

MCDONALDS CORP  
Form 10-Q  
November 06, 2008  
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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 September 30, 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)

**McDonald s Plaza**

**Oak Brook, Illinois**  
(Address of Principal Executive Offices)

**36-2361282**  
(I.R.S. Employer

Identification No.)

**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

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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, 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

**1,114,544,888**

(Number of shares of common stock

outstanding as of September 30, 2008)

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

| <b>In millions, except per share data</b>   | <b>(unaudited)<br/>September 30,<br/>2008</b> | <b>December 31,<br/>2007</b> |
|---|---|------------------------------|
| <b>Assets</b>   |   |                              |
| <b>Current assets</b>   |   |                              |
| Cash and equivalents  | \$ 1,487.2                                    | \$ 1,981.3                   |
| Accounts and notes receivable   | 856.8   | 1,053.8                      |
| Inventories, at cost, not in excess of market   | 114.7   | 125.3                        |
| Prepaid expenses and other current assets   | 352.9   | 421.5                        |
| <b>Total current assets</b>   | <b>2,811.6</b>                                | <b>3,581.9</b>               |
| <b>Other assets</b>   |   |                              |
| Investments in and advances to affiliates   | 1,126.0                                       | 1,156.4                      |
| Goodwill, net   | 2,272.0                                       | 2,301.3                      |
| Miscellaneous   | 1,327.9                                       | 1,367.4                      |
| <b>Total other assets</b>   | <b>4,725.9</b>                                | <b>4,825.1</b>               |
| <b>Property and equipment</b>   |   |                              |
| Property and equipment, at cost   | 31,865.9                                      | 32,203.7                     |
| Accumulated depreciation and amortization   | (11,269.0)                                    | (11,219.0)                   |
| <b>Net property and equipment</b>   | <b>20,596.9</b>                               | <b>20,984.7</b>              |
| <b>Total assets</b>   | <b>\$ 28,134.4</b>                            | <b>\$ 29,391.7</b>           |
| <b>Liabilities and shareholders' equity</b>   |   |                              |
| <b>Current liabilities</b>  |   |                              |
| Notes payable   |   | \$ 1,126.6                   |
| Accounts payable  | \$ 481.0                                      | 624.1                        |
| Dividends payable   | 557.3   |                              |
| Other taxes   | 256.3   | 248.0                        |
| Accrued interest  | 164.7   | 148.4                        |
| Accrued payroll and other liabilities   | 1,391.2                                       | 1,486.9                      |
| Current maturities of long-term debt  | 18.0  | 864.5                        |
| <b>Total current liabilities</b>  | <b>2,868.5</b>                                | <b>4,498.5</b>               |
| <b>Long-term debt</b>   | <b>9,860.6</b>                                | <b>7,310.0</b>               |
| <b>Other long-term liabilities</b>  | <b>1,363.1</b>                                | <b>1,342.5</b>               |
| <b>Deferred income taxes</b>  | <b>990.6</b>                                  | <b>960.9</b>                 |
| <b>Shareholders' equity</b>   |   |                              |
| Preferred stock, no par value; authorized 165.0 million shares; issued none                 |   | 16.6                         |
| Common stock, \$.01 par value; authorized 3.5 billion shares; issued 1,660.6 million shares | 16.6  | 16.6                         |
| Additional paid-in capital  | 4,521.6                                       | 4,226.7                      |
| Retained earnings   | 27,968.3                                      | 26,461.5                     |
| Accumulated other comprehensive income  | 763.6   | 1,337.4                      |
| Common stock in treasury, at cost; 546.1 and 495.3 million shares                           | (20,218.5)                                    | (16,762.4)                   |
| <b>Total shareholders' equity</b>   | <b>13,051.6</b>                               | <b>15,279.8</b>              |

**Total liabilities and shareholders' equity**

\$ 28,134.4

\$ 29,391.7

See Notes to condensed consolidated financial statements.

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

| <b>In millions, except per share data</b>                                  | <b>Quarters Ended</b> |                   | <b>Nine Months Ended</b> |                   |
|--|-----------------------|-------------------|--------------------------|-------------------|
|  | <b>September 30,</b>  |                   | <b>September 30,</b>     |                   |
|  | <b>2008</b>           | <b>2007</b>       | <b>2008</b>              | <b>2007</b>       |
| <b>Revenues</b>  |                       |                   |                          |                   |
| Sales by Company-operated restaurants                                      | \$ 4,411.1            | \$ 4,276.2        | \$ 12,705.9              | \$ 12,507.8       |
| Revenues from franchised and affiliated restaurants                        | 1,856.2               | 1,624.7           | 5,251.5                  | 4,525.2           |
| <b>Total revenues</b>  | <b>6,267.3</b>        | <b>5,900.9</b>    | <b>17,957.4</b>          | <b>17,033.0</b>   |
| <b>Operating costs and expenses</b>  |                       |                   |                          |                   |
| Company-operated restaurant expenses                                       | 3,587.2               | 3,492.3           | 10,462.0                 | 10,343.8          |
| Franchised restaurants occupancy expenses                                  | 316.9                 | 287.4             | 932.0                    | 844.6             |
| Selling, general & administrative expenses                                 | 582.1                 | 569.4             | 1,733.2                  | 1,706.5           |
| Impairment and other charges, net  |                       | 52.7              | 1.0                      | 1,666.6           |
| Other operating (income) expense, net                                      | (42.6)                | (25.7)            | (111.5)                  | (52.9)            |
| <b>Total operating costs and expenses</b>                                  | <b>4,443.6</b>        | <b>4,376.1</b>    | <b>13,016.7</b>          | <b>14,508.6</b>   |
| <b>Operating income</b>  | <b>1,823.7</b>        | <b>1,524.8</b>    | <b>4,940.7</b>           | <b>2,524.4</b>    |
| Interest expense   | 131.6                 | 97.9              | 406.4                    | 296.9             |
| Nonoperating (income) expense, net   | (6.8)                 | (26.7)            | (66.5)                   | (60.3)            |
| Gain on sale of investment   |                       |                   | (160.1)                  |                   |
| <b>Income from continuing operations before provision for income taxes</b> | <b>1,698.9</b>        | <b>1,453.6</b>    | <b>4,760.9</b>           | <b>2,287.8</b>    |
| Provision for income taxes   | 507.6                 | 449.9             | 1,433.0                  | 1,226.0           |
| <b>Income from continuing operations</b>                                   | <b>1,191.3</b>        | <b>1,003.7</b>    | <b>3,327.9</b>           | <b>1,061.8</b>    |
| Income from discontinued operations (net of taxes of \$39.5 and \$34.5)    |                       | 67.5              |                          | 60.1              |
| <b>Net income</b>  | <b>\$ 1,191.3</b>     | <b>\$ 1,071.2</b> | <b>\$ 3,327.9</b>        | <b>\$ 1,121.9</b> |
| <b>Per common share basic:</b>   |                       |                   |                          |                   |
| Continuing operations  | \$ 1.07               | \$ 0.85           | \$ 2.94                  | \$ 0.89           |
| Discontinued operations  |                       | 0.06              |                          | 0.05              |
| Net income   | \$ 1.07               | \$ 0.90           | \$ 2.94                  | \$ 0.94           |
| <b>Per common share diluted:</b>   |                       |                   |                          |                   |
| Continuing operations  | \$ 1.05               | \$ 0.83           | \$ 2.89                  | \$ 0.87           |
| Discontinued operations  |                       | 0.06              |                          | 0.05              |
| Net income   | \$ 1.05               | \$ 0.89           | \$ 2.89                  | \$ 0.92           |
| <b>Dividends declared per common share</b>                                 | <b>\$ 0.875</b>       | <b>\$ 1.50</b>    | <b>\$ 1.625</b>          | <b>\$ 1.50</b>    |
| <b>Weighted-average shares outstanding basic</b>                           | <b>1,116.6</b>        | <b>1,185.0</b>    | <b>1,130.3</b>           | <b>1,193.2</b>    |
| <b>Weighted-average shares outstanding diluted</b>                         | <b>1,136.0</b>        | <b>1,207.1</b>    | <b>1,150.4</b>           | <b>1,216.3</b>    |

