

MCDONALDS CORP  
Form 10-Q  
May 06, 2008

**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 March 31, 2008

**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.)

**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 to such filing requirements for the past 90 days.

Edgar Filing: MCDONALDS CORP - Form 10-Q

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

**1,133,525,530**

(Number of shares of common stock

outstanding as of March 31, 2008)

MCDONALD S CORPORATION

INDEX

	Page Reference
Part I. <u>Financial Information</u>	
Item 1 <u>Financial Statements</u>	
<u>Condensed consolidated balance sheet, March 31, 2008 (unaudited) and December 31, 2007</u>	3
<u>Condensed consolidated statement of income (unaudited), first quarters ended March 31, 2008 and 2007</u>	4
<u>Condensed consolidated statement of cash flows (unaudited), first quarters ended March 31, 2008 and 2007</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>	9
Item 3 <u>Quantitative and Qualitative Disclosures About Market Risk</u>	23
Item 4 <u>Controls and Procedures</u>	23
Part II. <u>Other Information</u>	
Item 1 <u>Legal Proceedings</u>	24
Item 1A <u>Risk Factors</u>	24
Item 2 <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	24
Item 6 <u>Exhibits</u>	25
<u>Signature</u>	28

The following trademarks used herein are the property of McDonald's Corporation or the Company: McDonald's and Happy Meal. All other trademarks are property of their respective owners.

## PART I FINANCIAL INFORMATION

## Item 1. Financial Statements

## CONDENSED CONSOLIDATED BALANCE SHEET

In millions, except per share data	(unaudited) March 31, 2008	December 31, 2007
<b>Assets</b>		
<b>Current assets</b>		
Cash and equivalents	\$ 2,922.2	\$ 1,981.3
Accounts and notes receivable	895.9	1,053.8
Inventories, at cost, not in excess of market	114.5	125.3
Prepaid expenses and other current assets	393.0	421.5
<b>Total current assets</b>	<b>4,325.6</b>	<b>3,581.9</b>
<b>Other assets</b>		
Investments in and advances to affiliates	1,256.6	1,156.4
Goodwill, net	2,371.5	2,301.3
Miscellaneous	1,379.0	1,367.4
<b>Total other assets</b>	<b>5,007.1</b>	<b>4,825.1</b>
<b>Property and equipment</b>		
Property and equipment, at cost	33,450.5	32,203.7
Accumulated depreciation and amortization	(11,861.2)	(11,219.0)
<b>Net property and equipment</b>	<b>21,589.3</b>	<b>20,984.7</b>
<b>Total assets</b>	<b>\$ 30,922.0</b>	<b>\$ 29,391.7</b>
<b>Liabilities and shareholders' equity</b>		
<b>Current liabilities</b>		
Notes payable	\$ 1,070.0	\$ 1,126.6
Accounts payable	579.6	624.1
Income taxes	16.2	
Other taxes	309.5	248.0
Accrued interest	187.2	148.4
Accrued payroll and other liabilities	1,300.5	1,486.9
Current maturities of long-term debt	220.3	864.5
<b>Total current liabilities</b>	<b>3,683.3</b>	<b>4,498.5</b>
<b>Long-term debt</b>	<b>10,443.6</b>	<b>7,310.0</b>
<b>Other long-term liabilities</b>	<b>1,363.4</b>	<b>1,342.5</b>
<b>Deferred income taxes</b>	<b>1,017.5</b>	<b>960.9</b>
<b>Shareholders' equity</b>		
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	4,308.9	4,226.7
Retained earnings	26,981.8	26,461.5
Accumulated other comprehensive income	1,775.8	1,337.4
Common stock in treasury, at cost; 527.1 and 495.3 million shares	(18,668.9)	(16,762.4)
<b>Total shareholders' equity</b>	<b>14,414.2</b>	<b>15,279.8</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 30,922.0</b>	<b>\$ 29,391.7</b>

See Notes to condensed consolidated financial statements.

## CONDENSED CONSOLIDATED STATEMENT OF INCOME (UNAUDITED)

In millions, except per share data	Quarters Ended	
	2008	2007
<b>Revenues</b>		
Sales by Company-operated restaurants	\$ 3,998.8	\$ 3,913.8
Revenues from franchised and affiliated restaurants	1,616.0	1,378.9
<b>Total revenues</b>	<b>5,614.8</b>	<b>5,292.7</b>
<b>Operating costs and expenses</b>		
Company-operated restaurant expenses	3,339.6	3,293.3
Franchised restaurants occupancy expenses	299.8	275.7
Selling, general & administrative expenses	552.4	545.2
Impairment and other charges, net	0.5	2.6
Other operating (income) expense, net	(40.3)	(5.4)
<b>Total operating costs and expenses</b>	<b>4,152.0</b>	<b>4,111.4</b>
<b>Operating income</b>	<b>1,462.8</b>	<b>1,181.3</b>
Interest expense	128.5	97.2
Nonoperating (income) expense, net	(28.9)	(16.7)
<b>Income from continuing operations before provision for income taxes</b>	<b>1,363.2</b>	<b>1,100.8</b>
Provision for income taxes	417.1	334.3
<b>Income from continuing operations</b>	<b>946.1</b>	<b>766.5</b>
Income (loss) from discontinued operations (net of tax benefit of \$2.7)		(4.1)
<b>Net income</b>	<b>\$ 946.1</b>	<b>\$ 762.4</b>
<b>Per common share basic:</b>		
Continuing operations	\$ 0.83	\$ 0.64
Discontinued operations		
Net income	\$ 0.83	\$ 0.63
<b>Per common share diluted:</b>		
Continuing operations	\$ 0.81	\$ 0.63
Discontinued operations		
Net income	\$ 0.81	\$ 0.62
<b>Dividends per common share</b>	<b>\$ 0.38</b>	
<b>Weighted-average shares outstanding basic</b>	<b>1,145.6</b>	<b>1,201.2</b>
<b>Weighted-average shares outstanding diluted</b>	<b>1,165.3</b>	<b>1,222.3</b>

See Notes to condensed consolidated financial statements.

## CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS (UNAUDITED)

In millions	Quarters Ended	
	2008	2007
<b>Operating activities</b>		
Net income	\$ 946.1	\$ 762.4
Adjustments to reconcile to cash provided by operations		
Charges and credits:		
Depreciation and amortization	304.7	311.5
Deferred income taxes	12.8	(20.3)
Share-based compensation	35.1	37.0
Other	39.5	(75.8)
Changes in working capital items	140.3	(86.4)
<b>Cash provided by operations</b>	<b>1,478.5</b>	<b>928.4</b>
<b>Investing activities</b>		
Property and equipment expenditures	(405.1)	(408.9)
Purchases and sales of restaurant businesses and property sales	72.4	1.9
Other	15.2	1.5
<b>Cash used for investing activities</b>	<b>(317.5)</b>	<b>(405.5)</b>
<b>Financing activities</b>		
Notes payable and long-term financing issuances and repayments	2,095.5	330.2
Treasury stock purchases	(2,011.3)	(968.4)
Common stock dividends	(426.4)	
Proceeds from stock option exercises	108.6	370.4
Excess tax benefit on share-based compensation	32.4	47.9
Other	(80.2)	(17.5)
<b>Cash used for financing activities</b>	<b>(281.4)</b>	<b>(237.4)</b>
<b>Effect of exchange rates on cash and cash equivalents</b>	<b>61.3</b>	<b>15.0</b>
Cash and equivalents increase	940.9	300.5
Cash and equivalents at beginning of period	1,981.3	2,128.1
<b>Cash and equivalents at end of period</b>	<b>\$ 2,922.2</b>	<b>\$ 2,428.6</b>

See Notes to condensed consolidated financial statements.

**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, 2007 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 ended March 31, 2008 do not necessarily indicate the results that may be expected for the full year.

Certain prior period amounts have been reclassified to conform to current year presentation, including reclassifying results and amounts of Boston Market to discontinued operations as a result of the sale in August 2007.

The results of operations of McDonald's restaurant businesses purchased and sold were not material to the condensed consolidated financial statements for periods prior to purchase and sale.

**Restaurant Information**

The following table presents restaurant information by ownership type:

<b>Restaurants at March 31,</b>	<b>2008</b>	<b>2007</b>
Operated by franchisees*	<b>20,635</b>	18,766
Operated by the Company**	<b>6,815</b>	8,190
Operated by affiliates	<b>3,989</b>	4,106
Systemwide restaurants	<b>31,439</b>	31,062

\* At March 31, 2008 and 2007 included 2,804 and 1,093 restaurants, respectively, operated by developmental licensees.

\*\* The decrease is primarily due to the August 2007 Latam transaction.

**Conversion of Certain Markets to Developmental License**

In August 2007, the Company completed the sale of its businesses in Brazil, Argentina, Mexico, Puerto Rico, Venezuela and 13 other countries in Latin America and the Caribbean to a developmental licensee organization. The Company refers to these markets, which total about 1,600 restaurants, as "Latam". Under a developmental license, a local licensee owns the business, including the real estate, and uses his/her capital and local knowledge to build the McDonald's Brand and optimize sales and profitability over the long term. Under this arrangement, the Company collects a royalty, which varies by market, based on a percent of sales, but does not invest any capital.

The buyers of the Company's operations in Latam have entered into a 20-year master franchise agreement that requires the buyers, among other obligations, to pay monthly royalties commencing at a rate of approximately 5% of gross sales of the restaurants in these markets, substantially consistent with market rates for similar license arrangements.

**Comprehensive Income**

The following table presents the components of comprehensive income for the quarters ended March 31, 2008 and 2007:

**Quarters Ended**



<b>In millions</b>	<b>March 31,</b>	
	<b>2008</b>	<b>2007</b>
Net income	\$ 946.1	\$ 762.4
Other comprehensive income (loss):		
Foreign currency translation adjustments	421.8	89.0
Deferred hedging adjustments	31.5	4.4
Pension liability adjustment	(14.9)	1.8
Total other comprehensive income (loss)	438.4	95.2
<b>Total comprehensive income</b>	<b>\$ 1,384.5</b>	<b>\$ 857.6</b>
<b>Per Common Share Information</b>		

Diluted net income per common share is calculated using net income divided by diluted weighted-average shares outstanding. Diluted weighted-average shares outstanding included weighted-average shares outstanding plus the dilutive effect of share-based compensation, calculated using the treasury stock method, of 19.7 million shares and 21.1 million shares for the first quarter 2008 and 2007, respectively. Stock options that were not included in diluted weighted-average shares outstanding because they would have been antidilutive were 5.2 million shares for the first quarter 2008 and 6.0 million shares for the first quarter 2007.

## Fair Value Measurements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. This statement does not require any new fair value measurements; rather, it applies to other accounting pronouncements that require or permit fair value measurements. The provisions of SFAS No. 157, as issued, were effective January 1, 2008. However, the FASB issued FASB Staff Position No. FAS 157-2, *Effective Date of FASB Statement No. 157*, which allows entities to defer the effective date of SFAS No. 157, for one year, for certain non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (i.e., at least annually). The Company adopted SFAS No. 157 as of January 1, 2008 and elected the deferral for non-financial assets and liabilities. The effect of adopting this standard was not significant.

Fair value is defined under SFAS No. 157 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. SFAS No. 157 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. In accordance with the requirements of SFAS No. 157, derivative valuations incorporate credit risk adjustments that are necessary to reflect the probability of default by the counterparty or the Company.

The following table presents assets and liabilities measured at fair value on a recurring basis as of March 31, 2008 by SFAS No. 157 valuation hierarchy:

<i>In millions</i>	<i>Level 1</i>	<i>Level 2</i>	<i>Level 3</i>	<i>Carrying Value</i>
Cash equivalents	\$ 163.2			\$163.2
Investments	121.6*			121.6
Derivative receivables	98.1*	\$ 87.9		186.0
<b>Total assets at fair value</b>	<b>\$ 382.9</b>	<b>\$ 87.9</b>		<b>\$470.8</b>
Derivative payables**		\$ (50.1)		\$(50.1)
<b>Total liabilities at fair value</b>		<b>\$ (50.1)</b>		<b>\$(50.1)</b>

\* Represents long-term investments and derivatives entered into to hedge market driven changes in liabilities associated with the Company's supplemental benefit plans.

\*\* Includes cash collateral posted of \$68.3 million against derivative payables of \$118.4 million in accordance with FASB Staff Position No. FIN 39-1, *Amendment of FASB Interpretation No. 39*.



