

MCDONALDS CORP
Form 10-Q
May 04, 2007
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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, 2007

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)

(630) 623-3000
(Zip Code)

(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.

Yes No

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

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Large accelerated filer

Accelerated filer

Non-accelerated filer

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

Yes No

1,193,875,641

(Number of shares of common stock
outstanding as of March 31, 2007)

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MCDONALD S CORPORATION

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The following trademarks used herein are the property of McDonald's Corporation and its affiliates: Boston Market and McDonald's.

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

| In millions, except per share data | (unaudited) March 31, 2007 | December 31, 2006 |
|---|----------------------------------|----------------------|
| Assets | | |
| Current assets | | |
| Cash and equivalents | \$ 2,438.4 | \$ 2,136.4 |
| Accounts and notes receivable | 848.0 | 904.2 |
| Inventories, at cost, not in excess of market | 143.7 | 149.0 |
| Prepaid expenses and other current assets | 449.3 | 435.7 |
| Total current assets | 3,879.4 | 3,625.3 |
| Other assets | | |
| Investments in and advances to affiliates | 1,064.4 | 1,036.2 |
| Goodwill, net | 2,254.3 | 2,209.2 |
| Miscellaneous | 1,300.2 | 1,307.4 |
| Total other assets | 4,618.9 | 4,552.8 |
| Property and equipment | | |
| Property and equipment, at cost | 32,163.4 | 31,810.2 |
| Accumulated depreciation and amortization | (11,188.2) | (10,964.5) |
| Net property and equipment | 20,975.2 | 20,845.7 |
| Total assets | \$ 29,473.5 | \$ 29,023.8 |
| Liabilities and shareholders' equity | | |
| Current liabilities | | |
| Accounts payable | \$669.2 | \$834.1 |
| Income taxes | 100.5 | 250.9 |
| Other taxes | 297.1 | 251.4 |
| Accrued interest | 140.2 | 135.1 |
| Accrued payroll and other liabilities | 1,244.0 | 1,518.9 |
| Current maturities of long-term debt | 613.5 | 17.7 |
| Total current liabilities | 3,064.5 | 3,008.1 |
| Long-term debt | 8,199.9 | 8,416.5 |
| Other long-term liabilities | 1,471.0 | 1,074.9 |
| Deferred income taxes | 971.1 | 1,066.0 |
| 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 | 3,731.3 | 3,445.0 |
| Retained earnings | 26,592.5 | 25,845.6 |
| Accumulated other comprehensive income (loss) | (201.5) | (296.7) |
| Common stock in treasury, at cost; 466.7 and 456.9 million shares | (14,371.9) | (13,552.2) |
| Total shareholders' equity | 15,767.0 | 15,458.3 |
| Total liabilities and shareholders' equity | \$ 29,473.5 | \$ 29,023.8 |

See notes to condensed Consolidated financial statements.

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

| In millions, except per share data | Quarters Ended March 31, | |
|--|-----------------------------|-----------------|
| | 2007 | 2006 |
| Revenues | | |
| Sales by Company-operated restaurants | \$ 4,082.8 | \$ 3,669.5 |
| Revenues from franchised and affiliated restaurants | 1,381.3 | 1,244.4 |
| Total revenues | 5,464.1 | 4,913.9 |
| Operating costs and expenses | | |
| Company-operated restaurant expenses | 3,456.2 | 3,144.4 |
| Franchised restaurants occupancy expenses | 276.2 | 252.0 |
| Selling, general & administrative expenses | 558.2 | 535.4 |
| Impairment and other charges, net | 2.6 | 86.1 |
| Other operating (income) expense, net | (3.7) | (15.4) |
| Total operating costs and expenses | 4,289.5 | 4,002.5 |
| Operating income | 1,174.6 | 911.4 |
| Interest expense | 97.3 | 102.3 |
| Nonoperating income, net | (16.6) | (35.0) |
| Income from continuing operations before provision for income taxes | 1,093.9 | 844.1 |
| Provision for income taxes | 331.5 | 270.7 |
| Income from continuing operations | 762.4 | 573.4 |
| Income from discontinued operations (net of taxes of \$9.8) | | 51.9 |
| Net income | \$ 762.4 | \$ 625.3 |
| Per common share basic: | | |
| Continuing operations | \$ 0.63 | \$ 0.46 |
| Discontinued operations | | 0.04 |
| Net income | \$ 0.63 | \$ 0.50 |
| Per common share diluted: | | |
| Continuing operations | \$ 0.62 | \$ 0.45 |
| Discontinued operations | | 0.04 |
| Net income | \$ 0.62 | \$ 0.49 |
| Weighted average shares outstanding basic | 1,201.2 | 1,254.1 |
| Weighted average shares outstanding diluted | 1,222.3 | 1,271.2 |

See notes to condensed Consolidated financial statements.

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

| In millions | Quarters Ended | |
|---|-----------------------|---------------------------|
| | 2007 | March 31, 2006 |
| Operating activities | | |
| Net income | \$ 762.4 | \$ 625.3 |
| Adjustments to reconcile to cash provided by operations | | |
| Charges and credits: | | |
| Depreciation and amortization | 311.5 | 305.4 |
| Deferred income taxes | (20.3) | (3.8) |
| Impairment and other charges, net | 2.6 | 86.1 |
| Share-based compensation | 37.0 | 38.9 |
| Gains on Chipotle transactions | | (51.2) |
| Other | (78.4) | 28.0 |
| Changes in working capital items | (86.4) | (413.9) |
| Cash provided by operations | 928.4 | 614.8 |
| Investing activities | | |
| Property and equipment expenditures | (408.9) | (289.2) |
| Purchases and sales of restaurant businesses and property sales | 1.9 | (20.6) |
| Chipotle transactions, net | | 48.8 |
| Other | 3.0 | 57.3 |
| Cash used for investing activities | (404.0) | (203.7) |
| Financing activities | | |
| Notes payable and long-term financing issuances and repayments | 330.2 | (323.7) |
| Treasury stock purchases | (968.4) | (981.4) |
| Proceeds from stock option exercises | 370.4 | 249.6 |
| Excess tax benefit on share-based compensation | 47.9 | 31.7 |
| Other | (17.5) | (23.1) |
| Cash used for financing activities | (237.4) | (1,046.9) |
| Effect of exchange rates on cash and cash equivalents | 15.0 | 44.8 |
| Cash and equivalents increase/(decrease) | 302.0 | (591.0) |
| Cash and equivalents at beginning of period | 2,136.4 | 4,260.6 |
| Cash and equivalents at end of period | \$ 2,438.4 | \$ 3,669.6 |

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, 2006 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, 2007 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 to the condensed Consolidated financial statements for periods prior to purchase and sale.