See Notes to condensed consolidated financial statements.

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

| <b>In millions</b>  | <b>Quarters Ended</b> |                   | <b>Nine Months Ended</b> |                   |
|---|-----------------------|-------------------|--------------------------|-------------------|
|   | <b>September 30,</b>  |                   | <b>September 30,</b>     |                   |
|   | <b>2008</b>           | <b>2007</b>       | <b>2008</b>              | <b>2007</b>       |
| <b>Operating activities</b>                                     |                       |                   |                          |                   |
| Net income  | \$ 1,191.3            | \$ 1,071.2        | \$ 3,327.9               | \$ 1,121.9        |
| Adjustments to reconcile to cash provided by operations         |                       |                   |                          |                   |
| Charges and credits:  |                       |                   |                          |                   |
| Depreciation and amortization                                   | 311.0                 | 297.0             | 930.0                    | 911.6             |
| Deferred income taxes   | 17.6                  | (16.8)            | (3.3)                    | (72.5)            |
| Impairment and other charges, net                               |                       | 52.7              | 1.0                      | 1,666.6           |
| Share-based compensation  | 26.4                  | 35.5              | 87.2                     | 107.6             |
| Gain on sale of investment                                      |                       |                   | (160.1)                  |                   |
| Gains on discontinued operations, net of tax                    |                       | (68.6)            |                          | (68.6)            |
| Other   | 14.7                  | 32.3              | 66.3                     | (41.8)            |
| Changes in working capital items                                | 145.4                 | 177.6             | 197.9                    | (33.2)            |
| <b>Cash provided by operations</b>                              | <b>1,706.4</b>        | <b>1,580.9</b>    | <b>4,446.9</b>           | <b>3,591.6</b>    |
| <b>Investing activities</b>                                     |                       |                   |                          |                   |
| Property and equipment expenditures                             | (534.9)               | (399.8)           | (1,422.0)                | (1,222.1)         |
| Purchases and sales of restaurant businesses and property sales | 45.0                  | 12.1              | 226.4                    | 13.5              |
| Latam transaction, net  |                       | 654.0             |                          | 654.0             |
| Proceeds on sale of investment                                  |                       |                   | 229.4                    |                   |
| Proceeds from disposals of discontinued operations, net         |                       | 194.1             |                          | 194.1             |
| Other   | (7.2)                 | (0.7)             | (22.8)                   | (30.8)            |
| <b>Cash (used for) provided by investing activities</b>         | <b>(497.1)</b>        | <b>459.7</b>      | <b>(989.0)</b>           | <b>(391.3)</b>    |
| <b>Financing activities</b>                                     |                       |                   |                          |                   |
| Notes payable and long-term financing issuances and repayments  | (782.3)               | (654.9)           | 737.6                    | (951.6)           |
| Treasury stock purchases  | (1,022.9)             | (881.5)           | (3,821.3)                | (2,546.3)         |
| Common stock dividends  | (417.7)               |                   | (1,265.7)                |                   |
| Proceeds from stock option exercises                            | 206.6                 | 261.2             | 453.3                    | 967.2             |
| Excess tax benefit on share-based compensation                  | 51.1                  | 53.6              | 113.5                    | 156.4             |
| Other   | (3.0)                 | (28.3)            | (139.7)                  | (72.0)            |
| <b>Cash used for financing activities</b>                       | <b>(1,968.2)</b>      | <b>(1,249.9)</b>  | <b>(3,922.3)</b>         | <b>(2,446.3)</b>  |
| <b>Effect of exchange rates on cash and cash equivalents</b>    | <b>(96.4)</b>         | <b>68.9</b>       | <b>(29.7)</b>            | <b>110.4</b>      |
| Cash and equivalents increase (decrease)                        | (855.3)               | 859.6             | (494.1)                  | 864.4             |
| Cash and equivalents at beginning of period                     | 2,342.5               | 2,132.9           | 1,981.3                  | 2,128.1           |
| <b>Cash and equivalents at end of period</b>                    | <b>\$ 1,487.2</b>     | <b>\$ 2,992.5</b> | <b>\$ 1,487.2</b>        | <b>\$ 2,992.5</b> |

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, 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 and nine months ended September 30, 2008 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.

**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, which totaled 1,571 restaurants, to a developmental licensee organization. The Company refers to these markets 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. As a result of the Latam transaction, the Company receives only royalties in these markets instead of a combination of Company-operated sales and franchised rents and royalties.

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.

Based on approval by the Company's Board of Directors 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 recorded an impairment charge of approximately \$1.6 billion in the second quarter of 2007, substantially all of which was noncash. In the third quarter 2007, the Company recorded an additional \$53 million of charges in connection with the transaction. The total charges for the nine months included the difference between the net book value of the Latam business and cash proceeds, 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 charges also included historical foreign currency translation losses recorded in shareholders' equity. The Company recorded a tax benefit of \$62 million in connection with this transaction. The tax benefit was minimal for the nine months 2007 due to the Company's inability to utilize most of the capital losses generated by this transaction. As a result of meeting the held for sale criteria, the Company ceased recording depreciation expense with respect to Latam effective April 17, 2007. In connection with the sale, the Company agreed to indemnify the buyers for certain tax and other claims, certain of which are reflected as liabilities on McDonald's consolidated balance sheet, totaling \$169.1 million at September 30, 2008 and \$179.2 million at December 31, 2007. The change in the balance was primarily due to foreign currency translation.

**Restaurant Information**

The following table presents restaurant information by ownership type:

| <b>Restaurants at September 30,</b> | <b>2008</b>   | <b>2007</b> |
|-------------------------------------|---------------|-------------|
| Operated by franchisees*            | <b>21,183</b> | 20,204      |
| Operated by the Company             | <b>6,639</b>  | 7,004       |
| Operated by affiliates              | <b>3,855</b>  | 4,031       |
| Systemwide restaurants              | <b>31,677</b> | 31,239      |



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\* At September 30, 2008 and 2007 included 2,870 and 2,723 restaurants, respectively, operated by developmental licensees.

