millions, except per share data

| | | | Currency Translation Benefit / (Cost) |
|--|-------------|-------------|--|
| Six Months Ended June 30, | 2010 | 2009 | 2010 |
| Revenues | \$ 11,555.6 | \$ 10,724.6 | \$ 355.7 |
| Company-operated margins | 1,490.8 | 1,255.1 | 52.2 |
| Franchised margins | 3,065.5 | 2,755.0 | 55.4 |
| Selling, general & administrative expenses | 1,111.2 | 1,028.8 | (24.9) |
| Operating income | 3,519.4 | 3,081.9 | 86.0 |
| Net income | 2,315.6 | 2,073.2 | 57.1 |
| Earnings per common share diluted | 2.13 | 1.85 | 0.05 |

Foreign currency translation had a minimal impact on consolidated operating results for the quarter due to the weaker Euro offset primarily by the stronger Australian Dollar and Canadian Dollar. Foreign currency translation had a positive impact on consolidated operating results for the six months, primarily driven by the stronger Australian Dollar and Canadian Dollar.

Net Income and Diluted Earnings per Common Share

For the second quarter and six months ended June 30, 2010, net income was \$1,225.8 million and \$2,315.6 million, respectively, and diluted earnings per share were \$1.13 and \$2.13, respectively. Results for the six months included after tax impairment charges of \$35.3 million or \$0.03 per share related to restaurant closings in Japan in conjunction with the previously announced strategic review of the market's restaurant portfolio. Foreign currency translation had no impact on diluted earnings per share for the quarter and a positive impact of \$0.05 per share for the six months.

For the second quarter and six months ended June 30, 2009, net income was \$1,093.7 million and \$2,073.2 million, respectively, and diluted earnings per share were \$0.98 and \$1.85, respectively. Results benefited by an after tax gain of \$58.5 million, or \$0.05 per share, for the six months due to the sale of the Company's minority interest in Redbox Automated Retail, LLC (Redbox).

During the second quarter 2010, the Company repurchased 14.1 million shares of its stock for nearly \$1.0 billion, bringing the total repurchases for 2010 to 20.8 million shares or \$1.4 billion. During the second quarter 2010, the Company paid a quarterly dividend of \$0.55 per share or \$589.1 million, bringing the total dividends paid for 2010 to nearly \$1.2 billion.

Table of Contents**Revenues**

Revenues consist of sales by Company-operated restaurants and fees from restaurants operated by franchisees. Revenues from conventional franchised restaurants include rent and royalties based on a percent of sales along with minimum rent payments and initial fees. Revenues from franchised restaurants that are licensed to affiliates and developmental licensees include a royalty based on a percent of sales and generally include initial fees.

REVENUES

Dollars in millions

| | | | % Inc / | |
|--------------------------------|-------------------|-------------|--------------|--------------------|
| | | | | (Dec) |
| | | | % Inc / | Excluding |
| | | | | Currency |
| Quarters Ended June 30, | 2010 | 2009 | (Dec) | Translation |
| <i>Company-operated sales</i> | | | | |
| U.S. | \$ 1,085.0 | \$ 1,115.5 | (3) | (3) |
| Europe | 1,697.7 | 1,651.6 | 3 | 6 |
| APMEA | 1,033.8 | 901.2 | 15 | 9 |
| Other Countries & Corporate | 196.9 | 181.9 | 8 | (4) |
| Total | \$ 4,013.4 | \$ 3,850.2 | 4 | 3 |
| <i>Franchised revenues</i> | | | | |
| U.S. | \$ 991.9 | \$ 928.7 | 7 | 7 |
| Europe | 628.4 | 612.4 | 3 | 9 |
| APMEA | 177.4 | 146.7 | 21 | 9 |
| Other Countries & Corporate | 134.4 | 109.2 | 23 | 16 |
| Total | \$ 1,932.1 | \$ 1,797.0 | 8 | 8 |
| <i>Total revenues</i> | | | | |
| U.S. | \$ 2,076.9 | \$ 2,044.2 | 2 | 2 |
| Europe | 2,326.1 | 2,264.0 | 3 | 6 |
| APMEA | 1,211.2 | 1,047.9 | 16 | 9 |
| Other Countries & Corporate | 331.3 | 291.1 | 14 | 3 |
| Total | \$ 5,945.5 | \$ 5,647.2 | 5 | 5 |

Table of Contents**REVENUES***Dollars in millions*

| | | | % Inc / (Dec) | % Inc / (Dec) | Excluding Currency |
|----------------------------------|-------------|-------------|------------------|------------------|-----------------------|
| | | | | | Translation |
| Six Months Ended June 30, | 2010 | 2009 | (Dec) | | |
| <i>Company-operated sales</i> | | | | | |
| U.S. | \$ 2,072.3 | \$ 2,159.0 | (4) | | (4) |
| Europe | 3,320.3 | 3,065.3 | 8 | | 6 |
| APMEA | 2,051.7 | 1,776.9 | 15 | | 7 |
| Other Countries & Corporate | 372.2 | 333.7 | 12 | | (4) |
| Total | \$ 7,816.5 | \$ 7,334.9 | 7 | | 3 |
| <i>Franchised revenues</i> | | | | | |
| U.S. | \$ 1,881.3 | \$ 1,761.6 | 7 | | 7 |
| Europe | 1,251.2 | 1,146.9 | 9 | | 9 |
| APMEA | 350.8 | 280.1 | 25 | | 8 |
| Other Countries & Corporate | 255.8 | 201.1 | 27 | | 18 |
| Total | \$ 3,739.1 | \$ 3,389.7 | 10 | | 8 |
| <i>Total revenues</i> | | | | | |
| U.S. | \$ 3,953.6 | \$ 3,920.6 | 1 | | 1 |
| Europe | 4,571.5 | 4,212.2 | 9 | | 6 |
| APMEA | 2,402.5 | 2,057.0 | 17 | | 7 |
| Other Countries & Corporate | 628.0 | 534.8 | 17 | | 4 |
| Total | \$ 11,555.6 | \$ 10,724.6 | 8 | | 4 |

Consolidated revenues increased 5% (5% in constant currencies) for the quarter and 8% (4% in constant currencies) for the six months. The constant currency growth was driven by positive comparable sales and expansion, partly offset by the impact of the refranchising strategy in certain of the Company's major markets. The Company continues to optimize its restaurant ownership mix, cash flow and returns through its refranchising strategy. The shift to a greater percentage of franchised restaurants negatively impacts consolidated revenues as Company-operated sales shift to franchised sales, where the Company receives rent and/or royalties based primarily on a percent of sales. Franchised restaurants represent 81% of Systemwide restaurants at June 30, 2010.