Comprehensive Income

The following table presents the components of comprehensive income for the quarters ended March 31, 2007 and 2006:

| In millions | Quarters Ended | |
|--|-----------------------|-----------------|
| | March 31, | 2006 |
| | 2007 | 2006 |
| Net income | \$ 762.4 | \$ 625.3 |
| Other comprehensive income (loss): | | |
| Foreign currency translation adjustments | 89.0 | 103.1 |
| Deferred hedging adjustments | 4.4 | (6.9) |
| Pension liability adjustment | 1.8 | |
| Total other comprehensive income (loss) | 95.2 | 96.2 |
| Total comprehensive income | \$ 857.6 | \$ 721.5 |

Per Common Share Information

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 employee compensation, calculated using the treasury stock method, of 21.1 million shares and 17.1 million shares for the first quarter 2007 and 2006, respectively. Stock options that were not included in diluted weighted-average shares outstanding because they would have been antidilutive were 6.0 million shares and 37.6 million shares for the first quarter 2007 and 2006, respectively.

Sabbatical Leave

In June 2006, the Financial Accounting Standards Board (FASB) ratified Emerging Issues Task Force Issue 06-2, *Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43, Accounting for Compensated Absences* (EITF 06-2). Under EITF 06-2, compensation costs associated with a sabbatical should be accrued over the requisite service period, assuming certain conditions are met. Previously, the Company expensed sabbatical costs as incurred. The Company adopted EITF 06-2 effective January 1, 2007, as required and accordingly, we recorded a \$36.1 million cumulative adjustment, net of tax, to decrease the January 1, 2007 balance of retained earnings. We expect the annual impact to earnings to be insignificant.

Income Tax Contingencies

In July 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), which is an interpretation of FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company adopted the provisions of FIN 48 effective January 1, 2007, as required. As a result of the implementation of FIN 48, the Company recorded a \$20.1 million cumulative adjustment to increase the January 1, 2007 balance of retained earnings. FIN 48 requires that a liability associated with an unrecognized tax benefit be classified as a long-term liability except for the amount for which a cash payment is anticipated within one year. Upon adoption of FIN 48, \$338.7 million of tax liabilities, net of deposits, were reclassified from current to long-term and are now included in other long-term

liabilities.

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As of the date of adoption and after recognizing the impact of FIN 48, the Company's gross unrecognized tax benefits totaled \$664.3 million. Of this total, approximately \$600 million, after considering the federal impact on state issues, would favorably affect the effective tax rate if resolved in the Company's favor.

During the three months ended March 31, 2007, the Company reduced the unrecognized tax benefit related to prior years' tax positions by \$51 million. The reduction was due to new tax developments during the quarter, primarily related to international operations, which impacted our evaluation of uncertain tax positions claimed on prior years' returns.

The Internal Revenue Service (IRS) is examining the Company's U.S. federal income tax returns for 2003 and 2004. In connection with this examination, the IRS has proposed certain significant adjustments to the Company's filing positions. These adjustments primarily relate to the valuations of the Company's investments in certain foreign subsidiaries. It is not known how these adjustments will be settled. The Company expects to finalize this examination in 2007. As a result, it is reasonably possible that the total amount of unrecognized tax benefits will decrease by approximately \$380 million by the end of 2007. An estimate of the impact on the effective tax rate for this decrease cannot be made at this time; however, the Company does not expect to make a significant cash payment as a result of settling the examination.

With few exceptions, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2001.

The Company's continuing practice is to recognize interest and penalties related to income tax matters in income tax expense. The Company had \$46.4 million accrued for interest and no accrual for penalties at January 1, 2007.

Recently Issued Accounting Standards

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). SFAS 159 permits entities to voluntarily choose to measure many financial instruments and certain other items at fair value. SFAS No. 159 is effective beginning January 1, 2008, but the Company has not decided whether to elect this standard at this time.

Discontinued operations

The Company continues to focus its management and financial resources on the McDonald's restaurant business as it believes the opportunities for growth remain significant. Accordingly, during 2006, the Company disposed of its investment in Chipotle Mexican Grill (Chipotle) via public stock offerings in the first and second quarters and a tax-free exchange for McDonald's common stock in the fourth quarter. As a result of the disposal, Chipotle's results of operations and transaction gains are reflected as discontinued operations.

In first quarter 2006, Chipotle completed an IPO of 6.1 million shares resulting in a tax-free gain to McDonald's of \$32.0 million to reflect an increase in the carrying value of the Company's investment as a result of Chipotle selling shares in the public offering. Concurrent with the IPO, McDonald's sold 3.0 million Chipotle shares, resulting in net proceeds to the Company of \$61.4 million and an additional gain of \$13.6 million after tax. In addition, McDonald's share of Chipotle's results of operations for the first quarter 2006 was \$6.3 million after tax.

Results related to Chipotle, which previously were included in the Company's Other segment, consisted of revenues and pretax profits for the first quarter 2006 of \$187.0 million and \$61.7 million, respectively.

Table of Contents**Segment Information**

The Company primarily franchises and operates McDonald's restaurants in the food service industry. In addition, the Company operates and has investments in certain non-McDonald's brands that are not material to the Company's overall results.

The following table presents the Company's revenues and operating income by geographic segment. The APMEA segment represents McDonald's restaurant operations in Asia/Pacific, Middle East and Africa. The Corporate & Other segment represents Corporate activities and non-McDonald's brands.

| In millions | Quarters Ended | |
|--------------------------------|-------------------|-------------------|
| | March 31, | |
| | 2007 | 2006 |
| Revenues | | |
| U.S. | \$ 1,841.4 | \$ 1,737.9 |
| Europe | 1,926.5 | 1,655.4 |
| APMEA | 830.3 | 727.4 |
| Latin America | 456.9 | 380.2 |
| Canada | 237.6 | 241.4 |
| Corporate & Other | 171.4 | 171.6 |
| Total revenues | \$ 5,464.1 | \$ 4,913.9 |
| Operating income (loss) | | |
| U.S. | \$ 649.6 | \$ 628.9 |
| Europe | 393.1 | 261.1 |
| APMEA | 148.7 | 95.7 |
| Latin America | 39.7 | (8.5) |
| Canada | 44.5 | 38.7 |
| Corporate & Other | (101.0) | (104.5) |
| Total operating income | \$ 1,174.6 | \$ 911.4 |
| Subsequent Event | | |

On April 17, 2007, the Board of Directors approved an agreement for the Company to sell its existing 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 comprise nearly 1,600 restaurants, as "Latam". The sale of Latam is subject to satisfaction of customary conditions, including final documentation of the licensing arrangement and receipt of regulatory approvals.