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The following table presents the components of comprehensive income for the quarters and nine months ended September 30, 2008 and 2007:

| <b>In millions</b>                       | <b>Quarters Ended</b>     |                   | <b>Nine Months Ended</b>  |                  |
|--|---------------------------|-------------------|---------------------------|------------------|
|  | <b>September 30, 2008</b> | <b>2007</b>       | <b>September 30, 2008</b> | <b>2007</b>      |
| Net income                               | \$ 1,191.3                | \$ 1,071.2        | \$3,327.9                 | \$1,121.9        |
| Other comprehensive income (loss):       |                           |                   |                           |                  |
| Foreign currency translation adjustments | (1,074.3)                 | 1,163.2           | (599.6)                   | 1,510.5          |
| Deferred hedging adjustments             | 23.1                      | (2.0)             | 38.1                      | 8.0              |
| Pension liability adjustment             | 1.8                       | 1.5               | (12.3)                    | 4.5              |
| Total other comprehensive income (loss)  | (1,049.4)                 | 1,162.7           | (573.8)                   | 1,523.0          |
| <b>Total comprehensive income</b>        | <b>\$ 141.9</b>           | <b>\$ 2,233.9</b> | <b>\$2,754.1</b>          | <b>\$2,644.9</b> |

**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 compensation, calculated using the treasury stock method, of 19.4 million shares and 22.1 million shares for the third quarter 2008 and 2007, respectively, and 20.1 million shares and 23.1 million shares for the nine months ended September 30, 2008 and 2007, respectively. Stock options that were not included in diluted weighted-average shares outstanding because they would have been antidilutive were 0.9 million shares and 1.0 million shares for the nine months ended September 30, 2008 and 2007, respectively.

**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

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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.

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The following table presents assets and liabilities measured at fair value on a recurring basis as of September 30, 2008 by SFAS No. 157 valuation hierarchy:

| In millions                            | Level 1         | Level 2         | Level 3 | Carrying Value  |
|--|-----------------|-----------------|---------|-----------------|
| Cash equivalents                       | \$ 83.9         |                 |         | \$ 83.9         |
| Investments                            | 123.0*          |                 |         | 123.0           |
| Derivative receivables                 | 108.5*          | \$ 75.8         |         | 184.3           |
| <b>Total assets at fair value</b>      | <b>\$ 315.4</b> | <b>\$ 75.8</b>  |         | <b>\$ 391.2</b> |
| Derivative payables                    |                 | \$ (4.0)        |         | \$ (4.0)        |
| <b>Total liabilities at fair value</b> |                 | <b>\$ (4.0)</b> |         | <b>\$ (4.0)</b> |

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

**Gain on Sale of Investment**

In second quarter 2008, the Company sold its minority ownership interest in U.K.-based Pret A Manger. In connection with the sale, the Company received cash proceeds of \$229.4 million and recognized a nonoperating pretax gain of \$160.1 million.

**Discontinued Operations**

In August 2007, the Company sold its investment in Boston Market and as a result, Boston Market's results of operations and transaction gain have been reflected in discontinued operations. In connection with the sale, the Company received net proceeds of approximately \$250 million and recorded a gain of \$68.6 million after tax. Boston Market's results of operations (exclusive of the transaction gain), which previously were included in Other Countries & Corporate, consisted of: revenues and pretax loss for the third quarter 2007 of \$101.6 million and \$4.6 million, respectively; and revenues and pretax loss for the nine months ended September 30, 2007 of \$444.1 million and \$17.0 million, respectively. Boston Market's net loss for the third quarter and nine months 2007 (exclusive of the transaction gain) was \$1.1 million and \$8.5 million, respectively.

**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<br>September 30, |            | Nine Months Ended<br>September 30, |             |
|------------------------------|---------------------------------|------------|------------------------------------|-------------|
|                              | 2008                            | 2007       | 2008                               | 2007        |
| <b>Revenues</b>              |                                 |            |                                    |             |
| U.S.                         | <b>\$ 2,084.4</b>               | \$ 2,033.0 | <b>\$ 6,047.2</b>                  | \$ 5,890.7  |
| Europe                       | <b>2,688.9</b>                  | 2,383.9    | <b>7,670.7</b>                     | 6,490.5     |
| APMEA                        | <b>1,143.3</b>                  | 957.0      | <b>3,233.6</b>                     | 2,639.3     |
| Other Countries & Corporate  | <b>350.7</b>                    | 527.0      | <b>1,005.9</b>                     | 2,012.5     |
| <b>Total revenues</b>        | <b>\$ 6,267.3</b>               | \$ 5,900.9 | <b>\$ 17,957.4</b>                 | \$ 17,033.0 |
| <b>Operating income</b>      |                                 |            |                                    |             |
| U.S.                         | <b>\$ 815.5</b>                 | \$ 750.5   | <b>\$ 2,294.3</b>                  | \$ 2,154.0  |
| Europe                       | <b>769.1</b>                    | 627.4      | <b>2,018.1</b>                     | 1,542.2     |
| APMEA                        | <b>234.1</b>                    | 182.4      | <b>642.9</b>                       | 471.1       |
| Other Countries & Corporate* | <b>5.0</b>                      | (35.5)     | <b>(14.6)</b>                      | (1,642.9)   |

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|                                |                   |            |                   |            |
|--------------------------------|-------------------|------------|-------------------|------------|
| <b>Total operating income*</b> | <b>\$ 1,823.7</b> | \$ 1,524.8 | <b>\$ 4,940.7</b> | \$ 2,524.4 |
|--------------------------------|-------------------|------------|-------------------|------------|

\* Results for 2007 included the impact of the Latam transaction of \$45.5 million and \$1,639.9 million of net expense for the quarter and nine months, respectively.

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

#### **Overview**

The Company franchises and operates McDonald's restaurants. Of the 31,677 restaurants in 118 countries at September 30, 2008, 21,183 are operated by franchisees (including 2,870 operated by developmental licensees), 3,855 are operated by affiliates (primarily in Japan) and 6,639 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 strategic changes in restaurant ownership.

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 nearly 35% and 45% of total revenues, respectively.

In second quarter 2008, the Company sold its minority ownership interest in U.K.-based Pret A Manger. In connection with the sale, the Company received cash proceeds of \$229.4 million and recognized a nonoperating pretax gain of \$160.1 million.

In August 2007, the Company sold its investment in Boston Market and as a result, Boston Market's results of operations and transaction gain have been reflected in discontinued operations. In connection with the sale, the Company received net proceeds of approximately \$250 million and recorded a gain of \$68.6 million after tax.

#### **Strategic Direction and Financial Performance**

Since implementing the customer-centered Plan to Win in 2003, 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 drivers of exceptional customer experiences—people, products, place, price and promotion. While our focus has remained the same, we have adapted our initiatives based on the changing needs and preferences of our customers. These initiatives have increased our consumer relevance and contributed to sales and guest counts worldwide increasing every year since 2003. In the third quarter and first nine months of 2008, our unwavering commitment to providing an outstanding restaurant experience to every customer, every time, drove comparable sales and guest count momentum along with profitability growth in every area of the world.