In the U.S., revenues increased for the quarter and six months primarily due to positive comparable sales, partly offset by the impact of the refranchising strategy. Comparable sales were driven by the beverage line-up, featuring the popular new Frappés and value-based beverages, as well as classic core menu favorites and the everyday affordability of the Dollar Menu.

In Europe, the constant currency increase in revenues for the quarter and six months was primarily driven by strong comparable sales in the U.K., France and Russia (which is entirely Company-operated) as well as expansion in Russia. These increases were partly offset by the impact of the refranchising strategy, primarily in the U.K.

In APMEA, the constant currency increase in revenues for the quarter and six months was primarily driven by comparable sales increases in Australia, China and most other markets, as well as expansion in China.

Table of Contents

The following table presents the percent change in comparable sales for the quarters and six months ended June 30, 2010 and 2009:

| COMPARABLE SALES | % Increase | | | |
|-----------------------------|----------------|------|------------------|------|
| | Quarters Ended | | Six Months Ended | |
| | June 30, | | June 30,* | |
| | 2010 | 2009 | 2010 | 2009 |
| U.S. | 3.7 | 3.5 | 2.6 | 4.1 |
| Europe | 5.2 | 6.9 | 5.2 | 5.1 |
| APMEA | 4.6 | 4.4 | 5.1 | 4.9 |
| Other Countries & Corporate | 9.9 | 4.7 | 11.0 | 4.5 |
| Total | 4.8 | 4.8 | 4.5 | 4.6 |

* On a consolidated basis, comparable guest counts increased 3.9% and 1.3% for the six months ended June 30, 2010 and 2009, respectively. The following table presents the percent change in Systemwide sales for the quarter and six months ended June 30, 2010:

SYSTEMWIDE SALES

| | Quarter Ended | | Six Months Ended | |
|-----------------------------|---------------|-------------|------------------|-------------|
| | June 30, 2010 | | June 30, 2010 | |
| | % Inc | % Inc | % Inc | % Inc |
| | Excluding | Excluding | Excluding | Excluding |
| | Currency | Currency | Currency | Currency |
| | % Inc | Translation | % Inc | Translation |
| U.S. | 4 | 4 | 3 | 3 |
| Europe | 2 | 7 | 8 | 7 |
| APMEA | 14 | 7 | 16 | 8 |
| Other Countries & Corporate | 14 | 12 | 18 | 13 |
| Total | 6 | 6 | 8 | 6 |

The following table presents franchised sales, which are not recorded in the income statement, and the related percentage change for the quarters and six months ended June 30, 2010 and 2009:

FRANCHISED SALES

Dollars in millions

| Quarters Ended June 30, | 2010 | 2009 | % Inc | |
|-----------------------------|-------------|-------------|-----------|-------------|
| | | | Excluding | Translation |
| | | | Currency | |
| U.S. | \$ 7,178.6 | \$ 6,808.6 | 5 | 5 |
| Europe | 3,594.6 | 3,513.4 | 2 | 8 |
| APMEA | 2,617.6 | 2,300.6 | 14 | 6 |
| Other Countries & Corporate | 1,557.0 | 1,352.1 | 15 | 14 |
| Total* | \$ 14,947.8 | \$ 13,974.7 | 7 | 7 |

Table of Contents**FRANCHISED SALES***Dollars in millions*

| | | | | % Inc Excluding Currency |
|----------------------------------|--------------------|-------------|--------------|--------------------------------|
| Six Months Ended June 30, | 2010 | 2009 | % Inc | Translation |
| U.S. | \$ 13,642.1 | \$ 13,062.5 | 4 | 4 |
| Europe | 7,145.4 | 6,580.9 | 9 | 8 |
| APMEA | 5,354.8 | 4,581.0 | 17 | 8 |
| Other Countries & Corporate | 3,009.4 | 2,530.0 | 19 | 15 |
| Total* | \$ 29,151.7 | \$ 26,754.4 | 9 | 7 |

* For the quarters, included \$2,945.3 million and \$2,751.7 million of sales in 2010 and 2009, respectively, and for the six months, included \$6,011.7 million and \$5,480.7 million of sales in 2010 and 2009, respectively, derived from developmental licensee restaurants or foreign affiliated markets where the Company earns a royalty based on sales. The remaining balance of franchised sales is derived from conventional franchised restaurants where the Company earns rent and royalties based primarily on a percent of sales.

Restaurant Margins**FRANCHISED AND COMPANY-OPERATED RESTAURANT MARGINS***Dollars in millions*

| Quarters Ended June 30, | Percent | | Amount | | % Inc | % Inc Excluding Currency Translation |
|--------------------------------|----------------|-------------|-------------------|-------------|--------------|---|
| | 2010 | 2009 | 2010 | 2009 | | |
| <i>Franchised</i> | | | | | | |
| U.S. | 84.0 | 83.5 | \$ 832.6 | \$ 775.0 | 7 | 7 |
| Europe | 78.3 | 78.2 | 491.8 | 478.8 | 3 | 9 |
| APMEA | 88.9 | 89.5 | 157.8 | 131.4 | 20 | 9 |
| Other Countries & Corporate | 86.0 | 85.9 | 115.6 | 93.8 | 23 | 17 |
| Total | 82.7 | 82.3 | \$ 1,597.8 | \$ 1,479.0 | 8 | 9 |
| <i>Company-operated</i> | | | | | | |
| U.S. | 22.2 | 19.6 | \$ 241.3 | \$ 218.8 | 10 | 10 |
| Europe | 20.3 | 18.1 | 344.0 | 298.6 | 15 | 18 |
| APMEA | 17.1 | 16.2 | 177.3 | 145.7 | 22 | 14 |
| Other Countries & Corporate | 18.3 | 15.3 | 36.0 | 27.8 | 29 | 15 |
| Total | 19.9 | 17.9 | \$ 798.6 | \$ 690.9 | 16 | 15 |