Based on approval by the Company's Board of Directors, the Company concluded Latam was held for sale as of that date in accordance with the requirements of SFAS No. 144, *Accounting for the Impairment or Disposal of Long-lived Assets*. As a result, the Company will record an impairment charge of approximately \$1.6 billion in the second quarter of 2007, substantially all of which is noncash. The charge includes approximately \$800 million for the difference between the net book value of the Latam business and the estimated \$700 million in cash proceeds to be received at closing (subject to working capital adjustments), less costs of disposal. This loss in value was primarily due to a historically difficult economic environment coupled with volatility experienced in many of the markets included in this transaction. The charge also includes historical foreign currency translation losses of approximately \$825 million recorded in shareholders' equity. The Company expects a minimal tax benefit from this transaction. As a result of meeting the held for sale criteria, the Company will cease recording depreciation expense with respect to Latam effective April 17, 2007. In connection with the sale, the Company has agreed to indemnify the buyers for certain tax and other claims.

The buyers of Latam will enter into a 20-year master franchise agreement that will require the buyers, among other obligations, (i) 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; (ii) to commit to opening approximately 150 new McDonald's restaurants over the first three years and pay an initial franchise fee for each new restaurant opened; and (iii) to commit to specified annual capital expenditures for existing restaurants. The Company expects to complete the sale and licensing transaction within the next few months and, upon completion, may record an adjustment to the impairment charge.

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

Overview

The Company primarily franchises and operates McDonald's restaurants. In addition, the Company operates and has investments in certain non-McDonald's brands that are not material to the Company's overall results. Of the 31,062 McDonald's restaurants in 118 countries at March 31, 2007, 18,766 are operated by franchisees (including 1,107 operated by developmental licensees), 4,106 are operated by affiliates and 8,190 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 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 ongoing 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 joint venture) 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 operating 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 we introduce Systemwide only those that we believe are most beneficial. In addition, we firmly believe that owning restaurants is paramount to being a credible franchisor. 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. 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: United States; Europe; Asia/Pacific, Middle East and Africa (APMEA); Latin America; and Canada. In addition, throughout this report we present a segment entitled Corporate & Other that includes Corporate activities and non-McDonald's brands (e.g., Boston Market). The U.S. and Europe segments each account for approximately 35% of total revenues.

During 2006, the Company disposed of its entire investment in Chipotle Mexican Grill (Chipotle) via public stock offerings and a tax-free exchange for McDonald's common stock. As a result of the complete disposition of Chipotle, the Company has reflected Chipotle's 2006 results and transaction gains as discontinued operations.

Strategic Direction and Financial Performance

The Company remains focused on increasing McDonald's relevance to consumers through the execution of multiple initiatives under our Plan to Win in order to be better, not just bigger. This plan is designed to deliver operational excellence and leadership marketing leveraged around five key drivers of exceptional customer experiences—people, products, place, price and promotion. Our focus and disciplined approach to executing these initiatives have increased our consumer relevance and delivered strong results in each of the last four years with revenue growth, operating income growth and returns on incremental invested capital meeting or exceeding our long-term financial targets. In the first quarter 2007, our strong results reflected higher revenues, increased customer visits and enhanced profitability as we keep our brand relevant through contemporary food and beverage offerings, modern restaurants and attractive everyday value.

In the U.S., initiatives such as reimagining restaurants, extending operating hours and providing cashless payment options helped make McDonald's more inviting and convenient for customers. March 2007 marked 48 consecutive months of positive comparable sales. We continue to optimize our U.S. performance by focusing on strategic initiatives that build upon our fundamental strengths of unparalleled convenience, compelling value and menu choice and variety.

Results in Europe are being achieved with a focus on three core strategies—upgrading the customer experience, building brand transparency, and enhancing our local relevance. We delivered strong growth in the first quarter fueled by robust comparable sales across the segment. We are encouraged by the progress of our European business and the momentum created through focused execution of the Plan to Win.

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APMEA's focus on branded affordability and breakfast, combined with convenience extensions, such as 24 hour drive-thrus and delivery, are producing results. First quarter performance was strong, driven by positive comparable sales across the segment.

As previously announced, we identified about 2,300 restaurants to be transitioned to a developmental license. Under a developmental license, a local licensee owns the business, including controlling the real estate, and uses his/her capital and local knowledge to build the 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.

Consistent with this strategy, in April 2007, the Company's Board of Directors approved an agreement that will result in the franchising of nearly 1,600 existing restaurants in Latin America and the Caribbean to a developmental licensee organization led by Woods Staton. As part of this transaction, McDonald's expects to receive approximately \$700 million in cash proceeds from the sale of these operations, which will be coupled with a 20-year license arrangement. In line with our previous guidance, we expect to record an impairment charge of approximately \$1.6 billion in the second quarter, which consists of about \$800 million for the difference between the net book value of assets and the estimated cash proceeds, as well as \$825 million for accumulated currency translation losses. The charge will be substantially all noncash. The sale is subject to satisfaction of customary conditions, including final documentation of the licensing arrangement and receipt of regulatory approvals, and we anticipate that it will close in the next few months.

We remain committed to returning value to shareholders through share repurchases and dividends. In the first quarter 2007, we repurchased 22.4 million shares of McDonald's stock for \$1.0 billion.

We continue to focus our management and financial resources on the McDonald's restaurant business as the opportunities for growth remain significant. The McDonald's System is energized by our current momentum and we remain intent on further enhancing every element of the Brand experience to capture the tremendous opportunities that lie ahead. Our results confirm that our strategy of growing by improving our existing restaurants and focusing on the Plan to Win is the right strategy for McDonald's, our customers and our shareholders. Our long-term financial targets remain unchanged: average annual Systemwide sales and revenue growth of 3% to 5%, average annual operating income growth of 6% to 7%, and annual returns on incremental invested capital in the high teens. These targets exclude the impact of foreign currency translation.

Operating Highlights Included:

Revenues increased 11% (7% in constant currencies)

Global comparable sales increased 6.3% and were positive in all segments

Company-operated and franchised restaurant margins improved for the fifth consecutive quarter

Consolidated results reflected double-digit growth in operating income

The Company repurchased \$1 billion or 22.4 million shares of its stock

Cash provided by operations totaled \$928.4 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.