In the U.S., the business continues to increase sales and guest counts by featuring chicken products, core menu classics and value-based beverages that offer menu variety and everyday affordability that resonate with consumers. As a result, comparable sales increased 4.7% for the quarter and 3.7% for the nine months.

Europe generated strong top-line sales in virtually every market, posting a comparable sales increase of 8.2% for the quarter and 8.8% for the nine months. Alignment behind Europe's key priorities of enhancing local relevance, upgrading the customer and employee experience and building brand transparency continues to deliver robust results for the segment.

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In APMEA, comparable sales increased 7.8% for the quarter and 8.6% for the nine months, reflecting broad-based strength across the segment. Throughout APMEA, the growth drivers of convenience, core menu extensions, breakfast, value and operations excellence are continuing to deliver results.

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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 third quarter 2008, we repurchased 16.9 million shares of McDonald's stock for \$1.0 billion, bringing the total repurchases for the nine months of 2008 to 67.3 million shares or \$3.8 billion. During the third quarter 2008, we paid a quarterly dividend of \$0.375 per share or \$417.6 million, bringing the total dividends paid for the nine months of 2008 to \$1.3 billion. Also during the third quarter, the Company declared a fourth quarter 2008 dividend of \$0.50 per share, reflecting an increase of 33% over the third quarter. For the full year 2007 and first nine months of 2008 combined, the Company returned \$10.8 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 by the end of 2010, primarily in its major markets. In the first nine months of 2008, the Company refranchised about 425 restaurants.

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, which totaled 1,571 restaurants, to a developmental licensee organization. The Company refers to these markets as Latam. Under the new ownership structure, the Company receives only royalties in these markets instead of a combination of Company-operated sales and franchised rents and royalties.

### **Operating Highlights Included:**

Global comparable sales increased 7.1% for the quarter and 6.8% for the nine months

Growth in consolidated Company-operated and franchised restaurant margins continued for the quarter and nine months

Net income per share from continuing operations was \$1.05 for the quarter, a 27% increase (22% in constant currencies) and \$2.89 for the nine months, a 33% increase (26% in constant currencies), after adjusting for the impact of the 2007 Latam transaction. Net income from continuing operations for the nine months 2008 includes a \$0.09 per share benefit from the sale of the Company's interest in Pret A Manger.

During the nine months, the Company repurchased \$3.8 billion or 67.3 million shares of its stock and paid quarterly dividends totaling \$1.3 billion

Cash provided by operations increased \$855.3 million, or 24%, to \$4.4 billion for the nine months

### **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



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increase annual net income per share by about 2.5 cents.

With about 75% of McDonald's grocery bill comprised of 10 different commodities, a basket of goods approach is the most comprehensive way to look at the Company's commodity costs. For the full year 2008, the total basket of goods is expected to rise about 7% in the U.S. and about 8% in Europe. 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.

Based on current interest and foreign currency exchange rates, the Company expects interest expense in 2008 to increase approximately 30% compared with 2007, while 2008 interest income is expected to decrease about 30% compared with 2007. In first quarter 2008, the Company issued certain debt to take advantage of favorable market conditions to pre-fund a portion of its debt retired in third quarter 2008.

A significant part of the Company's operating income is generated outside the U.S., and about 40% of its total debt is denominated in foreign currencies. Accordingly, earnings are affected by changes in foreign currency exchange rates, particularly the Euro 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.

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Due to the recent strengthening of the U.S. Dollar relative to several major foreign currencies, fourth quarter 2008 revenues and operating income are expected to be negatively impacted by foreign currency translation. As a point of reference, for the fourth quarter 2007, the weighted average exchange rate used to translate the Company's Statement of Income (U.S. Dollar rate for one unit of foreign currency) was \$1.45 for the Euro and \$2.04 for the British Pound. For the nine months ended September 30, 2008, approximately 65% and 15% of operating income in Europe was generated in the Euro and British Pound, respectively.

The Company expects the effective income tax rate for the full-year 2008 to be approximately 29% to 31%, 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 first nine months of 2008 combined, the Company returned \$10.8 billion to shareholders.

The Company continually reviews its restaurant ownership structures to maximize cash flow and returns and to enhance local relevance. The Company expects to optimize its restaurant ownership mix by refranchising 1,000 to 1,500 Company-operated restaurants by the end of 2010, primarily in its major markets, and by continuing to utilize its developmental license strategy. In the first nine months of 2008, the Company refranchised about 425 restaurants, primarily in its major markets.

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

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

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

**Table of Contents****CONSOLIDATED OPERATING RESULTS**

| Dollars in millions, except per share data                                 | Quarter Ended<br>September 30, 2008 |                            | Nine Months Ended<br>September 30, 2008 |                            |
|--|-------------------------------------|----------------------------|---|----------------------------|
|  | Amount                              | % Increase /<br>(Decrease) | Amount                                  | % Increase /<br>(Decrease) |
| <b>Revenues</b>  |                                     |                            |   |                            |
| Sales by Company-operated restaurants                                      | \$ 4,411.1                          | 3                          | \$ 12,705.9                             | 2                          |
| Revenues from franchised and affiliated restaurants                        | 1,856.2                             | 14                         | 5,251.5                                 | 16                         |
| <b>Total revenues</b>  | <b>6,267.3</b>                      | <b>6</b>                   | <b>17,957.4</b>                         | <b>5</b>                   |
| <b>Operating costs and expenses</b>  |                                     |                            |   |                            |
| Company-operated restaurant expenses                                       | 3,587.2                             | 3                          | 10,462.0                                | 1                          |
| Franchised restaurants occupancy expenses                                  | 316.9                               | 10                         | 932.0                                   | 10                         |
| Selling, general & administrative expenses                                 | 582.1                               | 2                          | 1,733.2                                 | 2                          |
| Impairment and other charges, net  |                                     | n/m                        | 1.0                                     | n/m                        |
| Other operating (income) expense, net                                      | (42.6)                              | (66)                       | (111.5)                                 | n/m                        |
| <b>Total operating costs and expenses</b>                                  | <b>4,443.6</b>                      | <b>2</b>                   | <b>13,016.7</b>                         | <b>(10)</b>                |
| <b>Operating income</b>  | <b>1,823.7</b>                      | <b>20</b>                  | <b>4,940.7</b>                          | <b>96</b>                  |
| Interest expense   | 131.6                               | 34                         | 406.4                                   | 37                         |
| Nonoperating (income) expense, net   | (6.8)                               | 75                         | (66.5)                                  | (10)                       |
| Gain on sale of investment   |                                     |                            | (160.1)                                 | n/m                        |
| <b>Income from continuing operations before provision for income taxes</b> | <b>1,698.9</b>                      | <b>17</b>                  | <b>4,760.9</b>                          | <b>n/m</b>                 |
| Provision for income taxes   | 507.6                               | 13                         | 1,433.0                                 | 17                         |
| <b>Income from continuing operations</b>                                   | <b>1,191.3</b>                      | <b>19</b>                  | <b>3,327.9</b>                          | <b>n/m</b>                 |
| Income from discontinued operations  |                                     | n/m                        |   | n/m                        |
| <b>Net income</b>  | <b>\$ 1,191.3</b>                   | <b>11</b>                  | <b>\$ 3,327.9</b>                       | <b>n/m</b>                 |
| <b>Income per common share basic:</b>                                      |                                     |                            |   |                            |
| Continuing operations  | \$ 1.07                             | 26                         | \$ 2.94                                 | n/m                        |
| Discontinued operations  |                                     | n/m                        |   | n/m                        |
| Net income   | \$ 1.07                             | 19                         | \$ 2.94                                 | n/m                        |
| <b>Income per common share diluted:</b>                                    |                                     |                            |   |                            |
| Continuing operations  | \$ 1.05                             | 27                         | \$ 2.89                                 | n/m                        |
| Discontinued operations  |                                     | n/m                        |   | n/m                        |
| Net income   | \$ 1.05                             | 18                         | \$ 2.89                                 | n/m                        |