Table of Contents**FRANCHISED AND COMPANY-OPERATED RESTAURANT MARGINS***Dollars in millions*

| Six Months Ended June 30, | Percent | | Amount | | % Inc | % Inc Excluding Currency Translation |
|-----------------------------|-------------|------|-------------------|------------|-------|---|
| | 2010 | 2009 | 2010 | 2009 | | |
| <i>Franchised</i> | | | | | | |
| U.S. | 83.2 | 83.0 | \$ 1,564.7 | \$ 1,461.9 | 7 | 7 |
| Europe | 77.5 | 77.5 | 969.8 | 889.1 | 9 | 9 |
| APMEA | 88.9 | 89.8 | 311.8 | 251.7 | 24 | 8 |
| Other Countries & Corporate | 85.7 | 85.7 | 219.2 | 172.3 | 27 | 19 |
| Total | 82.0 | 81.9 | \$ 3,065.5 | \$ 2,775.0 | 10 | 8 |
| <i>Company-operated</i> | | | | | | |
| U.S. | 21.4 | 19.0 | \$ 442.6 | \$ 409.6 | 8 | 8 |
| Europe | 18.8 | 16.8 | 624.0 | 515.0 | 21 | 19 |
| APMEA | 17.6 | 16.0 | 360.3 | 284.1 | 27 | 16 |
| Other Countries & Corporate | 17.2 | 13.9 | 63.9 | 46.4 | 38 | 19 |
| Total | 19.1 | 17.1 | \$ 1,490.8 | \$ 1,255.1 | 19 | 15 |

Franchised margin dollars increased \$118.8 million or 8% (9% in constant currencies) for the quarter and \$290.5 million or 10% (8% in constant currencies) for the six months. Positive comparable sales and the refranchising strategy were the primary drivers of the constant currency growth in franchised margin dollars.

In the U.S., the franchised margin percent increased for the quarter and six months primarily due to positive comparable sales. For the six months, this increase was partly offset by additional depreciation related to the Company's investment in the beverage initiative.

In Europe, the franchised margin percent remained relatively flat for the quarter and six months as positive comparable sales were offset by higher occupancy expenses, the cost of strategic brand and sales building initiatives, and the refranchising strategy.

In APMEA, the franchised margin percent declined for the quarter and six months primarily driven by foreign currency translation, mostly due to the stronger Australian dollar.

Company-operated margin dollars increased \$107.7 million or 16% (15% in constant currencies) for the quarter and \$235.7 million or 19% (15% in constant currencies) for the six months. Positive comparable sales and lower commodity costs were the primary drivers of the constant currency growth in Company-operated margin dollars. The refranchising strategy negatively impacted Company-operated margin dollars and had a slightly positive impact on the Company-operated margin percent.

In the U.S., the Company-operated margin percent increased for the quarter and six months primarily due to lower commodity costs.

Europe's Company-operated margin percent increased for the quarter and six months due to positive comparable sales and lower commodity costs, partly offset by higher labor costs.

In APMEA, the Company-operated margin percent increased for the quarter and six months primarily due to positive comparable sales and lower commodity costs, partly offset by higher labor and other costs.

Table of Contents

The following table presents Company-operated restaurant margin components as a percent of sales:

CONSOLIDATED COMPANY-OPERATED RESTAURANT EXPENSES AND MARGINS AS A PERCENT OF**SALES**

| | Quarters Ended | | Six Months Ended | |
|---|----------------|------|------------------|------|
| | June 30, | | June 30, | |
| | 2010 | 2009 | 2010 | 2009 |
| Food & paper | 32.6 | 33.8 | 32.8 | 34.2 |
| Payroll & employee benefits | 25.4 | 25.8 | 25.6 | 25.9 |
| Occupancy & other operating expenses | 22.1 | 22.5 | 22.5 | 22.8 |
| Total expenses | 80.1 | 82.1 | 80.9 | 82.9 |
| Company-operated margins | 19.9 | 17.9 | 19.1 | 17.1 |
| Selling, General & Administrative Expenses | | | | |

Selling, general & administrative expenses increased 6% (6% in constant currencies) for the quarter and increased 8% (6% in constant currencies) for the six months. Expenses in 2010 included costs related to the Vancouver Winter Olympics in February and the Company's biennial Worldwide Owner/Operator Convention in April. For the six months 2010 compared with 2009, selling, general & administrative expenses as a percent of revenues and Systemwide sales remained flat at 9.6% and 3.0%, respectively.

Impairment and Other Charges (Credits), Net

In the first quarter, McDonald's Japan (a 50%-owned affiliate) announced plans to close approximately 430 restaurants by mid-2011 in conjunction with the strategic review of the market's restaurant portfolio. These actions are designed to enhance the brand image, overall profitability and returns of the market. For the six months 2010, the Company recorded after tax impairment charges of \$35.3 million related to its share of restaurant closing costs in Japan. The Company does not expect to record significant charges related to these restaurant closings in the second half of 2010.