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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 2007 Systemwide sales growth (in constant currencies), most of which will be due to McDonald's restaurants added during 2006. In 2007, the Company expects to open about 800 McDonald's restaurants (700 traditional and 100 satellites). We expect net additions of about 400 (450 net traditional additions and 50 net satellite closings).

The Company does not 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 cents.

The primary food commodities impacting McDonald's business are beef and chicken. In 2007, U.S. beef costs are expected to be down about 2%, while we expect U.S. chicken costs to rise 5% to 7%. In Europe, we expect our costs for beef and chicken to be relatively flat in 2007.

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The Company expects full-year 2007 selling, general & administrative expenses to decline modestly as a percent of revenues and Systemwide sales compared with 2006.

A significant part of the Company's operating income is generated outside the U.S., and about 75% 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 2006, the Company's annual net income per share would change by about 7 cents to 8 cents.

In 2007, based on current business performance and plans, the Company expects to maintain a debt-to-capital ratio of 35% to 40%. Based on current interest and foreign currency exchange rates, the Company expects interest expense in 2007 to remain relatively flat compared with 2006, while it expects interest income to decrease about 40% to 50% due to lower cash balances.

The Company expects capital expenditures for 2007 to be approximately \$1.9 billion. About half of this amount will be reinvested in existing restaurants while the rest will primarily be used to build new restaurants.

In 2007 and 2008 combined, the Company expects to return at least \$5.7 billion to shareholders through a combination of share repurchases and dividends.

Beyond the Latam transaction, the Company will continue to pursue the sale of certain existing markets, which represent about 600 restaurants, to developmental licensees. We expect these transactions to be completed by the end of 2008.

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

Constant currency results are calculated by translating current year results at prior year average exchange rates. Management reviews and analyzes business results excluding the effect of foreign currency translation and bases certain compensation plans on these results because it believes they better represent the Company's underlying business trends.

Systemwide sales include sales at all restaurants, including those operated by the Company, franchisees and affiliates. Management believes Systemwide sales information is useful in analyzing the Company's revenues because franchisees and affiliates pay rent and/or royalties that generally are based on a percent of sales with specified minimum rent payments.

Comparable sales represent sales at all McDonald's 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 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.

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| Dollars in millions, except per share data | Quarter Ended March 31, 2007 | |
|--|---------------------------------|------------|
| | Amount | % Increase |
| Revenues | | |
| Sales by Company-operated restaurants | \$ 4,082.8 | 11 |
| Revenues from franchised and affiliated restaurants | 1,381.3 | 11 |
| Total revenues | 5,464.1 | 11 |
| Operating costs and expenses | | |
| Company-operated restaurant expenses | 3,456.2 | 10 |
| Franchised restaurants occupancy expenses | 276.2 | 10 |
| Selling, general & administrative expenses | 558.2 | 4 |
| Impairment and other charges, net | 2.6 | (97) |
| Other operating (income) expense, net | (3.7) | 76 |
| Total operating costs and expenses | 4,289.5 | 7 |
| Operating income | 1,174.6 | 29 |
| Interest expense | 97.3 | (5) |
| Nonoperating income, net | (16.6) | (53) |
| Income from continuing operations before provision for income taxes | 1,093.9 | 30 |
| Provision for income taxes | 331.5 | 22 |
| Income from continuing operations | 762.4 | 33 |
| Income from discontinued operations | | n/m |
| Net income | \$ 762.4 | 22 |
| Income per common share basic: | | |
| Continuing operations | \$ 0.63 | 37 |
| Discontinued operations | | n/m |
| Net income | \$ 0.63 | 26 |
| Income per common share diluted: | | |
| Continuing operations | \$ 0.62 | 38 |
| Discontinued operations | | n/m |
| Net income | \$ 0.62 | 27 |

n/m Not meaningful

Net Income and Diluted Net Income per Common Share

For the first quarter 2007, net income was \$762.4 million and diluted net income per common share was \$0.62. For the first quarter 2006, net income was \$625.3 million and diluted net income per common share was \$0.49. The 2006 results included income from continuing operations of \$573.4 million or \$0.45 per share, and \$51.9 million or \$0.04 per share of income from discontinued operations related to Chipotle. The 2006 results also included impairment and other charges of \$59.1 million after tax or \$0.05 per share primarily related to strategic actions taken to enhance overall profitability and improve returns.

During the quarter, the Company repurchased 22.4 million shares of its stock for \$1.0 billion.

Table of Contents**Impact of Foreign Currency Translation on Reported Results****IMPACT OF FOREIGN CURRENCY TRANSLATION ON REPORTED RESULTS***Dollars in millions, except per share data*

| | <u>Reported Amount</u> | | Currency Translation |
|--|------------------------|-----------|-----------------------|
| | 2007 | 2006 | Benefit / (Loss) 2007 |
| Quarters ended March 31, | | | |
| Revenues | \$5,464.1 | \$4,913.9 | \$186.7 |
| Combined operating margins* | 1,723.7 | 1,505.0 | 52.9 |
| Selling, general & administrative expenses | 558.2 | 535.4 | (14.2) |
| Operating income | 1,174.6 | 911.4 | 37.2 |
| Income from continuing operations | 762.4 | 573.4 | 20.3 |
| Net income | 762.4 | 625.3 | 20.3 |
| Income from continuing operations per common share diluted | 0.62 | 0.45 | 0.01 |
| Net income per common share diluted | 0.62 | 0.49 | 0.01 |

* Reflects both franchised and Company-operated margin dollars and excludes non-McDonald's brands
Foreign currency translation had a positive impact on consolidated revenues, operating income, net income and diluted net income per common share for the quarter, primarily driven by the stronger Euro and British Pound.