n/m Not meaningful

In addition to the reported consolidated operating results for the quarter and nine months ended September 30, 2007, consolidated results for these periods are presented throughout this report excluding the impact of the Latam transaction. Management believes the Latam transaction and the associated charge are not indicative of ongoing operations due to the size and scope of the transaction. Management believes that the adjusted results better reflect the underlying business trends relevant to the periods presented.

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The following tables present reconciliations of the key consolidated operating results for the quarters and nine months ended September 30, 2008 and 2007 to the operating results excluding the net impact of the impairment charge from the Latam transaction.

| Quarters ended September 30,                          | 2008       | 2007*      | Latam<br>Transaction* | 2007<br>Excluding<br>Latam<br>Transaction | Adjusted<br>% Inc | Currency<br>Translation<br>Benefit | Adjusted |
|---|------------|------------|-----------------------|---|-------------------|------------------------------------|----------|
|   |            |            |                       |   |                   |                                    | % Inc    |
| Revenues  | \$ 6,267.3 | \$ 5,900.9 |                       | \$ 5,900.9                                | 6                 | \$ 204.8                           | 3        |
| Operating income (loss)                               | 1,823.7    | 1,524.8    | \$ (45.5)             | 1,570.3                                   | 16                | 73.5                               | 11       |
| Income from continuing operations                     | 1,191.3    | 1,003.7    | 3.9                   | 999.8                                     | 19                | 44.7                               | 15       |
| Income from discontinued operations                   |            | 67.5       |                       | 67.5                                      | n/m               |                                    | n/m      |
| Net income  | 1,191.3    | 1,071.2    | 3.9                   | 1,067.3                                   | 12                | 44.7                               | 7        |
| Income per share from continuing operations-diluted   | 1.05       | 0.83       |                       | 0.83                                      | 27                | 0.04                               | 22       |
| Income per share from discontinued operations-diluted |            | 0.06       |                       | 0.06                                      | n/m               |                                    | n/m      |
| Net income per share-diluted                          | 1.05       | 0.89       | 0.01                  | 0.88                                      | 19                | 0.04                               | 15       |

  

| Nine months ended September 30,                            | 2008        | 2007**      | Latam<br>Transaction** | 2007<br>Excluding<br>Latam<br>Transaction | Adjusted<br>% Inc | Currency<br>Translation<br>Benefit | Adjusted |
|--|-------------|-------------|------------------------|---|-------------------|------------------------------------|----------|
|  |             |             |                        |   |                   |                                    | % Inc    |
| Revenues   | \$ 17,957.4 | \$ 17,033.0 |                        | \$ 17,033.0                               | 5                 | \$ 925.2                           |          |
| Operating income (loss)                                    | 4,940.7     | 2,524.4     | \$ (1,639.9)           | 4,164.3                                   | 19                | 282.0                              | 12       |
| Income (loss) from continuing operations                   | 3,327.9     | 1,061.8     | (1,577.7)              | 2,639.5                                   | 26                | 178.8                              | 19       |
| Income from discontinued operations                        |             | 60.1        |                        | 60.1                                      | n/m               |                                    | n/m      |
| Net income (loss)  | 3,327.9     | 1,121.9     | (1,577.7)              | 2,699.6                                   | 23                | 178.8                              | 17       |
| Income (loss) per share from continuing operations-diluted | 2.89        | 0.87        | (1.30)                 | 2.17                                      | 33                | 0.15                               | 26       |
| Income per share from discontinued operations-diluted      |             | 0.05        |                        | 0.05                                      | n/m               |                                    | n/m      |
| Net income (loss) per share-diluted                        | 2.89        | 0.92        | (1.30)                 | 2.22                                      | 30                | 0.15                               | 23       |

n/m Not meaningful

\* Included impairment and other charges of \$52.7 million, partly offset by a benefit of \$7.2 million due to eliminating depreciation on the assets in Latam in mid-April 2007, and a tax benefit of \$49.4 million.

\*\* Included impairment and other charges of \$1,664.6 million, partly offset by a benefit of \$24.7 million due to eliminating depreciation on the assets in Latam in mid-April 2007, and a tax benefit of \$62.2 million.

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

For the third quarter and nine months ended September 2008, net income was \$1,191.3 million and \$3,327.9 million, respectively, and diluted net income per share was \$1.05 and \$2.89, respectively. Results for the nine months benefited by a \$109.0 million or \$0.09 per share after tax gain on the sale of the Company's minority interest in Pret A Manger.

For the third quarter 2007, net income was \$1,071.2 million and diluted net income per share was \$0.89. In August 2007, the Company sold its investment in Boston Market. As a result, Boston Market's results of operations and transaction gain are reflected as income from discontinued operations of \$67.5 million or \$0.06 per share. Income from continuing operations was \$1,003.7 million or \$0.83 per share. These results

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included a net benefit of \$3.9 million related to the Company's sale of its business in Latam to a developmental licensee.

For the first nine months of 2007, net income was \$1,121.9 million and diluted net income per share was \$0.92, which included income from continuing operations of \$1,061.8 million or \$0.87 per share and \$60.1 million or \$0.05 per share of income from discontinued operations related to Boston Market. The 2007 results included \$1,577.7 million or \$1.30 per share of net expense related to the Latam transaction. This reflects an impairment charge of \$1.32 per share, partly offset by a \$0.02 per share benefit due to eliminating depreciation in mid-April 2007 on the assets in Latam. Excluding the impact of the Latam transaction, income from continuing operations was \$2,639.5 million and diluted income per share from continuing operations was \$2.17.

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During the third quarter 2008, the Company repurchased 16.9 million shares of its stock for \$1.0 billion, bringing the total repurchases for the nine months of 2008 to 67.3 million shares or \$3.8 billion. During the third quarter 2008, the Company paid a quarterly dividend of \$0.375 per share or \$417.6 million, bringing the total dividends paid for the nine months of 2008 to \$1.3 billion. The Company also declared a fourth quarter 2008 dividend of \$0.50 per share, reflecting an increase of 33% over the third quarter.