**Discontinued Operations**

In August 2007, the Company sold its investment in Boston Market and as a result, Boston Market's results of operations have been reflected in discontinued operations. Boston Market's results of operations, which previously were included in Other Countries & Corporate, consisted of revenues and pretax loss for the first quarter 2007 of \$171.4 million and \$6.8 million, respectively. Boston Market's net loss for the first quarter 2007 was \$4.1 million.

**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	
	March 31, 2008	2007
<b>Revenues</b>		
U.S.	\$ 1,896.6	\$ 1,841.4
Europe	2,375.6	1,926.5
APMEA	1,032.4	830.3
Other Countries & Corporate	310.2	694.5
<b>Total revenues</b>	<b>\$ 5,614.8</b>	<b>\$ 5,292.7</b>
<b>Operating income</b>		
U.S.	\$ 682.5	\$ 649.6
Europe	577.2	393.1
APMEA	217.5	148.7
Other Countries & Corporate	(14.4)	(10.1)
<b>Total operating income</b>	<b>\$ 1,462.8</b>	<b>\$ 1,181.3</b>

---

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

### Overview

The Company primarily franchises and operates McDonald's restaurants. Of the 31,439 restaurants in 118 countries at March 31, 2008, 20,635 are operated by franchisees (including 2,804 operated by developmental licensees), 3,989 are operated by affiliates (primarily in Japan) and 6,815 are operated by the Company. Under our conventional franchise arrangement, franchisees provide a portion of the required capital 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 ensures long-term occupancy rights, helps control related costs and improves alignment with franchisees. Under our developmental license arrangement, licensees provide capital for the entire business, including the real estate interest, while the Company generally has no capital invested.

We view ourselves primarily as a franchisor and continually review our restaurant ownership mix (that is, our mix among Company-operated, franchised - conventional or developmental license, and affiliated) to deliver a great customer experience and drive profitability. In most cases, franchising is the best way to achieve both goals. Although direct restaurant operation is more capital-intensive relative to franchising and results in lower restaurant margins as a percent of revenues, Company-operated restaurants are important to our success in both mature and developing markets. In our Company-operated restaurants, and in collaboration with our 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. In addition, we firmly believe that owning restaurants is paramount to being a credible franchisor and essential to providing Company personnel with restaurant operations experience. Our Company-operated business also helps to facilitate changes in restaurant ownership as warranted by strategic considerations.

Revenues consist of sales by Company-operated restaurants and fees from restaurants operated by franchisees and affiliates. These fees primarily include rent and/or royalties that are based on a percent of sales, with specified minimum rent payments, along with initial fees. Fees vary by type of site, amount of Company investment and local business conditions. These fees, along with occupancy and operating rights, are stipulated in franchise/license agreements that generally have 20-year terms.

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. and Europe segments account for about 35% and 40% of total revenues, respectively.

In August 2007, the Company sold its investment in Boston Market and as a result, Boston Market's results of operations have been reflected as discontinued operations.

### Strategic Direction and Financial Performance

Since implementing the customer-centered Plan to Win several years ago, the Company remains focused on being better, not just bigger. Our strategic alignment behind this plan has created better McDonald's experiences through the execution of multiple initiatives surrounding the five factors of exceptional customer experiences - people, products, place, price and promotion. While our focus has remained the same, we have adapted and evolved our initiatives based on the changing needs and preferences of our customers. These multiple initiatives have increased our consumer relevance and contributed to sales and guest counts worldwide increasing every year since 2003. In the first quarter 2008, our strong results were driven by positive comparable sales across all geographic segments.

In the U.S., the strategies of everyday affordability, menu variety and our market-leading breakfast enabled the Company to build market share and deliver solid quarterly results. We remain focused on what is most important - the customer. We will continue to provide a relevant restaurant experience that resonates with customers and leverages the strength of our 3-tiered menu.

In Europe, our execution along three key priorities - strengthening local relevance, upgrading the customer and employee experience and building greater brand transparency - continued to drive results. Double-digit revenue and operating income growth was fueled by an 11.1% comparable sales increase - the highest in the segment's history. These strong results reflected broad-based strength throughout the segment.

In APMEA, first quarter performance was strong, driven by positive comparable sales across the segment. Our focus on value, convenience, breakfast and core menu items contributed to the segment's strong results with revenues over \$1 billion.

We remain committed to returning value to shareholders through share repurchases and dividends. For 2007 through 2009, the Company expects to return \$15 billion to \$17 billion to shareholders, subject to business and market conditions. In the first quarter 2008, we repurchased

## Edgar Filing: MCDONALDS CORP - Form 10-Q

37.1 million shares of McDonald's stock for \$2.0 billion and paid a dividend of \$0.375 per share or \$426.4 million. For the full year 2007 and the first quarter 2008 combined, the Company returned \$8.2 billion to shareholders.

We also continue to enhance the mix of franchised and Company-operated restaurants, including refranchising certain Company-operated restaurants and executing our developmental license strategy, to maximize long-term brand performance and returns. The Company expects to refranchise 1,000 to 1,500 Company-operated restaurants over the next three or more years, primarily in our major markets. In first quarter 2008, the Company refranchised about 130 restaurants, primarily in our major markets.

In August 2007, the Company completed the sale of its businesses in Brazil, Argentina, Mexico, Puerto Rico, Venezuela and 13 other countries in Latin America and the Caribbean to a developmental licensee organization. The Company refers to these markets, which total about 1,600 restaurants, as Latam. Under a developmental license, a local licensee owns the business, including the real estate, and uses his/her capital and local knowledge to build the McDonald's Brand and optimize sales and profitability over the long term. Under this arrangement, the Company collects a royalty, which varies by market, based on a percent of sales, but does not invest any capital.

**Operating Highlights Included:**

Global comparable sales increased 7.4%

Consolidated Company-operated and franchised restaurant margins grew for the ninth consecutive quarter

Consolidated operating income increased 24% (16% in constant currencies)

Earnings per share were \$0.81, up 31% versus \$0.62 in 2007, and included \$0.05 per share of currency benefit

The Company repurchased \$2 billion of stock and paid a quarterly dividend of \$0.375 per share, totaling \$426.4 million

**Outlook**

While the Company does not provide specific guidance on net income 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 slightly more than 1 percentage point to 2008 Systemwide sales growth (in constant currencies), most of which will be due to the 503 net traditional restaurants added in 2007.