Table of Contents**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

| Quarters Ended March 31, | 2007 | 2006 | % Inc / (Dec) | % Inc / (Dec) Excluding Currency Translation |
|---|-------------------|-------------|--------------------------|---|
| <i>Company-operated sales</i> | | | | |
| U.S. | \$ 1,091.5 | \$ 1,025.0 | 6 | 6 |
| Europe | 1,472.9 | 1,285.7 | 15 | 5 |
| APMEA* | 729.3 | 636.9 | 15 | 11 |
| Latin America | 428.1 | 355.1 | 21 | 19 |
| Canada | 192.0 | 197.7 | (3) | (1) |
| Corporate & Other** | 169.0 | 169.1 | | |
| Total | \$ 4,082.8 | \$ 3,669.5 | 11 | 7 |
| <i>Franchised and affiliated revenues</i> | | | | |
| U.S. | \$ 749.9 | \$ 712.9 | 5 | 5 |
| Europe | 453.6 | 369.7 | 23 | 12 |
| APMEA* | 101.0 | 90.5 | 12 | 9 |
| Latin America | 28.8 | 25.1 | 15 | 14 |
| Canada | 45.6 | 43.7 | 4 | 6 |
| Corporate & Other** | 2.4 | 2.5 | (4) | (3) |
| Total | \$ 1,381.3 | \$ 1,244.4 | 11 | 8 |
| <i>Total revenues</i> | | | | |
| U.S. | \$ 1,841.4 | \$ 1,737.9 | 6 | 6 |
| Europe | 1,926.5 | 1,655.4 | 16 | 7 |
| APMEA* | 830.3 | 727.4 | 14 | 11 |
| Latin America | 456.9 | 380.2 | 20 | 19 |
| Canada | 237.6 | 241.4 | (2) | |
| Corporate & Other** | 171.4 | 171.6 | | |
| Total | \$ 5,464.1 | \$ 4,913.9 | 11 | 7 |

* APMEA represents Asia/Pacific, Middle East and Africa

** Corporate & Other represents Corporate activities and non-McDonald's brands
Consolidated revenues increased 11% (7% in constant currencies) for the quarter, primarily due to positive comparable sales in all segments.

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

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In Europe, the constant currency increase in revenues was primarily due to strong comparable sales in France and Russia (which is entirely Company-operated), as well as positive comparable sales across all other markets. These increases were partly offset by a higher proportion of franchised and affiliated restaurants compared with first quarter 2006, primarily due to sales of Company-operated restaurants and Company-operated restaurant closings in the U.K. during 2006.

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

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The following table presents the percent change in comparable sales for the quarters ended March 31, 2007 and 2006:

COMPARABLE SALES - McDONALD'S RESTAURANTS*

| | % Increase | |
|------------------------|----------------|------|
| | Quarters Ended | |
| | March 31, | |
| | 2007 | 2006 |
| U.S. | 4.4 | 6.6 |
| Europe | 8.0 | 2.0 |
| APMEA | 8.5 | 4.1 |
| Latin America | 14.7 | 15.3 |
| Canada | 0.7 | 8.5 |
| McDonald's Restaurants | 6.3 | 5.2 |

* Excludes non-McDonald's brands

The following table presents the percent change in Systemwide sales for the quarter ended March 31, 2007:

SYSTEMWIDE SALES - McDONALD'S RESTAURANTS

| | Quarter Ended | |
|---------------|----------------|-------------|
| | March 31, 2007 | |
| | % Inc | % Inc |
| | | Excluding |
| | | Currency |
| | % Inc | Translation |
| U.S. | 5 | 5 |
| Europe | 19 | 9 |
| APMEA | 12 | 11 |
| Latin America | 18 | 17 |
| Canada | | 1 |
| Total | 10 | 7 |

Table of Contents**Operating Margins****FRANCHISED AND COMPANY-OPERATED RESTAURANT MARGINS****McDONALD S RESTAURANTS***Dollars in millions*

| Quarters ended March 31, | Percent | | Amount | | % Inc / (Dec) | % Inc Excluding Currency Translation |
|--------------------------|-------------|------|-------------------|----------|------------------|---|
| | 2007 | 2006 | 2007 | 2006 | | |
| <i>Franchised</i> | | | | | | |
| U.S. | 81.8 | 81.5 | \$ 613.7 | \$ 581.0 | 6 | 6 |
| Europe | 76.0 | 75.6 | 344.6 | 279.5 | 23 | 13 |
| APMEA | 87.7 | 87.1 | 88.6 | 78.8 | 12 | 10 |
| Latin America | 73.6 | 70.4 | 21.2 | 17.7 | 20 | 20 |
| Canada | 77.0 | 76.2 | 35.1 | 33.3 | 5 | 7 |
| Total | 80.0 | 79.7 | \$ 1,103.2 | \$ 990.3 | 11 | 8 |
| <i>Company-operated</i> | | | | | | |
| U.S. | 18.0 | 18.3 | \$ 195.9 | \$ 187.1 | 5 | 5 |
| Europe | 15.4 | 13.6 | 226.9 | 174.9 | 30 | 19 |
| APMEA | 14.9 | 12.3 | 108.9 | 78.7 | 38 | 34 |
| Latin America | 14.4 | 13.2 | 61.9 | 46.8 | 32 | 30 |
| Canada | 14.0 | 13.7 | 26.9 | 27.2 | (1) | 1 |
| Total | 15.9 | 14.7 | \$ 620.5 | \$ 514.7 | 21 | 16 |

Franchised margin dollars increased \$112.9 million or 11% (8% in constant currencies) for the quarter. The U.S. and Europe segments accounted for more than 85% of the franchised margin dollars in both periods.

In the U.S., the increase in the franchised margin percent was primarily driven by positive comparable sales.

Europe's franchised margin percent improved due to strong comparable sales, partly offset by higher rent expense in several markets and the impact of sales of certain Company-operated restaurants to franchisees and affiliates in the U.K. throughout 2006. Company-operated margin dollars increased \$105.8 million or 21% (16% 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.

In the U.S., positive comparable sales were offset by cost pressures including higher labor costs, primarily due to a higher average hourly rate for crew, higher performance-based compensation for restaurant managers, and an increase in certain other employee-related costs.

Europe's Company-operated margin percent increased primarily due to strong comparable sales. In addition, initiatives in the U.K. throughout 2006 including the closing of certain underperforming restaurants, as well as the sales of certain Company-operated restaurants to franchisees and affiliates in conjunction with our overall franchising strategy, contributed to the increase.

In APMEA, the Company-operated margin percent reflected strong comparable sales and continued improving results in China and many other markets.

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

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

| | Quarters Ended March 31, | |
|---|-----------------------------|------|
| | 2007 | 2006 |
| Food & paper | 33.3 | 33.5 |
| Payroll & employee benefits | 26.2 | 26.4 |
| Occupancy & other operating expenses | 24.6 | 25.4 |
| Total expenses | 84.1 | 85.3 |
| Company-operated margins | 15.9 | 14.7 |
| Selling, General & Administrative Expenses | | |

Selling, general & administrative expenses increased 4% for the quarter (2% in constant currencies) primarily due to higher employee-related costs. Selling, general & administrative expenses as a percent of revenues decreased to 10.2% for the first quarter 2007 compared with 10.9% for 2006 and as a percent of Systemwide sales decreased to 3.9% for 2007 compared with 4.1% for 2006.