Other Operating (Income) Expense, Net**OTHER OPERATING (INCOME) EXPENSE, NET**

In millions

| | Quarters Ended | | Six Months Ended | |
|---|----------------|-----------|------------------|-----------|
| | June 30, | | June 30, | |
| | 2010 | 2009 | 2010 | 2009 |
| Gains on sales of restaurant businesses | \$ (11.0) | \$ (22.3) | \$ (38.6) | \$ (46.1) |
| Equity in earnings of unconsolidated affiliates | (35.6) | (33.9) | (81.7) | (63.3) |
| Asset dispositions and other (income) expense | 26.0 | 11.9 | 8.4 | 26.4 |
| Total | \$ (20.6) | \$ (44.3) | \$ (111.9) | \$ (83.0) |

Gains on sales of restaurant businesses for the quarter and six months reflected less than half the number of refranchised sites in 2010 compared with 2009.

Equity in earnings of unconsolidated affiliates for the six months reflected improved operating performance in Japan (impairment charges relating to Japan are recorded separately in Impairment and Other Charges (Credits), Net).

Asset dispositions and other expense for the quarter and six months reflected charges related to the Shrek glassware voluntary recall. The six months 2010 included gains on partnership dissolutions in the U.S. as the Company continues to optimize its restaurant ownership mix.

Table of Contents**Operating Income****OPERATING INCOME***Dollars in millions*

| | | | | % Inc/(Dec) |
|--------------------------------|-------------------|------------|-------|-------------|
| | | | | Excluding |
| | | | | Currency |
| Quarters ended June 30, | 2010 | 2009 | % Inc | Translation |
| U.S. | \$ 895.1 | \$ 834.9 | 7 | 7 |
| Europe | 673.6 | 618.9 | 9 | 14 |
| APMEA | 273.5 | 230.6 | 19 | 9 |
| Other Countries & Corporate | 3.1 | (2.9) | n/m | (28) |
| Total | \$ 1,845.3 | \$ 1,681.5 | 10 | 10 |

OPERATING INCOME*Dollars in millions*

| | | | | % Inc |
|----------------------------------|-------------------|------------|-------|-------------|
| | | | | Excluding |
| | | | | Currency |
| Six Months ended June 30, | 2010 | 2009 | % Inc | Translation |
| U.S. | \$ 1,704.5 | \$ 1,560.4 | 9 | 9 |
| Europe | 1,274.6 | 1,108.8 | 15 | 14 |
| APMEA | 545.6 | 444.2 | 23 | 9 |
| Other Countries & Corporate | (5.3) | (31.5) | 83 | 37 |
| Total | \$ 3,519.4 | \$ 3,081.9 | 14 | 11 |
| n/m Not meaningful | | | | |

In the U.S., operating results increased for the quarter and six months primarily due to higher margin dollars.

In Europe, constant currency operating results for the quarter and six months reflected stronger operating performance in France, Russia, the U.K. and Germany.

In APMEA, constant currency operating results for the quarter and six months were driven primarily by stronger results in Australia, China and most other markets. For the six months, equity in earnings from improved operating performance in Japan was mostly offset by the Company's share of impairment charges related to restaurant closings in the market.

Combined Operating Margin

Combined operating margin is defined as operating income as a percent of total revenues. Combined operating margin for the six months 2010 and 2009 was 30.5% and 28.7%, respectively.

Interest Expense

Interest expense for the quarter and six months decreased primarily due to lower average interest rates.

Table of Contents**Nonoperating (Income) Expense, Net****NONOPERATING (INCOME) EXPENSE, NET**

In millions

| | Quarters Ended | | Six Months Ended | |
|----------------------------------|----------------|-----------|------------------|-----------|
| | June 30, | | June 30, | |
| | 2010 | 2009 | 2010 | 2009 |
| Interest income | \$ (3.6) | \$ (4.6) | \$ (8.2) | \$ (10.3) |
| Translation and hedging activity | 1.1 | (13.0) | 4.6 | (25.1) |
| Other expense | 4.4 | 5.6 | 11.7 | 7.0 |
| Total | \$ 1.9 | \$ (12.0) | \$ 8.1 | \$ (28.4) |

Translation and hedging activity for 2009 included higher gains on the hedging of certain foreign-denominated cash flows.

Gain on Sale of Investment

In 2009, the Company sold its minority ownership interest in Redbox to Coinstar, Inc., the majority owner, and recognized a nonoperating pretax gain of \$17.8 million in the second quarter 2009 and \$94.3 million for the six months.

Income Taxes

The effective income tax rate was 29.7% for the six months 2010 compared with 30.1% for the six months 2009 and 29.4% for second quarter 2010 compared with 31.3% for second quarter 2009.

Cash Flows and Financial Position

The Company generates significant cash from operations and has substantial credit capacity to fund operating and discretionary spending such as capital expenditures, debt repayments, dividends and share repurchases.

Cash provided by operations totaled \$2.7 billion and exceeded capital expenditures by \$1.9 billion for the six months 2010. Cash provided by operations increased \$120.6 million compared with the six months 2009 primarily due to stronger operating results, partly offset by changes in working capital, primarily related to higher income tax payments.

Cash used for investing activities totaled \$781.1 million for the six months 2010, an increase of \$109.6 million over the six months 2009, primarily as a result of receiving proceeds from sale of Redbox in 2009.

Cash used for financing activities totaled \$1,930.7 million for the six months 2010, an increase of \$105.1 million. Financing activities in 2010 reflected lower net debt issuances and higher dividends, partly offset by lower treasury stock purchases and higher proceeds from stock option exercises.

Debt obligations at June 30, 2010 totaled \$10.6 billion, an increase of \$47.8 million from December 31, 2009, as net borrowings were partly offset by the impact of changes in exchange rates on foreign currency denominated debt. In August 2010, the Company issued \$450 million of 10-year U.S. Dollar-denominated notes at a coupon rate of 3.5% and \$300 million of 30-year U.S. Dollar-denominated bonds at a coupon rate of 4.875%.

Return on Average Assets

Return on average assets for the trailing 12 month period ended June 30, 2010 was 24.4% compared with 23.4% for the full year 2009. Return on average assets is computed as operating income for the most recent four quarters divided by average assets based on month-end balances. Operating income, as reported, does not include interest income; however, cash balances are included in average assets. The inclusion of cash

Edgar Filing: MCDONALDS CORP - Form 10-Q

balances in average assets reduced return on average assets by 1.9 percentage points and 2.0 percentage points in 2010 and 2009, respectively.