**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, which totaled 1,571 restaurants, 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 Company receives only royalties in these markets instead of a combination of Company-operated sales and franchised rents and royalties.

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.

Based on approval by the Company's Board of Directors 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 recorded an impairment charge of approximately \$1.6 billion in the second quarter of 2007, substantially all of which was noncash. In the third quarter 2007, the Company recorded an additional \$53 million of charges in connection with the transaction. The total charges for the nine months included the difference between the net book value of the Latam business and cash proceeds, 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 charges also included historical foreign currency translation losses recorded in shareholders' equity. The Company recorded a tax benefit of \$62 million in connection with this transaction. The tax benefit was minimal for the nine months 2007 due to the Company's inability to utilize most of the capital losses generated by this transaction. As a result of meeting the held for sale criteria, the Company ceased recording depreciation expense with respect to Latam effective April 17, 2007. In connection with the sale, the Company agreed to indemnify the buyers for certain tax and other claims, certain of which are reflected as liabilities on McDonald's consolidated balance sheet, totaling \$169.1 million at September 30, 2008 and \$179.2 million at December 31, 2007. The change in the balance was primarily due to foreign currency translation.

**Impact of Foreign Currency Translation****IMPACT OF FOREIGN CURRENCY TRANSLATION**

*Dollars in millions, except per share data*

|  |             |             | Currency<br>Translation<br>Benefit /<br>(Loss) |
|--|-------------|-------------|--|
| <b>Quarters Ended September 30,</b>                          | <b>2008</b> | <b>2007</b> | <b>2008</b>                                    |
| Revenues   | \$ 6,267.3  | \$ 5,900.9  | \$204.8  |
| Combined operating margins*                                  | 2,363.2     | 2,121.2     | 81.9   |
| Selling, general & administrative expenses                   | 582.1       | 569.4       | (10.9)   |
| Operating income**   | 1,823.7     | 1,570.3     | 73.5   |
| Income from continuing operations**                          | 1,191.3     | 999.8       | 44.7   |
| Net income**   | 1,191.3     | 1,067.3     | 44.7   |
| Income from continuing operations per common share diluted** | 1.05        | 0.83        | 0.04   |
| Net income per common share diluted**                        | 1.05        | 0.88        | 0.04   |



**Table of Contents****IMPACT OF FOREIGN CURRENCY TRANSLATION***Dollars in millions, except per share data*

|  |             |             | Currency<br>Translation<br>Benefit /<br>(Loss) |
|--|-------------|-------------|--|
| <b>Nine Months Ended September 30,</b>                       | <b>2008</b> | 2007        | <b>2008</b>                                    |
| Revenues   | \$ 17,957.4 | \$ 17,033.0 | \$925.2  |
| Combined operating margins*                                  | 6,563.4     | 5,844.6     | 335.4  |
| Selling, general & administrative expenses                   | 1,733.2     | 1,706.5     | (58.8)   |
| Operating income**   | 4,940.7     | 4,164.3     | 282.0  |
| Income from continuing operations**                          | 3,327.9     | 2,639.5     | 178.8  |
| Net income**   | 3,327.9     | 2,699.6     | 178.8  |
| Income from continuing operations per common share diluted** | 2.89        | 2.17        | 0.15   |
| Net income per common share diluted**                        | 2.89        | 2.22        | 0.15   |

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

\*\* 2007 results exclude the impact of the Latam transaction in order to provide management's view of the underlying business performance. Foreign currency translation had a positive impact on consolidated revenues and operating income for the quarter and nine months, driven by the Euro and most other currencies, partly offset by the British Pound.

**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 /<br>(Dec)<br>Excluding<br>Currency |
|---|-------------|------------|---|
| <b>Quarters Ended September 30,</b>       | <b>2008</b> | 2007       | (Dec)                                     |
| <i>Company-operated sales</i>             |             |            | Translation                               |
| U.S.                                      | \$ 1,185.0  | \$ 1,199.7 | (1)                                       |
| Europe                                    | 2,007.1     | 1,818.4    | 10  |
| APMEA                                     | 992.7       | 834.7      | 19  |
| Other Countries & Corporate               | 226.3       | 423.4      | (47)                                      |
| Total                                     | \$ 4,411.1  | \$ 4,276.2 | 3   |
| <i>Franchised and affiliated revenues</i> |             |            |   |
| U.S.                                      | \$ 899.4    | \$ 833.3   | 8   |
| Europe                                    | 681.8       | 565.5      | 21  |
| APMEA                                     | 150.6       | 122.3      | 23  |
| Other Countries & Corporate               | 124.4       | 103.6      | 20  |



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|                             |                   |            |      |      |
|-----------------------------|-------------------|------------|------|------|
| Total                       | <b>\$ 1,856.2</b> | \$ 1,624.7 | 14   | 11   |
| <i>Total revenues</i>       |                   |            |      |      |
| U.S.                        | <b>\$ 2,084.4</b> | \$ 2,033.0 | 3    | 3    |
| Europe                      | <b>2,688.9</b>    | 2,383.9    | 13   | 6    |
| APMEA                       | <b>1,143.3</b>    | 957.0      | 19   | 15   |
| Other Countries & Corporate | <b>350.7</b>      | 527.0      | (33) | (34) |
| Total                       | <b>\$ 6,267.3</b> | \$ 5,900.9 | 6    | 3    |

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

|   |                    |             | % Inc /<br>(Dec) | Excluding<br>Currency |
|---|--------------------|-------------|------------------|-----------------------|
|   |                    |             | % Inc /          | Translation           |
| <b>Nine Months Ended September 30,</b>    | <b>2008</b>        | <b>2007</b> | <b>(Dec)</b>     |                       |
| <i>Company-operated sales</i>             |                    |             |                  |                       |
| U.S.                                      | <b>\$ 3,490.1</b>  | \$ 3,491.7  |                  |                       |
| Europe                                    | <b>5,752.3</b>     | 4,965.5     | 16               | 7                     |
| APMEA                                     | <b>2,801.9</b>     | 2,306.2     | 21               | 15                    |
| Other Countries & Corporate               | <b>661.6</b>       | 1,744.4     | (62)             | (65)                  |
| Total                                     | <b>\$ 12,705.9</b> | \$ 12,507.8 | 2                | (4)                   |
| <i>Franchised and affiliated revenues</i> |                    |             |                  |                       |
| U.S.                                      | <b>\$ 2,557.1</b>  | \$ 2,399.0  | 7                | 7                     |
| Europe                                    | <b>1,918.4</b>     | 1,525.0     | 26               | 13                    |
| APMEA                                     | <b>431.7</b>       | 333.1       | 30               | 19                    |
| Other Countries & Corporate               | <b>344.3</b>       | 268.1       | 28               | 19                    |
| Total                                     | <b>\$ 5,251.5</b>  | \$ 4,525.2  | 16               | 10                    |
| <i>Total revenues</i>                     |                    |             |                  |                       |
| U.S.                                      | <b>\$ 6,047.2</b>  | \$ 5,890.7  | 3                | 3                     |
| Europe                                    | <b>7,670.7</b>     | 6,490.5     | 18               | 8                     |
| APMEA                                     | <b>3,233.6</b>     | 2,639.3     | 23               | 15                    |
| Other Countries & Corporate               | <b>1,005.9</b>     | 2,012.5     | (50)             | (54)                  |
| Total                                     | <b>\$ 17,957.4</b> | \$ 17,033.0 | 5                |                       |

Consolidated revenues increased 6% (3% in constant currencies) for the quarter and 5% (flat in constant currencies) for the nine months, primarily due to positive comparable sales in all segments. Revenue growth was offset by the impact of the Company's August 2007 Latam transaction as well as the impact of the refranchising strategy, occurring primarily in certain of the Company's major markets. As a result of the Latam transaction, the Company now receives royalties based on a percent of sales in these markets. 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 for the quarter and nine months was primarily driven by our market-leading breakfast business, the ongoing appeal of new products and continued focus on everyday value. These increases were partly offset by the impact of the refranchising strategy.