Impairment and Other Charges, Net

In first quarter 2006, the Company recorded \$86.1 million of expense related to the following strategic actions taken to enhance overall profitability and improve returns: the closing of 25 restaurants in the U.K. in conjunction with an overall restaurant portfolio review (\$41.8 million); costs to buy out certain litigating franchisees in Brazil (\$29.0 million); a loss incurred on the transfer of the Company's ownership interest in Bulgaria to a developmental licensee (\$7.8 million); and asset write-offs in APMEA (\$7.5 million).

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

Dollars in millions

| | Quarters Ended March 31, | |
|---|-----------------------------|-----------|
| | 2007 | 2006 |
| Gains on sales of restaurant businesses | \$ (7.7) | \$ (8.2) |
| Equity in earnings of unconsolidated affiliates | (24.0) | (13.4) |
| Asset disposition and other expense | 28.0 | 6.2 |
| Total | \$ (3.7) | \$ (15.4) |

Equity in earnings of unconsolidated affiliates increased primarily due to improved results from our Japanese affiliate.

Asset dispositions and other expense increased primarily due to higher losses on restaurant closings and property disposals.

Table of Contents**Operating Income****OPERATING INCOME (LOSS)***Dollars in millions*

| Quarters Ended March 31, | 2007 | 2006 | % Inc | % Inc Excluding Currency Translation |
|---------------------------------|-------------------|----------|--------------|---|
| U.S. | \$ 649.6 | \$ 628.9 | 3 | 3 |
| Europe | 393.1 | 261.1 | 51 | 38 |
| APMEA | 148.7 | 95.7 | 55 | 51 |
| Latin America | 39.7 | (8.5) | n/m | n/m |
| Canada | 44.5 | 38.7 | 15 | 17 |
| Corporate & Other | (101.0) | (104.5) | 3 | 3 |
| Total operating income | \$ 1,174.6 | \$ 911.4 | 29 | 25 |
| n/m Not meaningful | | | | |

In the U.S., results increased primarily due to higher combined operating margin dollars, partly offset by lower other operating income.

In Europe, operating results for the first quarter 2007 reflected strong performance in France and Russia, as well as positive results in most other markets. Results for the first quarter 2006 included impairment and other charges totaling \$49.6 million.

In APMEA, operating results for the first quarter 2007 were driven by improved results in China, Japan and most other markets. First quarter 2006 results included impairment and other charges totaling \$7.5 million.

In Latin America, results increased for the quarter primarily due to continued strong sales performance in Brazil. Results for the first quarter 2006 included \$29.0 million of impairment and other charges.

Interest Expense

For the first quarter 2007, interest expense decreased primarily due to lower average debt levels, partly offset by higher average interest rates and stronger foreign currencies.

Nonoperating Income, Net**NONOPERATING (INCOME) EXPENSE, NET***Dollars in millions*

| | Quarters Ended March 31, | 2007 | 2006 |
|---------------------------|-------------------------------------|------------------|-----------|
| Interest income | | \$ (24.6) | \$ (37.3) |
| Translation (gain) / loss | | 2.9 | (5.9) |
| Other expense | | 5.1 | 8.2 |
| Total | | \$ (16.6) | \$ (35.0) |

Interest income decreased primarily due to lower cash levels.

Income Taxes

The effective income tax rate was 30.3% for first quarter 2007 compared with 32.1% for first quarter 2006. The 2007 tax rate reflected the net benefit of certain discrete tax items, which impacted the first quarter only and primarily related to international operations.

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Accounting Changes

Sabbatical Leave

In June 2006, the Financial Accounting Standards Board (FASB) ratified Emerging Issues Task Force Issue 06-2, *Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43, Accounting for Compensated Absences* (EITF 06-2). Under EITF 06-2, compensation costs associated with a sabbatical should be accrued over the requisite service period, assuming certain conditions are met. Previously, the Company expensed sabbatical costs as incurred. The Company adopted EITF 06-2 effective January 1, 2007, as required and accordingly, we recorded a \$36.1 million cumulative adjustment, net of tax, to decrease the January 1, 2007 balance of retained earnings. We expect the annual impact to earnings to be insignificant.

Income Tax Contingencies

In July 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), which is an interpretation of FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company adopted the provisions of FIN 48 effective January 1, 2007, as required and accordingly, we recorded a \$20.1 million cumulative adjustment to increase the January 1, 2007 balance of retained earnings.

Discontinued operations

During 2006, the Company disposed of its investment in Chipotle via public stock offerings in the first and second quarters and a tax-free exchange for McDonald's common stock in the fourth quarter. As a result of the disposal, Chipotle's results of operations and transaction gains are reflected as discontinued operations.

In first quarter 2006, Chipotle completed an IPO of 6.1 million shares resulting in a tax-free gain to McDonald's of \$32.0 million to reflect an increase in the carrying value of the Company's investment as a result of Chipotle selling shares in the public offering. Concurrent with the IPO, McDonald's sold 3.0 million Chipotle shares, resulting in net proceeds to the Company of \$61.4 million and an additional gain of \$13.6 million after tax. In addition, McDonald's share of Chipotle's results of operations for the first quarter 2006 was \$6.3 million after tax.

Conversion of Certain Markets to Developmental License

As previously announced, we identified about 2,300 restaurants to be transitioned to a developmental license. 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.

Consistent with this strategy, the Company has agreed to sell its existing operations in Brazil, Argentina, Mexico, Puerto Rico, Venezuela and 13 other countries in Latin America and the Caribbean to a developmental licensee organization led by Woods Staton, who has been a valued member of the McDonald's System for more than 20 years. The Company refers to these markets, which comprise nearly 1,600 restaurants, as Latam. The sale of Latam is subject to satisfaction of customary conditions, including final documentation of the licensing arrangement and receipt of regulatory approvals.

Based on approval by the Company's Board of Directors, which occurred on April 17, 2007, the Company concluded Latam was held for sale as of that date in accordance with the requirements of SFAS No. 144, *Accounting for the Impairment or Disposal of Long-lived Assets*. As a result, the Company will record an impairment charge of approximately \$1.6 billion in the second quarter of 2007, substantially all of which will be noncash. The charge includes approximately \$800 million for the difference between the net book value of the Latam business and the estimated \$700 million in cash proceeds to be received at closing (subject to working capital adjustments), less costs of disposal. This loss in value was primarily due to a historically difficult economic environment coupled with volatility experienced in many of the markets included in this transaction. The charge also includes historical foreign currency translation losses of approximately \$825 million recorded in shareholders equity. The Company expects a minimal tax benefit from this transaction. As a result of meeting the held for sale criteria, the Company will cease recording depreciation expense with respect to Latam effective April 17, 2007. In connection with the sale, the Company has agreed to indemnify the buyers for certain tax and other claims.