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 U.S. comparable sales would increase annual net income per share by about 2.5 cents. Similarly, an increase of 1 percentage point in Europe's comparable sales would increase annual net income per share by about 2.5 cents.

In 2008, U.S. beef costs are expected to be relatively flat and chicken costs are expected to rise about 5% to 6%. In Europe, beef costs are expected to be up 3% to 4%, while chicken costs are expected to increase approximately 6% to 8%. Some volatility may be experienced between quarters in the normal course of business.

The Company expects full-year 2008 selling, general & administrative expenses to decline, in constant currencies, although fluctuations may be experienced between the quarters due to items such as the 2008 biennial Worldwide Owner/Operator Convention, the 2008 Beijing Summer Olympics and the August 2007 sale of the Company's businesses in Latam.

Based on current interest and foreign currency exchange rates, the Company expects interest expense in 2008 to increase approximately 35% compared with 2007, while 2008 interest income is expected to decrease about 30% compared with 2007. In 2008, the Company issued certain debt earlier than originally expected to take advantage of favorable market conditions to pre-fund a portion of its debt maturing in the second half of the year.

## Edgar Filing: MCDONALDS CORP - Form 10-Q

A significant part of the Company's operating income is generated outside the U.S., and about 55% of its total debt is denominated in foreign currencies. Accordingly, earnings are affected by changes in foreign currency exchange rates, particularly the Euro and the British Pound. If the Euro and the British Pound both move 10% in the same direction compared with 2007, the Company's annual net income per share would change by about 8 cents to 9 cents.

The Company expects the effective income tax rate for the full-year 2008 to be approximately 30% to 32%, although some volatility may be experienced between the quarters in the normal course of business.

The Company expects capital expenditures for 2008 to be approximately \$2 billion. About half of this amount will be reinvested in existing restaurants while the rest will primarily be used to open 1,000 restaurants (950 traditional and 50 satellites). The Company expects net additions of about 600 restaurants (700 net traditional additions and 100 net satellite closings). These restaurant numbers include new unit openings in affiliate and developmental license markets, such as Japan and those in Latin America, where the Company invests no capital.

For 2007 through 2009, the Company expects to return \$15 billion to \$17 billion to shareholders through share repurchases and dividends, subject to business and market conditions. For the full year 2007 and the first quarter 2008 combined, the Company returned \$8.2 billion to shareholders.

As a result of the developmental licensee structure, the Company's operating results in Latin America will reflect royalty income of approximately 5% of sales and minimal selling, general and administrative expenses to support the business.



The Company continually reviews our restaurant ownership structures to maximize cash flow and returns and to enhance local relevance. The Company expects to optimize our restaurant ownership mix by refranchising 1,000 to 1,500 Company-operated restaurants over the next three or more years, primarily in our major markets, and by continuing to utilize our developmental license strategy. In first quarter 2008, the Company refranchised about 130 restaurants, primarily in our major markets.

In early April 2008, the Company sold its minority ownership interest in U.K.-based Pret A Manger. In connection with the sale, the Company received net proceeds of approximately \$215 million, resulting in a nonoperating gain of about \$150 million that will be reflected in the second quarter.

**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 compensation plans on these results because we believe they better represent the underlying business trends.

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

Comparable sales represent the change in sales at all restaurants, including those operated by the Company, franchisees and affiliates, in operation at least thirteen months including those temporarily closed, excluding the impact of currency translation. Some of the reasons restaurants may be temporarily closed include road construction, reimaging or remodeling, and natural disasters. Management reviews the increase or decrease in comparable sales compared with the same period in the prior year to assess business trends.

## CONSOLIDATED OPERATING RESULTS

Dollars in millions, except per share data	Quarter Ended	
	March 31, 2008	
	Amount	% Increase / (Decrease)
<b>Revenues</b>		
Sales by Company-operated restaurants	\$ 3,998.8	2
Revenues from franchised and affiliated restaurants	1,616.0	17
<b>Total revenues</b>	5,614.8	6
<b>Operating costs and expenses</b>		
Company-operated restaurant expenses	3,339.6	1
Franchised restaurants occupancy expenses	299.8	9
Selling, general & administrative expenses	552.4	1
Impairment and other charges, net	0.5	(81)
Other operating (income) expense, net	(40.3)	n/m
<b>Total operating costs and expenses</b>	4,152.0	1
<b>Operating income</b>	1,462.8	24
Interest expense	128.5	32
Nonoperating (income) expense, net	(28.9)	(73)
<b>Income from continuing operations before provision for income taxes</b>	1,363.2	24
Provision for income taxes	417.1	25
<b>Income from continuing operations</b>	946.1	23
Income from discontinued operations		n/m
<b>Net income</b>	\$ 946.1	24
<b>Income per common share basic:</b>		
Continuing operations	\$ 0.83	30
Discontinued operations		n/m
Net income	\$ 0.83	32
<b>Income per common share diluted:</b>		
Continuing operations	\$ 0.81	29
Discontinued operations		n/m
Net income	\$ 0.81	31

n/m Not meaningful

**Net Income and Diluted Net Income per Common Share**

For the first quarter 2008, net income was \$946.1 million and diluted net income per common share was \$0.81. For the first quarter 2007, net income was \$762.4 million and diluted net income per common share was \$0.62. The 2007 results included income from continuing operations of \$766.5 million or \$0.63 per share, and a loss of \$4.1 million from discontinued operations related to Boston Market, which was sold in August 2007.

During the first quarter, the Company repurchased 37.1 million shares of its stock for \$2.0 billion. As previously announced, the Company's Board of Directors decided that dividends declared will be paid on a quarterly basis, at the Board's discretion. During the first quarter 2008, the Company paid a dividend of \$0.375 per share or \$426.4 million.

**Impact of Foreign Currency Translation****IMPACT OF FOREIGN CURRENCY TRANSLATION***Dollars in millions, except per share data*

			Currency Translation Benefit / (Loss)
<b>Quarters Ended March 31,</b>	<b>2008</b>	2007	<b>2008</b>
Revenues	\$ 5,614.8	\$ 5,292.7	\$345.5
Combined restaurant margins*	1,975.4	1,723.7	119.4
Selling, general & administrative expenses	552.4	545.2	(23.3)
Operating income	1,462.8	1,181.3	97.4
Net income	946.1	762.4	61.0
Net income per common share diluted	0.81	0.62	0.05

\* Reflects both franchised and Company-operated margin dollars.