In 2010, return on average assets benefited from improved operating results across all geographic segments. The Company will continue to concentrate restaurant openings and invest new capital in markets with acceptable returns or opportunities for long-term growth.

Risk Factors and Cautionary Statement Regarding Forward-Looking Statements

The information in this report includes forward-looking statements about our plans and future performance, including those under Outlook. These statements use such words as may, will, expect, believe and plan. They reflect our expectations and speak only as of the date of this report. We do not undertake to update them. Our expectations (or the underlying assumptions) may change or not be realized, and you should not rely unduly on forward-looking statements.

Table of Contents

Our business and execution of our strategic plan, the Plan to Win, are subject to risks. The most important of these is our ability to remain relevant to our customers and a brand they trust. Meeting customer expectations is complicated by the risks inherent in our operating environment. The informal eating out (IEO) segment of the restaurant industry, although largely mature in our major markets, is highly fragmented and competitive. The current economic environment has caused the IEO segment to contract in many markets, including some of our major markets, and this may continue. The current environment has also increased consumer focus on value, heightening pricing pressures across the industry, which could affect our ability to continue to grow sales despite the strength of our Brand and value proposition. We have the added challenge of the cultural, economic and regulatory differences that exist among the more than 100 countries where we operate. Regulatory and similar initiatives around the world have also become more wide-ranging and prescriptive and affect how we operate and our results. In particular, increasing focus on nutritional content and on the production, processing and preparation of food from field to front counter presents challenges for our Brand.

The risks we face can have an impact both in the near- and long-term and are reflected in the following considerations and factors that we believe are most likely to affect our performance.

Our ability to remain a relevant and trusted brand and to increase sales depends largely on how well we execute the Plan to Win, particularly as the global economy emerges from recession.

The Plan to Win addresses the key drivers of our business and results people, products, place, price and promotion. The quality of our execution depends mainly on the following:

Our ability to anticipate and respond effectively to trends or other factors that affect the IEO segment and our competitive position in the diverse markets we serve, such as spending patterns, demographic changes, trends in food preparation, consumer preferences and publicity about us, all of which can drive popular perceptions of our business or affect the willingness of other companies to enter into site, supply or other arrangements or alliances with us;

Our ability to drive restaurant improvements and to motivate our restaurant personnel to achieve sustained high service levels so as to improve consumer perceptions of our ability to meet expectations for quality food served in clean and friendly environments;

Whether our restaurant remodeling and rebuilding efforts, which remain a priority notwithstanding the current challenging economic and operating environment, are targeted at the elements of the restaurant experience that will best accomplish our goals to enhance the relevance of our Brand and achieve an efficient allocation of our capital resources;

Our ability to maintain alignment with franchisees on operating, promotional and capital-intensive initiatives, particularly in the current challenging economic and operating environment;

The success of our initiatives to support menu choice, physical activity and nutritional awareness and to address these and other matters of social responsibility in a way that communicates our values effectively and inspires trust and confidence;

Our ability to respond effectively to adverse perceptions about the quick-service category of the IEO segment or about our products, promotions and premiums, such as Happy Meal toys (collectively, our products), or the reliability of our supply chain and the safety of our products, and our ability to manage the potential impact on McDonald's of food-borne illnesses or product safety issues;

The success of our plans to improve existing menu items and to roll out new menu items, as well as the impact of our competitors actions, including in response to our menu changes and product introductions, and our ability to continue robust menu development and manage the complexity of our restaurant operations;

Edgar Filing: MCDONALDS CORP - Form 10-Q

Our ability to differentiate the McDonald's experience in a way that balances consumer value with margin expansion, particularly in markets where pricing or cost pressures are significant or have been exacerbated by the current challenging economic and operating environment;

The impact of our and our franchisees' pricing, marketing and promotional plans on sales and margins and our ability to adjust our plans to respond quickly to changing economic conditions;

The impact of events such as boycotts or protests, labor strikes and supply chain interruptions (including due to lack of supply or price increases) that can adversely affect us directly or adversely affect the vendors, franchisees and others that are also part of the McDonald's System and whose performance has a material impact on our results;

Our ability to recruit and retain qualified local personnel to manage our operations and growth in certain developing markets;

The risks to our Brand if a franchisee defaults in its obligations (particularly requirements to pay royalties, make capital investments and open new restaurants), experiences food safety or other operational problems or projects a brand image inconsistent with our values, all of which are more significant risks if a franchisee controls a large number of restaurants as is the case in Latin America; and

Table of Contents

Our ability to leverage promotional or operating successes in individual markets into other markets in a timely and cost-effective way.

Our results and financial condition are affected by global and local market conditions, which can adversely affect our sales, margins and net income.

Our results of operations are substantially affected not only by global economic conditions, but also by local operating and economic conditions, which can vary substantially by market. Unfavorable conditions can depress sales in a given market or daypart (e.g., breakfast). To mitigate the impact of these conditions, we may take promotional or other actions that adversely affect our margins, limit our operating flexibility or result in charges, restaurant closings or sales of Company-operated restaurants. Some macroeconomic conditions could have an even more wide-ranging and prolonged impact. The current environment has been characterized by slowing economies, rising unemployment, declining wages, constrained credit and volatile financial markets. These conditions have significantly affected consumer spending and habits. Moreover, the strength of the current recovery is uncertain in many of our most important markets, and growth in consumer spending generally lags improvement in the broader economy. The key factors that affect our ability to manage the impact of these conditions are the following:

Whether our strategies will permit us to compete effectively and make continued market share gains, while at the same time achieving sales and operating income within our targeted long-term average annual range of growth;

The effectiveness of our supply chain management, including hedging strategies, to assure reliable and sufficient product supply on favorable terms;

Our ability to manage the impact of fluctuations in foreign exchange rates, changes in interest rates and governmental actions to manage national economic conditions such as credit availability, consumer spending, unemployment levels, foreign exchange and inflation rates;

The impact on our margins of labor costs given our labor-intensive business model, the long-term trend toward higher wages in both mature and developing markets and the potential impact of union organizing efforts on day-to-day operations of our restaurants;

Whether we are able to identify and develop restaurant sites consistent with our plans for net growth of Systemwide restaurants from year to year, and whether new sites are as profitable as expected;

The challenges and uncertainties associated with operating in developing markets, such as China, Russia and India, which may entail a relatively higher risk of political instability, economic volatility, crime, corruption and social and ethnic unrest, all of which are exacerbated in many cases by a lack of an independent and experienced judiciary and uncertainties in how local law is applied and enforced, including in areas most relevant to commercial transactions and foreign investment; and

The nature and timing of decisions about underperforming markets or assets, including decisions that result in impairment charges that reduce our earnings.