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The buyers of Latam will enter into a 20-year master franchise agreement that will require the buyers, among other obligations, (i) 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; (ii) to commit to adding approximately 150 new McDonald's restaurants over the first three years and pay an initial franchise fee for each new restaurant opened; and (iii) to commit to specified

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annual capital expenditures for existing restaurants. The Company expects to complete the sale and licensing transaction within the next few months and, upon completion, may record an adjustment to the impairment charge.

Based on 2006 results for Latam, the annualized consolidated financial statement impact of this transaction is expected to consist of:

A decrease in consolidated revenues of approximately \$1.5 billion

No significant impact on operating income as the franchising income, net of selling, general & administrative expenses, is expected to approximate the operating income previously earned

An increase in franchised and Company-operated margin percentages

A decrease in capital expenditure requirements

An increase in the consolidated return on assets by an estimated 90 basis points

The remaining 600 restaurants that we intend to convert to a developmental license structure are primarily located in APMEA and some small markets in Europe. Our annual impairment testing for these assets is based on the assumption that these markets will continue to be operated under the existing ownership structure until it becomes probable that a transaction will occur within 12 months, and we can reasonably estimate our sales proceeds. We expect these transactions to be completed by the end of 2008. These remaining restaurants have net assets with a net book value of less than \$500 million, including a small historical foreign currency translation impact, which we do not expect to entirely recover in the form of sales proceeds. These restaurants had sales of about \$800 million in 2006, but generated an operating loss of \$40 million (including impairment charges of about \$30 million). We spent about \$45 million in selling, general & administrative expenses and invested about \$25 million in capital expenditures in these markets in 2006.

Critical accounting policy: Conversion of existing businesses to developmental licenses

When the Company sells an existing business to a developmental licensee, the 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. The sale of the business includes primarily land, buildings and improvements, and equipment, along with the franchising and leasing rights under existing agreements. Under the related developmental licensing arrangement, the Company collects a royalty based on a percent of sales, as well as initial franchise fees, but does not have either any capital invested in the business or any commitment to invest future capital.

The Company determines when these businesses are held for sale in accordance with the requirements of SFAS No. 144, *Accounting for the Impairment or Disposal of Long-lived Assets*. Impairment charges on assets held for sale are recognized when management and, if required, the Company's Board of Directors have approved and committed to a plan to dispose of the assets, the assets are available for disposal, the disposal is probable of occurring within 12 months, and the net sales proceeds are expected to be less than the assets' net book value. An impairment charge is recognized for the difference between the net book value of the business (including foreign currency translation adjustments recorded in accumulated other comprehensive income in shareholders' equity) and the estimated cash sales price, less costs of disposal.

An alternative accounting policy would be to recharacterize some or all of the loss as an intangible asset and amortize it to expense over future periods based on the term of the relevant licensing arrangement and as revenue is recognized for royalties and initial franchise fees. Such a policy would be based on a view that the consideration for sale is receivable in two forms - the cash sales price and the future royalties and initial franchise and other fees.

The Company bases its accounting policy on management's determination that royalties payable under its developmental license arrangements are substantially consistent with market rates for similar license arrangements. The Company does not believe it would be appropriate to recognize an asset for the right to receive market-based fees in future periods. Thus, recognizing the impairment charge based on the net cash sales price reflects the substance of the sale transaction.

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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 \$928.4 million and exceeded capital expenditures by \$519.5 million in the first quarter. Cash provided by operations increased \$313.6 million compared to first quarter 2006 primarily due to lower income tax payments in 2007 and stronger operating results.

Cash used for investing activities totaled \$404.0 million in the first quarter, an increase of \$200.3 million primarily due to higher capital expenditures in 2007. Capital expenditures increased \$119.7 million for the quarter consistent with the Company's strategy to increase investment in existing restaurants, primarily in Europe and the U.S. In addition, 2006 reflected net proceeds from the Chipotle transactions.

Cash used for financing activities totaled \$237.4 million in the first quarter, a decrease of \$809.5 million primarily due to net debt issuances in 2007 compared with net debt repayments in 2006 and also higher proceeds from stock option exercises in 2007.

As a result of the above activity, the Company's cash balance increased \$302.0 million from December 31, 2006 to \$2,438.4 million at March 31, 2007.

Debt obligations at March 31, 2007 totaled \$8,813.4 million compared with \$8,434.2 million at December 31, 2006. The increase in 2007 was primarily due to net issuances of \$330.2 million and the impact of changes in exchange rates on foreign currency-denominated debt of \$59.2 million, partly offset by SFAS No. 133 noncash fair value adjustments of \$10.2 million.

Recently Issued Accounting Standards

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). SFAS 159 permits entities to voluntarily choose to measure many financial instruments and certain other items at fair value. SFAS No. 159 is effective beginning January 1, 2008, but the Company has not decided whether to elect this standard at this time.

Restaurant Information

The following table presents restaurant information by ownership type:

| Restaurants at March 31, | 2007 | 2006 |
|---------------------------------|---------------|-------------|
| Operated by franchisees | 18,768 | 18,367 |
| Operated by the Company | 8,803 | 8,972 |
| Operated by affiliates | 4,106 | 4,068 |
| Systemwide restaurants | 31,677 | 31,407 |

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. Our plan to reduce our ownership of restaurants may be difficult to achieve for many reasons, and the change in ownership mix may not affect our results as we now expect. Regulatory and similar initiatives around the world have also become more wide-ranging and

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prescriptive and affect how we operate, as well as 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.

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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.

We developed the Plan to Win to address 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, consumer food preferences, publicity about our products or operations that can drive consumer perceptions, as well as our success in planning and executing initiatives to address 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 or the reliability of our supply chain and the safety of the food ingredients we use, and our ability to manage the potential impact on McDonald's of food-borne illnesses involving other restaurant or food companies;

The success of our plans for 2007 and beyond 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 public boycotts, labor strikes and commodity or other supply chain 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 drive improvements in our restaurants, recruit qualified restaurant personnel and motivate employees to achieve sustained high service levels so as to improve consumer perceptions of our ability to meet their expectations for quality food served in clean and friendly environments;

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

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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.**

Our plans call for a reduction in Company-operated restaurants by franchising them or entering into developmental license agreements, including our planned transaction in Latin America. 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 complete the closing for the Latin America transaction, which accounts for two-thirds of the restaurants we have been considering for conversion to a developmental license structure and is subject to final documentation of the related 20-year developmental license agreement and other closing conditions;

Our ability to identify other 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;

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Whether there are regulatory or other constraints that restrict or prevent our ability to implement our plans or increase our costs and whether planned transactions will receive needed regulatory approvals, such as those that are required under antitrust laws as part of the Latin America transaction, on terms and conditions that are acceptable to us and our counterparties;

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 will retain in our planned Latin America transaction;

The risks to our Brand if a franchisee or licensee defaults in its obligations, particularly those involving payment of royalties and required investments and restaurant openings, or projects a brand image inconsistent with our values, which are risks that will be more significant if an agreement places multiple markets or a large number of restaurants under the control of a single franchisee or licensee as will be the case in our planned Latin America 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 development license agreements;

Whether the period during which we plan to make these changes will be sufficient to achieve them; 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.