Foreign currency translation had a positive impact on consolidated revenues, operating income, net income and net income per common share for the quarter, primarily driven by the stronger Euro, Australian Dollar and Canadian Dollar.

**Conversion of Certain Markets to Developmental License**

In August 2007, the Company completed the sale of Latam to a developmental licensee organization. Under a developmental license, a local licensee owns the business, including the real estate, and uses his/her capital and local knowledge to build the McDonald's Brand and optimize sales and profitability over the long term. Under this arrangement, the Company collects a royalty, which varies by market, based on a percent of sales, but does not invest any capital. As a result of the Latam transaction, the revenues generated from these markets were less than in the prior year.

The buyers of the Company's operations in Latam have entered into a 20-year master franchise agreement that requires the buyers, among other obligations, to pay monthly royalties commencing at a rate of approximately 5% of gross sales of the restaurants in these markets, substantially consistent with market rates for similar license arrangements.

**Revenues**

Revenues consist of sales by Company-operated restaurants and fees from restaurants operated by franchisees and affiliates. These fees primarily include rent and/or royalties that are based on a percent of sales, with specified minimum rent payments.

**REVENUES**

*Dollars in millions*

			% Inc / (Dec)	% Inc / (Dec)
			Excluding Currency	Translation
<b>Quarters Ended March 31,</b>	<b>2008</b>	<b>2007</b>	<b>(Dec)</b>	<b>Translation</b>
<i>Company-operated sales</i>				
U.S.	<b>\$ 1,110.1</b>	\$ 1,091.5	2	2
Europe	<b>1,785.6</b>	1,472.9	21	10
APMEA	<b>895.6</b>	729.3	23	15
Other Countries & Corporate	<b>207.5</b>	620.1	(67)	(71)
<b>Total</b>	<b>\$ 3,998.8</b>	\$ 3,913.8	2	(4)
<i>Franchised and affiliated revenues</i>				
U.S.	<b>\$ 786.5</b>	\$ 749.9	5	5
Europe	<b>590.0</b>	453.6	30	15
APMEA	<b>136.8</b>	101.0	35	20
Other Countries & Corporate	<b>102.7</b>	74.4	38	22
<b>Total</b>	<b>\$ 1,616.0</b>	\$ 1,378.9	17	10
<i>Total revenues</i>				
U.S.	<b>\$ 1,896.6</b>	\$ 1,841.4	3	3
Europe	<b>2,375.6</b>	1,926.5	23	11
APMEA	<b>1,032.4</b>	830.3	24	16
Other Countries & Corporate	<b>310.2</b>	694.5	(55)	(61)
<b>Total</b>	<b>\$ 5,614.8</b>	\$ 5,292.7	6	

Consolidated revenues increased 6% (flat in constant currencies) for the quarter, primarily due to positive comparable sales in all segments, offset by the Company's sale of its Latam business and the refranchising strategy in the Company's major markets. Upon completion of the Latam sale in August 2007, the Company receives royalties based on a percent of sales in these markets. All royalties are recorded in franchised and affiliated revenues. The Latam transaction and the refranchising strategy resulted in a higher proportion of franchised and affiliated restaurants compared with the prior year.

In the U.S., the increase in revenues was primarily driven by our market-leading breakfast business, continued focus on everyday value and the ongoing appeal of new products.

In Europe, the constant currency increase in revenues was primarily due to strong comparable sales in Russia (which is entirely Company-operated), France, Germany and the U.K., as well as positive comparable sales throughout the segment.

In APMEA, the constant currency increase in revenues was primarily driven by strong comparable sales in Australia and China, as well as positive comparable sales in substantially all other markets. In addition, expansion in China contributed to the increase.

Comparable sales for 2008 benefited from an extra day due to leap year. The following table presents the percent change in comparable sales for the quarters ended March 31, 2008 and 2007:

**COMPARABLE SALES**

	% Increase	
	Quarters Ended	
	March 31,	
	2008	2007
U.S.	2.9	4.4
Europe	11.1	8.0
APMEA	9.4	8.5
Other Countries & Corporate	15.3	7.7
Total	7.4	6.3

The following table presents the percent change in Systemwide sales for the quarter ended March 31, 2008:

**SYSTEMWIDE SALES**

	Quarter Ended	
	March 31, 2008	
	% Inc	Excluding Currency Translation
U.S.	4	4
Europe	26	13
APMEA	24	12
Other Countries & Corporate	31	16
Total	16	9

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

Quarters Ended March 31,	Percent		Amount		% Inc / (Dec)	% Inc / (Dec) Excluding Currency Translation
	2008	2007	2008	2007	(Dec)	
<i>Franchised</i>						
U.S.	<b>82.2</b>	81.8	\$ <b>646.2</b>	\$ 613.7	5	5
Europe	<b>78.0</b>	76.0	<b>460.0</b>	344.6	33	18
APMEA	<b>89.0</b>	87.7	<b>121.8</b>	88.6	37	22
Other Countries & Corporate	<b>85.9</b>	75.7	<b>88.2</b>	56.3	57	38
Total	<b>81.4</b>	80.0	\$ <b>1,316.2</b>	\$ 1,103.2	19	12
<i>Company-operated</i>						
U.S.	<b>17.8</b>	18.0	\$ <b>197.2</b>	\$ 195.9	1	1
Europe	<b>16.0</b>	15.4	<b>286.3</b>	226.9	26	14
APMEA	<b>16.6</b>	14.9	<b>148.4</b>	108.9	36	26
Other Countries & Corporate	<b>13.2</b>	14.3	<b>27.3</b>	88.8	(69)	(74)
Total	<b>16.5</b>	15.9	\$ <b>659.2</b>	\$ 620.5	6	(1)

Franchised margin dollars increased \$213.0 million or 19% (12% in constant currencies) for the quarter. The U.S. and Europe segments accounted for about 85% of the franchised margin dollars in both periods. The Latam transaction positively impacted the franchised margin percent increase by 60 basis points.

In the U.S., Europe and APMEA, the increase in the franchised margin percent for each segment was primarily driven by positive comparable sales.