Increasing regulatory complexity will continue to affect our operations and results in material ways.

Our legal and regulatory environment worldwide exposes us to complex compliance, litigation and similar risks that affect our operations and results in material ways. In many of our markets, including the United States and Europe, we are subject to increasing regulation, which has increased our cost of doing business. In developing markets, we face the risks associated with new and untested laws and judicial systems. Among the more important regulatory and litigation risks we face and must manage are the following:

Edgar Filing: MCDONALDS CORP - Form 10-Q

The cost, compliance and other risks associated with the often conflicting regulations we face, especially in the United States where inconsistent standards imposed by local, state and federal authorities can adversely affect popular perceptions of our business and increase our exposure to litigation or governmental investigations or proceedings, and the impact of new, potential or changing regulation that affects or restricts elements of our business, particularly those relating to marketing to children, nutritional content and product labeling and safety;

The impact of nutritional, health and other scientific inquiries and conclusions, which constantly evolve and often have contradictory implications, but nonetheless drive popular opinion, litigation and regulation, including taxation, in ways that could be material to our business;

The risks and costs of McDonald's nutritional labeling and other disclosure practices, particularly given differences among applicable legal requirements and practices within the restaurant industry with respect to testing and disclosure, ordinary variations in food preparation among our own restaurants, and the need to rely on the accuracy and completeness of information obtained from third party suppliers;

The risks and costs to us, our franchisees and our supply chain of increased focus by U.S. and overseas governmental authorities on environmental matters, such as climate change, the reduction of greenhouse gases and water consumption, including as a result of initiatives that effectively impose a tax on carbon emissions, such as the proposed cap and trade legislation pending in the U.S. Congress;

Table of Contents

The impact of litigation trends, particularly in our major markets, including class actions, labor and employment claims and landlord/tenant disputes; the relative level of our defense costs, which vary from period to period depending on the number, nature and procedural status of pending proceedings; and the cost and other effects of settlements or judgments, which may require us to make disclosures or take other actions that may affect perceptions of our Brand and products;

Adverse results of pending or future litigation, including litigation challenging the composition of our products, or the appropriateness or accuracy of our marketing or other communication practices;

The increasing costs and other effects of compliance with U.S. and overseas regulations affecting our workforce and labor practices, including regulations relating to wage and hour practices, immigration, mandatory healthcare benefits and unlawful workplace discrimination;

The impact of the current economic conditions on unemployment levels and consumer confidence and the effect of initiatives to stimulate economic recovery and to further regulate financial markets (including through changes in taxation) on the cost and availability of funding for the Company and its franchisees, inflation and foreign exchange rates;

Disruptions in our operations or price volatility in a market that can result from governmental actions, such as price, foreign exchange or import-export controls, increased tariffs or government-mandated closure of our or our vendors' operations, and the cost and disruption of responding to governmental investigations or proceedings, whether or not they have merit;

The risks associated with information security and the use of cashless payments, such as increased investment in technology, the costs of compliance with privacy, consumer protection and other laws, the impact on our margins as the use of cashless payments increases, the potential costs associated with alleged security breaches and the loss of consumer confidence that may result; and

The impact of changes in financial reporting requirements, accounting principles or practices, related legal or regulatory interpretations or our critical accounting estimates, changes in tax accounting or tax laws (or interpretations thereof), and the impact of settlements or adjustments proposed by the Internal Revenue Service or other taxing authorities in connection with our tax audits, all of which will depend on their timing, nature and scope.

The trading volatility and price of our common stock may be affected by many factors.

Many factors affect the volatility and price of our common stock in addition to our operating results and prospects. The most important of these, some of which are outside our control, are the following:

The current uncertain global economic conditions and market volatility;

Governmental action or inaction in light of key indicators of economic activity or events that can significantly influence financial markets, particularly in the United States which is the principal trading market for our common stock, and media reports and commentary about economic or other matters, even when the matter in question does not directly relate to our business;

Trading activity in our common stock or trading activity in derivative instruments with respect to our common stock or debt securities, which can reflect market commentary (including commentary that may be unreliable or incomplete in some cases) or expectations about our business, our creditworthiness or investor confidence generally; actions by shareholders and others seeking to influence our business strategies; portfolio transactions in our stock by significant shareholders; or trading activity that results from the ordinary course rebalancing of stock indices in which McDonald's may be included, such as the S&P 500 Index and the Dow

Edgar Filing: MCDONALDS CORP - Form 10-Q

Jones Industrial Average;

The impact of our stock repurchase program, dividend rate or changes in our debt levels on our credit ratings, interest expense, ability to obtain funding on favorable terms or our operating or financial flexibility, especially if lenders impose new operating or financial covenants; and

The impact on our results of other corporate actions, such as those we may take from time to time as part of our continuous review of our corporate structure in light of business, legal and tax considerations.

Table of Contents

Our results and financial condition are affected by our ownership mix.