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 fluctuations in commodity prices, interest and foreign exchange rates and the effects of local governmental initiatives to manage through national economic conditions such as consumer spending and inflation rates;

The impact on our margins of labor costs given our labor-intensive business model and the trend toward higher wages in both mature and developing markets;

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

The effects of governmental initiatives to manage economic conditions such as consumer spending or wage and inflation rates;

Whether the recent improvements in operating results in markets such as the U.K. and Japan will be sustained and whether we can develop effective initiatives in other markets that may be experiencing challenges;

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The nature and timing of decisions about underperforming markets or assets, including decisions that result in significant impairment charges that reduce our earnings, such as those that may occur as we change our ownership mix as described above; and

The success of our strategy in China, where we are planning significant growth, including our ability to identify and secure appropriate real estate sites and to manage the costs and profitability of our growth in light of competitive pressures and other operating conditions that may limit pricing flexibility.

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 significantly increased our cost of doing business. In developing markets, we face the risks

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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 or product labeling;

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 are material to our business;

The risks and costs of McDonald's nutritional labeling and other disclosure practices, particularly given differences in 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 appropriateness of information obtained from third party suppliers;

The impact of litigation trends, particularly in our major markets, including class actions involving consumers and shareholders, labor and employment matters or landlord liability and 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 possibility of settlements or judgments;

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;

Disruptions in our operations or price volatility in a market that can result from government actions, including price controls, limitations on the import or export of commodities we use or government-mandated closure of our or our vendors' operations;

The risks of operating in markets, such as Brazil and China, in which there are significant uncertainties, including with respect to the application of legal requirements and the enforceability of laws and contractual obligations;

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 consumer fraud and the loss of consumer confidence that may result from security breaches involving our point of sale and other systems; and

The impact of changes in 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. These factors include some over which we have no control, such as general market conditions and governmental actions or reports about economic activity that may have a market-moving impact, regardless of whether the action or activity directly relates to our business. Actions or reports by U.S. authorities are of special import since the United States is our largest segment and our principal trading market. Trading activity in our common stock (whether in the cash or derivative markets) also affects

prices and volatility. In addition to reflecting investor expectations about our prospects, trading activity can include significant purchases by shareholders who may seek to affect our business strategies, as well as both sales and purchases resulting 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. Finally, our stock price can be affected not only by operating actions we take, but also by non-operating initiatives, such as our plans to reduce shares outstanding through repurchases or increases in our dividend rate.

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

Severe weather conditions (such as hurricanes), terrorist activities, health epidemics or pandemics or the prospect of these events (such as the potential spread of avian flu) 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.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

There were no material changes to the disclosure made in the Annual Report on Form 10-K for the year ended December 31, 2006 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, 2007. 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, 2007 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, 2006 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, 2007:

Issuer Purchases of Equity Securities

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased Under the Program * | Maximum Dollar Amount that May Yet Be Purchased Under the Program * |
|---------------------|---|-------------------------------------|---|--|
| January 1-31, 2007 | 5,005,549 | \$43.56 | 5,005,549 | \$3,249,726,000 |
| February 1-28, 2007 | 8,689,130 | \$45.12 | 8,689,130 | \$2,857,709,000 |
| March 1-31, 2007 | 8,724,311 | \$44.27 | 8,724,311 | \$2,471,527,000 |
| Total | 22,418,990 | \$44.44 | 22,418,990 | \$2,471,527,000 |

* In March 2006, the Company's Board of Directors authorized a \$5.0 billion share repurchase program with no specified completion date. The Company repurchases shares directly in the open market during limited time frames in each month consistent with its internal trading policies and also repurchases shares under plans complying with Rule 10b5-1 under the Securities Exchange Act during periods when it is prohibited from making direct share repurchases under those policies.

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Item 6. Exhibits

| Exhibit Number | Description |
|----------------|--|
| (3) | <ul style="list-style-type: none"> (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 November 9, 2006, incorporated herein by reference from Form 8-K dated November 8, 2006. |
| (4) | <p>Instruments defining the rights of security holders, including Indentures: **</p> <ul style="list-style-type: none"> (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"> (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. (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. (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"> (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). |
| (10) | <p>Material Contracts:</p> <ul style="list-style-type: none"> (a) Directors' Deferred Compensation Plan, as amended and restated March 22, 2007, filed herewith.* (b) McDonald's Excess Benefit and Deferred Bonus Plan, effective January 1, 2005, as amended and restated June 2, 2005, incorporated herein by reference from Form 10-Q for the quarter ended June 30, 2005.* <ul style="list-style-type: none"> (i) First Amendment to the McDonald's Excess Benefit and Deferred Bonus Plan, as amended and restated June 2, 2005, incorporated by reference from Form 10-Q for the quarter ended March 31, 2006.* (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"> (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.* |

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- (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 February 14, 2007, filed herewith.*
- (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 February 14, 2007, filed herewith.*
- (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 Plan, as amended and restated December 1, 2004, incorporated herein by reference from Form 10-K for the year ended December 31, 2004.*
- (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 14, 2006, incorporated by reference from Form 10-Q for the quarter ended March 31, 2006.*
 - (ii) Second Amendment To McDonald's Corporation Amended and Restated 2001 Omnibus Stock Ownership Plan, effective February 14, 2007, filed herewith.*
- (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 April 1, 2006, incorporated by reference from Form 10-Q for the quarter ended March 31, 2006.*
- (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) Assignment Agreement between Timothy Fenton and the Company, dated January 2006, incorporated herein by reference from Form 10-K for the year ended December 31, 2006.*
- (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.*
- (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.

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- (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.
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* Denotes compensatory plan.

** 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.

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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.

May 4, 2007

McDONALD S CORPORATION
(Registrant)

/s/ Matthew H. Paull
Matthew H. Paull

*Corporate Senior Executive Vice President
and Chief Financial Officer*