In Other Countries & Corporate, Latin America's franchised margin percent increased significantly as a result of the sale of Latam in third quarter 2007. The Company receives royalties based on a percent of sales in these markets.

Company-operated margin dollars increased \$38.7 million or 6% (decreased 1% in constant currencies) for the quarter. The U.S. and Europe segments accounted for about 70% of the Company-operated margin dollars in both periods. As a result of the Latam transaction, there are no Company-operated restaurants remaining in Latin America in 2008. This transaction positively impacted the Company-operated margin percent increase by 20 basis points, but negatively impacted the Company-operated margin dollars.

In the U.S., the Company-operated margin percent decreased as higher commodity and other costs offset positive comparable sales.

Europe's Company-operated margin percent increased primarily due to strong comparable sales in most markets. This increase was partly offset by higher labor and commodity costs.

In APMEA, the Company-operated margin percent increased due to strong comparable sales in most markets.

The following table presents margin components as a percent of sales:

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

	Quarters Ended	
	March 31,	
	2008	2007
Food & paper	33.4	33.2
Payroll & employee benefits	26.8	26.2
Occupancy & other operating expenses	23.3	24.7
Total expenses	83.5	84.1
Company-operated margins	16.5	15.9
<b>Selling, General &amp; Administrative Expenses</b>		

Selling, general & administrative expenses increased 1% (decreased 3% in constant currencies) for the quarter. The constant currency change in selling, general & administrative expenses benefited by 6 percentage points due to the Latam transaction. Selling, general & administrative expenses as a percent of revenues decreased to 9.8% for the first quarter 2008 compared with 10.3% for 2007 and as a percent of Systemwide sales decreased to 3.3% for 2008 compared with 3.8% for 2007.

**Other Operating (Income) Expense, Net**

**OTHER OPERATING (INCOME) EXPENSE, NET**

*In millions*

	Quarters Ended	
	March 31,	
	2008	2007
Gains on sales of restaurant businesses	\$(13.1)	\$ (7.7)
Equity in earnings of unconsolidated affiliates	(23.4)	(24.0)
Asset dispositions and other (income) expense	(3.8)	26.3
Total	\$(40.3)	\$ (5.4)

Gains on sales of restaurant businesses increased primarily as a result of selling more Company-operated restaurants in connection with our franchising strategy in the Company's major markets.

Asset dispositions and other (income) expense included income of \$17.8 million due to the partial recovery of prior years' sales taxes in the U.K. in 2008. In addition, 2007 results reflected higher losses on restaurant closings and property disposals.

**Operating Income****OPERATING INCOME***Dollars in millions*

	2008	2007	% Inc Excluding	
			% Inc /	Currency
<b>Quarters ended March 31,</b>	<b>2008</b>	2007	(Dec)	Translation
U.S.	\$ 682.5	\$ 649.6	5	5
Europe	577.2	393.1	47	31
APMEA	217.5	148.7	46	31
Other Countries & Corporate	(14.4)	(10.1)	(43)	n/m
Total	\$ 1,462.8	\$ 1,181.3	24	16
n/m Not meaningful				

In the U.S., results increased for the quarter primarily due to higher franchised margin dollars.

In Europe, operating results for the quarter were driven by strong performance in France, the U.K. and Germany, as well as positive results in most other markets. In addition, 2008 reflected income of \$17.8 million due to the partial recovery of prior years sales taxes in the U.K.

In APMEA, operating results for the quarter were driven by strong results in Australia and China, as well as positive performance in most other markets.

**Combined Operating Margin**

Combined operating margin is defined as operating income as a percent of total revenues. Combined operating margin for the first quarter 2008 and 2007 was 26.1% and 22.3%, respectively.

**Interest Expense**

Interest expense for the quarter increased due to higher average debt levels and interest rates. Higher average debt levels were driven by net debt issuances in the first quarter 2008 and the fourth quarter 2007.

**Nonoperating (Income) Expense, Net****NONOPERATING (INCOME) EXPENSE, NET***In millions*

	Quarters Ended	
	2008	2007
Interest income	\$(31.4)	\$(24.5)
Translation and hedging activity	4.7	2.9
Other (income) expense	(2.2)	4.9
Total	\$(28.9)	\$(16.7)

Interest income increased for the quarter due to \$11.6 million of interest on the partial recovery of prior years sales taxes in the U.K.





### **Income Taxes**

The effective income tax rate was 30.6% for first quarter 2008 compared with 30.4% for first quarter 2007.

### **Discontinued Operations**

In August 2007, the Company sold its investment in Boston Market and as a result, Boston Market's results of operations have been reflected in discontinued operations. Boston Market's net loss for the first quarter 2007 was \$4.1 million.

### **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 \$1.5 billion and exceeded capital expenditures by \$1.1 billion for the first quarter 2008. Cash provided by operations increased \$550.1 million compared to first quarter 2007 driven by strong operating results and changes in working capital items, partly due to the receipt of \$123.5 million in first quarter 2008 related to the Internal Revenue Service (IRS) examination completed in fourth quarter 2007.

Cash used for investing activities totaled \$317.5 million in first quarter 2008, a decrease of \$88.0 million, primarily due to higher proceeds from sales of restaurant businesses in conjunction with our overall refranchising strategy and lower purchases of restaurant businesses. Capital expenditures were relatively flat compared with first quarter 2007.

Cash used for financing activities totaled \$281.4 million for first quarter 2008, an increase of \$44.0 million. First quarter 2008 reflected higher treasury stock purchases, the first quarter dividend payment, lower proceeds from stock option exercises and higher net debt issuances. As previously announced, the Company's Board of Directors decided that beginning in 2008 dividends declared will be paid on a quarterly basis, at the Board's discretion.

Debt obligations at March 31, 2008 totaled \$11.7 billion compared with \$9.3 billion at December 31, 2007. The increase in 2008 was primarily due to net issuances of \$2.1 billion. In 2008, the Company issued certain debt earlier than originally expected to take advantage of favorable market conditions to pre-fund a portion of its debt maturing in the second half of the year.