In Europe, the constant currency increase in revenues for the quarter and nine months was primarily due to strong comparable sales in Russia (which is entirely Company-operated), France and the U.K., as well as positive comparable sales in substantially all other markets. These increases were partly offset by the impact of the refranchising strategy, primarily in the U.K.

In APMEA, the constant currency increase in revenues for the quarter and nine months was primarily driven by strong comparable sales in Australia and China, as well as positive comparable sales throughout the segment. In addition, expansion in China contributed to the increase.

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The following table presents the percent change in comparable sales for the quarters and nine months ended September 30, 2008 and 2007:

| COMPARABLE SALES            | % Increase     |      |                   |      |
|-----------------------------|----------------|------|-------------------|------|
|                             | Quarters Ended |      | Nine Months Ended |      |
|                             | September 30,  |      | September 30,*    |      |
|                             | 2008           | 2007 | 2008              | 2007 |
| U.S.                        | 4.7            | 5.1  | 3.7               | 4.9  |
| Europe                      | 8.2            | 6.5  | 8.8               | 7.4  |
| APMEA                       | 7.8            | 11.4 | 8.6               | 10.3 |
| Other Countries & Corporate | 13.6           | 9.5  | 13.6              | 10.2 |
| Total                       | 7.1            | 6.9  | 6.8               | 6.9  |

\* On a consolidated basis, comparable guest counts increased 3.3% and 4.1% for the nine months 2008 and 2007, respectively. The following table presents the percent change in Systemwide sales for the quarter and nine months ended September 30, 2008:

| SYSTEMWIDE SALES            | Quarter Ended      |             | Nine Months Ended  |             |
|-----------------------------|--------------------|-------------|--------------------|-------------|
|                             | September 30, 2008 |             | September 30, 2008 |             |
|                             | % Inc              | % Inc       | % Inc              | % Inc       |
|                             | Excluding          | Excluding   | Excluding          | Excluding   |
|                             | Currency           | Currency    | Currency           | Currency    |
|                             | Translation        | Translation | Translation        | Translation |
| U.S.                        | 6                  | 6           | 5                  | 5           |
| Europe                      | 18                 | 10          | 22                 | 11          |
| APMEA                       | 17                 | 11          | 21                 | 11          |
| Other Countries & Corporate | 20                 | 15          | 25                 | 15          |
| Total                       | 12                 | 9           | 14                 | 8           |

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

| Quarters Ended September 30, | Percent           |      | Amount            |            | % Inc /<br>(Dec) | % Inc /<br>(Dec)<br>Excluding<br>Currency<br>Translation |
|------------------------------|-------------------|------|-------------------|------------|------------------|--|
|                              | 2008              | 2007 | 2008              | 2007       |                  |  |
|                              | <i>Franchised</i> |      |                   |            |                  |  |
| U.S.                         | <b>83.7</b>       | 83.2 | \$ <b>753.0</b>   | \$ 692.9   | 9                | 9  |
| Europe                       | <b>79.7</b>       | 79.4 | <b>543.6</b>      | 449.3      | 21               | 12   |
| APMEA                        | <b>89.7</b>       | 88.4 | <b>135.1</b>      | 108.1      | 25               | 20   |
| Other Countries & Corporate  | <b>86.6</b>       | 84.0 | <b>107.6</b>      | 87.0       | 24               | 19   |
| Total                        | <b>82.9</b>       | 82.3 | \$ <b>1,539.3</b> | \$ 1,337.3 | 15               | 11   |
| <i>Company-operated</i>      |                   |      |                   |            |                  |  |
| U.S.                         | <b>18.2</b>       | 18.4 | \$ <b>216.1</b>   | \$ 220.2   | (2)              | (2)  |
| Europe                       | <b>20.0</b>       | 19.5 | <b>400.7</b>      | 354.8      | 13               | 6  |
| APMEA                        | <b>17.0</b>       | 15.8 | <b>168.4</b>      | 132.2      | 27               | 22   |
| Other Countries & Corporate  | <b>17.1</b>       | 18.1 | <b>38.7</b>       | 76.7       | (50)             | (50)   |
| Total                        | <b>18.7</b>       | 18.3 | \$ <b>823.9</b>   | \$ 783.9   | 5                | 1  |

| Nine Months Ended September 30, | Percent           |      | Amount            |            | % Inc /<br>(Dec) | % Inc /<br>(Dec)<br>Excluding<br>Currency<br>Translation |
|---------------------------------|-------------------|------|-------------------|------------|------------------|--|
|                                 | 2008              | 2007 | 2008              | 2007       |                  |  |
|                                 | <i>Franchised</i> |      |                   |            |                  |  |
| U.S.                            | <b>83.2</b>       | 82.8 | \$ <b>2,127.0</b> | \$ 1,985.6 | 7                | 7  |
| Europe                          | <b>78.7</b>       | 77.9 | <b>1,509.7</b>    | 1,187.3    | 27               | 14   |
| APMEA                           | <b>89.3</b>       | 88.0 | <b>385.4</b>      | 293.2      | 31               | 20   |
| Other Countries & Corporate     | <b>86.4</b>       | 80.0 | <b>297.4</b>      | 214.5      | 39               | 28   |
| Total                           | <b>82.3</b>       | 81.3 | \$ <b>4,319.5</b> | \$ 3,680.6 | 17               | 12   |
| <i>Company-operated</i>         |                   |      |                   |            |                  |  |
| U.S.                            | <b>18.4</b>       | 18.6 | \$ <b>640.9</b>   | \$ 649.6   | (1)              | (1)  |
| Europe                          | <b>18.1</b>       | 17.8 | <b>1,040.2</b>    | 882.4      | 18               | 8  |
| APMEA                           | <b>16.4</b>       | 15.0 | <b>458.8</b>      | 346.8      | 32               | 24   |
| Other Countries & Corporate     | <b>15.7</b>       | 16.3 | <b>104.0</b>      | 285.2      | (64)             | (66)   |
| Total                           | <b>17.7</b>       | 17.3 | \$ <b>2,243.9</b> | \$ 2,164.0 | 4                | (2)  |

Franchised margin dollars increased \$202.0 million or 15% (11% in constant currencies) for the quarter and \$638.9 million or 17% (12% in constant currencies) for the nine months. The Latam transaction and the refranchising strategy contributed to the growth in franchised margin dollars in both periods. For both periods, the franchised margin percent was positively impacted by the Latam transaction and negatively impacted by the refranchising strategy, resulting in a minimal net impact.