Our refranchising strategy involves a shift to a greater percentage of franchised restaurants. The decision to own restaurants or to operate under franchise or license agreements is driven by many factors whose interrelationship is complex and changing. When we refranchise a restaurant, it reduces consolidated revenues as Company-operated sales shift to franchised sales, where we receive rent and/or royalties. It also reduces Company-operated margin dollars while increasing franchised margin dollars, with the impact on margin percentages varying based on sales and operating costs of the refranchised restaurants. Our refranchising strategy can also expose us to risks, including the following:

Whether the franchisees we select will have the experience and financial resources in the relevant markets to be effective operators of McDonald's restaurants;

Potential ongoing payment obligations as a result of our retention of any contingent liabilities in connection with refranchising transactions; and

The risk that our contractual and other rights and remedies to protect against defaults by our counterparties will be limited by local law, costly to exercise or otherwise subject to limitations or litigation that may impair our ability to prevent or mitigate any adverse impact on our Brand or on the financial performance we expect under our franchising and developmental license agreements.

Our results can be adversely affected by disruptions or events, such as the impact of severe weather conditions and natural disasters.

Severe weather conditions, natural disasters, terrorist activities, health epidemics or pandemics, or expectations about them, can have an adverse impact on consumer spending and confidence levels or on other factors that affect our results and prospects, such as commodity costs. Our receipt of proceeds under any insurance we maintain with respect to certain of these risks may be delayed or the proceeds may be insufficient to offset our losses fully.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There were no material changes to the disclosure made in our Annual Report on Form 10-K for the year ended December 31, 2009 regarding this matter.

Item 4. Controls and Procedures

An evaluation was conducted under the supervision and with the participation of the Company's management, including the Chief Executive Officer (CEO) and Chief Financial Officer (CFO), of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of June 30, 2010. Based on that evaluation, the CEO and CFO concluded that the Company's disclosure controls and procedures were effective as of such date to ensure that information required to be disclosed in the reports that it files or submits under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. Such officers also confirm that there was no change in the Company's internal control over financial reporting during the quarter ended June 30, 2010 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Table of Contents**PART II OTHER INFORMATION****Item 1. Legal Proceedings**

There were no material changes to the disclosure made in our Annual Report on Form 10-K for the year ended December 31, 2009 regarding these matters.

Item 1A. Risk Factors

This report contains certain forward-looking statements which reflect management's expectations regarding future events and operating performance and speak only as of the date hereof. These forward-looking statements involve a number of risks and uncertainties. These and other risks are noted in the Risk Factors and Cautionary Statement Regarding Forward-Looking Statements following Management's Discussion and Analysis.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**Issuer Purchases of Equity Securities***

The following table presents information related to repurchases of common stock the Company made during the three months ended June 30, 2010:

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of | Approximate Dollar |
|------------------|---|---|---|--|
| | | | Shares Purchased as Part of Publicly Announced Plans or Programs (1) | Value of Shares that May Yet Be Purchased Under the Plans or Programs (1) |
| April 1-30, 2010 | 1,533,062 | \$ 70.87 | 1,533,062 | \$ 8,999,119,000 |
| May 1-31, 2010 | 6,825,108 | \$ 68.80 | 6,825,108 | \$ 8,529,526,000 |
| June 1-30, 2010 | 5,763,838 | \$ 67.64 | 5,763,838 | \$ 8,139,665,000 |
| Total | 14,122,008 | \$ 68.55 | 14,122,008 | \$ 8,139,665,000 |

* Subject to applicable law, the Company may repurchase shares directly in the open market, in privately negotiated transactions, or pursuant to derivative instruments and plans complying with Rule 10b5-1, among other types of transactions and arrangements.

- (1) On September 24, 2009, the Company's Board of Directors approved a share repurchase program that authorizes the purchase of up to \$10 billion of the Company's outstanding common stock with no specified expiration date.

Table of Contents**Item 6. Exhibits**

| Exhibit Number | Description |
|----------------|---|
| (3) | (a) Restated Certificate of Incorporation, effective as of March 24, 1998, incorporated herein by reference from Form 8-K, dated April 17, 1998. |
| | (b) By-Laws, as amended and restated with effect as of January 21, 2010, incorporated herein by reference from Form 8-K, dated January 20, 2010. |
| (4) | Instruments defining the rights of security holders, including Indentures: * |
| | (a) Senior Debt Securities Indenture, incorporated herein by reference from Exhibit (4)(a) of Form S-3 Registration Statement (File No. 333-14141), filed October 15, 1996. |
| | (b) Subordinated Debt Securities Indenture, incorporated herein by reference from Exhibit (4)(b) of Form S-3 Registration Statement (File No. 333-14141), filed October 15, 1996. |
| | (c) Debt Securities Indenture, incorporated herein by reference from Exhibit (4)(a) of Form S-3 Registration Statement (File No. 33-12364), filed March 3, 1987. |
| (10) | Material Contracts |
| | (a) Directors' Deferred Compensation Plan, effective as of January 1, 2008, incorporated herein by reference from Form 8-K, dated November 28, 2007.** |
| | (b) McDonald's Excess Benefit and Deferred Bonus Plan, effective January 1, 2011, as amended and restated March 22, 2010, incorporated herein by reference from Form 10-Q, for the quarter ended March 31, 2010.** |
| | (c) McDonald's Corporation Supplemental Profit Sharing and Savings Plan, effective as of September 1, 2001, incorporated herein by reference from Form 10-K, for the year ended December 31, 2001.** |
| | (i) First Amendment to the McDonald's Corporation Supplemental Profit Sharing and Savings Plan, effective as of January 1, 2002, incorporated herein by reference from Form 10-K, for the year ended December 31, 2002.** |
| | (ii) Second Amendment to the McDonald's Corporation Supplemental Profit Sharing and Savings Plan, effective January 1, 2005, incorporated herein by reference from Form 10-K, for the year ended December 31, 2004.** |
| | (d) 1975 Stock Ownership Option Plan, as amended and restated July 30, 2001, incorporated herein by reference from Form 10-Q, for the quarter ended September 30, 2001.** |
| | (i) First Amendment to McDonald's Corporation 1975 Stock Ownership Option Plan, as amended and restated, effective as of February 14, 2007, incorporated herein by reference from Form 10-Q, for the quarter ended March 31, 2007.** |
| | (e) 1992 Stock Ownership Incentive Plan, as amended and restated January 1, 2001, incorporated herein by reference from Form 10-Q, for the quarter ended March 31, 2001.** |
| | (i) First Amendment to McDonald's Corporation 1992 Stock Ownership Incentive Plan, as amended and restated, effective as of February 14, 2007, incorporated herein by reference from Form 10-Q, for the quarter ended March 31, 2007.** |
| | (f) 1999 Non-Employee Director Stock Option Plan, as amended and restated September 12, 2000, incorporated herein by reference from Form 10-Q, for the quarter ended September 30, 2000.** |
| | (g) McDonald's Corporation Executive Retention Replacement Plan, effective as of December 31, 2007 (as amended and restated on December 31, 2008), incorporated herein by reference from Form 10-K, for the year ended December 31, 2008.** |
| | (h) McDonald's Corporation Amended and Restated 2001 Omnibus Stock Ownership Plan, effective July 1, 2008, incorporated herein by reference from Form 10-Q for the quarter ended June 30, 2009.** |