### **Accounting Changes**

#### ***Fair Value Measurements***

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. This statement does not require any new fair value measurements; rather, it applies to other accounting pronouncements that require or permit fair value measurements. The provisions of SFAS No. 157, as issued, were effective January 1, 2008. However, the FASB issued FASB Staff Position No. FAS 157-2, *Effective Date of FASB Statement No. 157*, which allows entities to defer the effective date of SFAS No. 157, for one year, for certain non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (i.e., at least annually). The Company adopted SFAS No. 157 as of January 1, 2008 and elected the deferral for non-financial assets and liabilities. The effect of adopting this standard was not significant.

## **Risk Factors and Cautionary Statement Regarding Forward-Looking Statements**

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.

Our business and execution of our strategic plan, the Plan to Win, are subject to risks. By far 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 segment of the restaurant industry, although largely mature in our major markets, is also highly fragmented and competitive. We have the added challenge of the cultural, economic and regulatory differences that exist among the more than 100 countries where we operate. We also face risk in adapting our business model in particular markets. The decision to own restaurants or to operate under franchise, developmental license or joint venture agreements is driven by many factors whose interrelationship is complex and changing. 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 and may adversely affect our results.

These risks 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.**

*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 to trends or other factors that affect the informal eating out market 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 our products, all of which can drive consumer perceptions or affect the willingness of other companies to enter into site, supply or other arrangements or alliances with us, as well as our success in addressing these trends and factors or other competitive pressures;

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 the trust and confidence of our customers;

Our ability to respond effectively to adverse consumer perceptions about the quick-service segment of the informal eating out market, our products and promotions (including the premiums we offer, such as our Happy Meal toys) or the reliability of our supply chain and the safety of the ingredients we use, 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 products and to roll-out new products and product line extensions, as well as the impact of our competitors' actions, including in response to our product improvements and introductions, and our ability to continue robust product development and manage the complexity of our restaurant operations;

Our ability to achieve an overall product mix that differentiates the McDonald's experience and balances consumer value with margin expansion, including in markets where cost or pricing pressures may be significant;

The impact of pricing, marketing and promotional plans on product sales and margins and on our ability to target these efforts effectively to maintain or expand market share;



The impact of events such as consumer 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;

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;

Our ability to maintain alignment with our franchisees on capital-intensive and other operating initiatives;

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

Whether our ongoing restaurant remodeling and rebuilding initiatives, which vary from year to year by market and type, 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; and

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 our ownership mix and whether we can achieve a mix that optimizes margins and returns, while meeting our business needs and customer expectations.**

*In recent years, we have reduced the number of Company-operated restaurants and we are planning further reductions by franchising Company-operated restaurants or entering into developmental license agreements. Whether and when we can achieve these plans, as well as their success, is uncertain and will be affected by the following:*

Our ability to identify prospective franchisees and licensees with the experience and financial resources in the relevant markets to be effective operators of McDonald's restaurants and how quickly we can reach agreement with our counterparties, which we expect will vary by market and could also vary significantly from period to period;

The nature and amount of contingent liabilities and other exposures we may retain in connection with developmental license agreements, such as the indemnification obligations we may incur as a result of the Latam transaction;

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; and

Changes in the operating or legal environment and other circumstances that cause us to delay or revise our plans to alter our ownership mix.

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

## Edgar Filing: MCDONALDS CORP - Form 10-Q

*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 and may prompt promotional or other actions that adversely affect our margins, constrain our operating flexibility or result in charges, restaurant closings or sales of Company-operated restaurants. Whether we can manage this risk effectively depends mainly on the following:*

Our ability to manage upward pressure on commodity prices, as well as fluctuations in interest and foreign exchange rates and local governmental actions to manage national economic conditions, such as consumer spending, inflation rates and unemployment levels, particularly in the United States, which faces an uncertain economy in 2008;

The impact on our margins of labor costs given our labor-intensive business model, the 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, either directly or through licensees or other parties, consistent with our plans for net growth of Systemwide restaurants from year to year, and whether new sites are as profitable as expected;

Whether we can develop effective initiatives in markets that may be experiencing challenges;

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, such as those that may occur as we change our ownership mix as described above.

**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 are the following:*

Our ability to manage 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 consumer perceptions 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 advertising 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 consumer perceptions, litigation and regulation 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 laws and among practices within the restaurant industry with respect to testing and disclosure, ordinary variations in food preparation among our own restaurants, and reliance on the accuracy and completeness of information obtained from third party suppliers;

The impact of litigation trends, particularly in our major markets, including class actions, labor and employment matters 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 advertising or other communications;

The costs and other effects of compliance with U.S. federal, state and local regulations regarding immigration and the enforcement of those regulations, as well as compliance with other U.S. and overseas labor regulations, including with respect to wage and hour matters, employee classification, mandatory healthcare benefits and unlawful workplace discrimination;

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

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

## Edgar Filing: MCDONALDS CORP - Form 10-Q

increases, the potential costs associated with consumer fraud and the loss of consumer confidence that may result from alleged security breaches involving our point of sale and other systems; 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 of adjustments proposed by the IRS 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:*

Governmental actions or media reports and commentary relating to economic activity or events, such as the current U.S. Presidential election, even where the action, report or event does not directly relate to our business or prospects, and particularly actions by U.S. authorities or U.S. economic activity, which are of special import because the United States is the principal trading market for our common stock;



Trading activity in our common stock (whether in the cash or derivative markets), which can reflect not only market commentary or expectations about our business, but also significant purchases by shareholders who may seek to affect our business strategies, 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 Jones Industrial Average; and

The impact of our stock repurchase program, dividend rate or changes in our debt levels that may affect our credit ratings, interest expense, ability to obtain funding on favorable terms or our flexibility, especially if lenders impose new operating or financial covenants, as well as the impact of other corporate actions, such as initiatives to rationalize our operating structure.

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

*Severe weather conditions, terrorist activities, health epidemics or pandemics or the prospect of these events can have an adverse impact on consumer spending and confidence levels and in turn the McDonald's System and our results and prospects in the affected markets. Our receipt of proceeds under any insurance we maintain for these purposes 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, 2007 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 March 31, 2008. 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 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 March 31, 2008 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

---

**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, 2007 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**

The following table presents information related to repurchases of common stock the Company made during the three months ended March 31, 2008:

**Issuer Purchases of Equity Securities\***

<b>Period</b>	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid per Share</b>	<b>Total Number of Shares Purchased Under the Program *</b>	<b>Maximum Dollar Amount that May Yet Be Purchased Under the Program *</b>
January 1-31, 2008	14,800,419	\$53.96	14,800,419	\$7,621,067,000
February 1-29, 2008	16,674,982	\$55.29	16,674,982	6,699,149,000
March 1-31, 2008	5,618,165	\$54.32	5,618,165	6,393,944,000
Total	37,093,566	\$54.61	37,093,566	\$6,393,944,000

\* On September 12, 2007, the Company's Board of Directors terminated a previously-approved share repurchase program and replaced it with a new share repurchase program that authorizes the purchase of up to \$10.0 billion of the Company's outstanding common stock with no specified expiration date. As of March 31, 2008, the maximum dollar amount that may yet be purchased under the new program was \$6,393,944,000.

Consistent with the above authorization and 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.

**Item 6. Exhibits**

Exhibit Number	Description
(3)	<ul style="list-style-type: none"> <li>(a) Restated Certificate of Incorporation, effective as of March 24, 1998, incorporated herein by reference from Form 8-K, dated April 17, 1998.</li> <li>(b) By-Laws, as amended and restated with effect as of November 9, 2006, incorporated herein by reference from Form 8-K, dated November 8, 2006.</li> </ul>
(4)	<p>Instruments defining the rights of security holders, including Indentures: *</p> <ul style="list-style-type: none"> <li>(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.                             <ul style="list-style-type: none"> <li>(i) Medium-Term Notes, Series I, Due from 1 Year to 60 Years from Date of Issue. Supplemental Indenture No. 8, incorporated herein by reference from Exhibit (4)(c) of Form S-3 Registration Statement (File No. 333-139431), filed December 15, 2006.</li> </ul> </li> <li>(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.</li> <li>(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.</li> <li>(d) McDonald's Corporation 2002 QSC Rewards Program, effective as of February 13, 2002, incorporated herein by reference from Exhibit (4) of Form S-3/A Registration Statement (File No. 333-82920), filed March 14, 2002.                             <ul style="list-style-type: none"> <li>(i) Prospectus dated March 15, 2002, incorporated by reference from Form 424(b)(4) (File No. 333-82920), filed March 20, 2002, as supplemented by the Prospectus Supplement, dated March 4, 2003 (incorporated by reference from Form 424(b)(3), filed March 4, 2003) and the Prospectus Supplement, dated September 25, 2003 (incorporated by reference from Form 424(b)(3), filed September 26, 2003).</li> </ul> </li> </ul>
(10)	<p>Material Contracts</p> <ul style="list-style-type: none"> <li>(a) Directors' Deferred Compensation Plan, effective as of January 1, 2008, incorporated herein by reference from Form 8-K, dated November 28, 2007.**</li> <li>(b) McDonald's Excess Benefit and Deferred Bonus Plan, effective January 1, 2008, incorporated herein by reference from Form 8-K, dated November 28, 2007.**</li> <li>(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.**                             <ul style="list-style-type: none"> <li>(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.**</li> <li>(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.**</li> </ul> </li> <li>(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.**                             <ul style="list-style-type: none"> <li>(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.**</li> </ul> </li> <li>(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.**</li> </ul>

- (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) Executive Retention Replacement Plan, effective as of December 31, 2007, incorporated herein by reference from Form 8-K, dated November 28, 2007.\*\*
- (h) McDonald's Corporation Amended and Restated 2001 Omnibus Stock Ownership Plan, as amended and restated March 18, 2004, incorporated herein by reference from Form 10-Q, for the quarter ended June 30, 2004.\*\*
  - (i) First Amendment to the McDonald's Corporation Amended and Restated 2001 Omnibus Stock Ownership Plan, effective February 4, 2006, incorporated by reference from Form 10-Q, for the quarter ended March 31, 2006.\*\*
  - (ii) Second Amendment to the McDonald's Corporation Amended and Restated 2001 Omnibus Stock Ownership Plan, effective as of February 14, 2007, incorporated herein by reference from Form 10-Q, for the quarter ended March 31, 2007.\*\*
- (i) Form of McDonald's Corporation Tier I Change of Control Employment Agreement, as amended, authorized by the Board of Directors, on December 3, 2003, incorporated herein by reference from Form 10-K, for the year ended December 31, 2003.\*\*
  - (i) First Amendment to Tier I Change of Control Employment Agreement, effective January 25, 2005, incorporated herein by reference from Form 10-K, for the year ended December 31, 2004.\*\*
- (j) McDonald's Corporation 2004 Cash Incentive Plan, effective as of January 1, 2004, incorporated herein by reference from Form 10-Q, for the quarter ended June 30, 2004.\*\*
- (k) Senior Director Letter Agreement between Donald G. Lubin and the Company, incorporated herein by reference from Form 8-K, dated May 24, 2006.\*\*
- (l) Form of Stock Option Grant Notice, incorporated herein by reference from Form 10-Q, for the quarter ended June 30, 2005.\*\*
- (m) Form of Restricted Stock Unit Award Notice, incorporated herein by reference from Form 10-Q, for the quarter ended June 30, 2005.\*\*
- (n) McDonald's Corporation Severance Plan, effective January 1, 2008, incorporated by reference from Form 8-K, dated November 28, 2007.\*\*
- (o) 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.\*\*
- (p) Amended Assignment Agreement between Timothy Fenton and the Company, dated January 2008, filed herewith.\*\*
- (q) Relocation Agreement between Timothy Fenton and the Company, dated January 12, 2006, incorporated herein by reference from Form 10-K, for the year ended December 31, 2006.\*\*
- (r) Description of Restricted Stock Units granted to Andrew J. McKenna, incorporated herein by reference from Form 10-Q, for the quarter ended June 30, 2007.\*\*
- (s) Terms of the RSUs 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 September 30, 2007.\*\*
- (t) McDonald's Corporation Target Incentive Plan, effective as of January 1, 2008, incorporated herein by reference from Form 8-K, dated January 23, 2008.\*\*
- (u) Terms of equity compensation awards granted in the European Union pursuant to the Company's Amended and Restated 2001 Omnibus Stock Ownership Plan, filed herewith.\*\*

- (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.

\* 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.

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)

May 6, 2008

/s/ Peter J. Bensen  
Peter J. Bensen  
*Corporate Executive Vice President and  
Chief Financial Officer*