Table of Contents

- (i) First amendment to the McDonald's Corporation Amended and Restated 2001 Omnibus Stock Ownership Plan, incorporated herein by reference from Form 10-K, for the year ended December 31, 2008.**
- (i) Form of McDonald's Corporation Tier I Change of Control Employment Agreement, incorporated herein by reference from Form 10-Q, for the quarter ended September 30, 2008.**
- (j) McDonald's Corporation 2009 Cash Incentive Plan, effective as of May 27, 2009, incorporated herein by reference from Form 10-Q for the quarter ended June 30, 2009.**
- (k) Form of Stock Option Grant Notice, incorporated herein by reference from Form 10-Q, for the quarter ended June 30, 2005.**
- (l) Form of Restricted Stock Unit Award Notice, incorporated herein by reference from Form 10-Q, for the quarter ended June 30, 2005.**
- (m) McDonald's Corporation Severance Plan, effective January 1, 2008, incorporated by reference from Form 8-K, dated November 28, 2007.**
 - (i) First Amendment of McDonald's Corporation Severance Plan, effective as of October 1, 2008, incorporated herein by reference from Form 10-Q, for the quarter ended September 30, 2008.**
- (n) Employment Contract between Denis Hennequin and the Company, dated February 26, 2007, incorporated herein by reference from Form 10-K, for the year ended December 31, 2006.**
- (o) Amended Assignment Agreement between Timothy Fenton and the Company, dated January 2008, incorporated herein by reference from Form 10-Q, for the quarter ended March 31, 2008.**
 - (i) 2009 Amendment to the Amended Assignment Agreement between Timothy Fenton and the Company, effective as of January 1, 2009, incorporated herein by reference from Form 10-Q, for the quarter ended March 31, 2009.**
- (p) Description of Restricted Stock Units granted to Andrew J. McKenna, filed herewith.**
- (q) Terms of the Restricted Stock Units granted pursuant to the Company's Amended and Restated 2001 Omnibus Stock Ownership Plan, incorporated herein by reference from Form 10-Q, for the quarter ended March 31, 2010.**
- (r) McDonald's Corporation Target Incentive Plan, effective as of January 1, 2008, incorporated herein by reference from Form 8-K, dated January 23, 2008.**
- (s) European Prospectus Supplement describing the terms of equity compensation awards granted in the European Union pursuant to the Company's Amended and Restated 2001 Omnibus Stock Ownership Plan, incorporated herein by reference from Form 10-Q, for the quarter ended March 31, 2010.**
- (t) Letter Agreement between Ralph Alvarez and the Company dated December 18, 2009, incorporated herein by reference from Form 8-K, dated December 18, 2009.**
- (u) McDonald's Corporation Cash Performance Unit Plan 2010-2012, effective as of February 9, 2010, incorporated herein by reference from Form 8-K, dated February 9, 2010.**
- (v) Executive Supplement describing the special terms of equity compensation awards granted to certain executive officers, pursuant to the Company's Amended and Restated 2001 Omnibus Stock Ownership Plan, incorporated herein by reference from Form 10-Q, for the quarter ended March 31, 2010.**

Table of Contents

| | |
|-----------|--|
| (12) | Computation of ratio of earnings to fixed charges. |
| (31.1) | Rule 13a-14(a) Certification of Chief Executive Officer. |
| (31.2) | Rule 13a-14(a) Certification of Chief Financial Officer. |
| (32.1) | Certification pursuant to 18 U.S.C. Section 1350 by the Chief Executive Officer, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| (32.2) | Certification pursuant to 18 U.S.C. Section 1350 by the Chief Financial Officer, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| (101.INS) | XBRL Instance Document.*** |
| (101.SCH) | XBRL Taxonomy Extension Schema Document.*** |
| (101.CAL) | XBRL Taxonomy Extension Calculation Linkbase Document.*** |
| (101.DEF) | XBRL Taxonomy Extension Definition Linkbase Document.*** |
| (101.LAB) | XBRL Taxonomy Extension Label Linkbase Document.*** |
| (101.PRE) | XBRL Taxonomy Extension Presentation Linkbase Document.*** |

* Other instruments defining the rights of holders of long-term debt of the registrant, and all of its subsidiaries for which consolidated financial statements are required to be filed and which are not required to be registered with the Commission, are not included herein as the securities authorized under these instruments, individually, do not exceed 10% of the total assets of the registrant and its subsidiaries on a consolidated basis. An agreement to furnish a copy of any such instruments to the Commission upon request has been filed with the Commission.

** Denotes compensatory plan.

*** In accordance with Regulation S-T, the XBRL-related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall be deemed to be furnished and not filed .

Table of Contents

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

McDONALD S CORPORATION

(Registrant)

August 5, 2010

/s/ Peter J. Bensen
Peter J. Bensen
Corporate Executive Vice President and

Chief Financial Officer

33