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

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In Other Countries & Corporate, Latin America's franchised margin percent for the quarter and nine months increased 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.

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Company-operated margin dollars increased \$40.0 million or 5% (1% in constant currencies) for the quarter and \$79.9 million or 4% (decreased 2% in constant currencies) for the nine months. As a result of the Latam transaction in August 2007, there are no Company-operated restaurants remaining in Latin America. This transaction and the refranchising strategy negatively impacted the Company-operated margin dollars. The refranchising strategy had a positive impact on the margin percent for the quarter and nine months.

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

Europe's Company-operated margin percent increased for the quarter and nine months primarily due to high margin markets such as Russia and France experiencing higher sales growth relative to the overall segment. Higher commodity and labor costs in both periods offset strong comparable sales in most markets.

In APMEA, the Company-operated margin percent for the quarter and nine months increased due to strong comparable sales in most markets, partly offset by higher commodity and labor costs.

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

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

|   | <b>Quarters Ended</b> |      | <b>Nine Months Ended</b> |      |
|---|-----------------------|------|--------------------------|------|
|   | <b>September 30,</b>  |      | <b>September 30,</b>     |      |
|   | <b>2008</b>           | 2007 | <b>2008</b>              | 2007 |
| Food & paper  | <b>33.8</b>           | 32.9 | <b>33.5</b>              | 33.1 |
| Payroll & employee benefits                           | <b>25.3</b>           | 25.7 | <b>26.1</b>              | 25.9 |
| Occupancy & other operating expenses                  | <b>22.2</b>           | 23.1 | <b>22.7</b>              | 23.7 |
| Total expenses  | <b>81.3</b>           | 81.7 | <b>82.3</b>              | 82.7 |
| Company-operated margins                              | <b>18.7</b>           | 18.3 | <b>17.7</b>              | 17.3 |
| <b>Selling, General &amp; Administrative Expenses</b> |                       |      |                          |      |

Selling, general & administrative expenses increased 2% (flat in constant currencies) for the quarter and increased 2% (decreased 2% in constant currencies) for the nine months. The constant currency change in selling, general & administrative expenses benefited by 2 percentage points for the quarter and 5 percentage points for the nine months due to the Latam transaction. Costs related to the Beijing Summer Olympics impacted both periods and costs from the Company's biennial Worldwide Owner/Operator Convention impacted the nine months. Selling, general & administrative expenses as a percent of revenues decreased to 9.7% for the nine months 2008 compared with 10.0% for 2007 and as a percent of Systemwide sales decreased to 3.2% for 2008 compared with 3.7% for 2007.

**Impairment and Other Charges, Net**

In the third quarter and nine months of 2007, the Company recorded \$52.7 million and \$1.7 billion of expense, respectively, primarily related to the Company's sale of its Latam business to a developmental licensee organization.

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

*Dollars in millions*

| <b>Quarters Ended</b> | <b>Nine Months Ended</b> |
|-----------------------|--------------------------|
| <b>September 30,</b>  | <b>September 30,</b>     |

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|   | <b>2008</b>      | 2007      | <b>2008</b>       | 2007      |
|---|------------------|-----------|-------------------|-----------|
| Gains on sales of restaurant businesses         | <b>\$ (30.5)</b> | \$ (18.9) | <b>\$ (73.8)</b>  | \$ (54.2) |
| Equity in earnings of unconsolidated affiliates | <b>(42.3)</b>    | (43.2)    | <b>(91.8)</b>     | (90.2)    |
| Asset dispositions and other expense            | <b>30.2</b>      | 36.4      | <b>54.1</b>       | 91.5      |
| Total   | <b>\$ (42.6)</b> | \$ (25.7) | <b>\$ (111.5)</b> | \$ (52.9) |

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

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

|  |             |            |       | % Inc<br>Excluding<br>Currency |
|--|-------------|------------|-------|--------------------------------|
| <b>Quarters ended September 30,</b>    | <b>2008</b> | 2007       | % Inc | Translation                    |
| U.S.                                   | \$ 815.5    | \$ 750.5   | 9     | 9                              |
| Europe                                 | 769.1       | 627.4      | 23    | 14                             |
| APMEA                                  | 234.1       | 182.4      | 28    | 21                             |
| Other Countries & Corporate            | 5.0         | (35.5)     | n/m   | n/m                            |
| Total                                  | \$ 1,823.7  | \$ 1,524.8 | 20    | 15                             |
| Latam transaction                      |             | 45.5       |       |                                |
| Total excluding Latam transaction*     | \$ 1,823.7  | \$ 1,570.3 | 16    | 11                             |
|  |             |            |       | % Inc<br>Excluding<br>Currency |
| <b>Nine Months ended September 30,</b> | <b>2008</b> | 2007       | % Inc | Translation                    |
| U.S.                                   | \$ 2,294.3  | \$ 2,154.0 | 7     | 7                              |
| Europe                                 | 2,018.1     | 1,542.2    | 31    | 18                             |
| APMEA                                  | 642.9       | 471.1      | 36    | 25                             |
| Other Countries & Corporate            | (14.6)      | (1,642.9)  | 99    | 98                             |
| Total                                  | \$ 4,940.7  | \$ 2,524.4 | 96    | 85                             |
| Latam transaction                      |             | 1,639.9    |       |                                |
| Total excluding Latam transaction**    | \$ 4,940.7  | \$ 4,164.3 | 19    | 12                             |
| n/m Not meaningful                     |             |            |       |                                |

\* The results for the quarter ended September 30, 2007 included impairment and other charges of \$52.7 million associated with the Latam transaction, partly offset by a benefit of \$7.2 million due to eliminating depreciation on the assets in Latam in mid-April 2007.

\*\* The results for the nine months ended September 30, 2007 included impairment and other charges of \$1,664.6 million associated with the Latam transaction, partly offset by a benefit of \$24.7 million due to eliminating depreciation on the assets in Latam in mid-April 2007. In the U.S., results increased for the quarter and nine months primarily due to higher franchised margin dollars.

In Europe, operating results were driven by strong performance in France, Russia and the U.K. for both periods and positive results in Germany and most other markets.

In APMEA, operating results for the quarter and nine months were driven by strong results in Australia and China, as well as positive performance in Japan and 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 nine months 2008 and 2007 was 27.5% and 14.8%, respectively. Impairment and other charges (credits) negatively impacted the 2007 operating margin by 9.8



percentage points.

**Interest Expense**

Interest expense for the quarter and nine months increased due primarily to higher average debt levels, and to a lesser extent, higher interest rates and stronger foreign currencies. Higher average debt levels were due to the Company issuing certain debt in first quarter 2008 to take advantage of favorable market conditions to pre-fund a portion of its debt retired in third quarter 2008.

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

|                                  | Quarters Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|----------------------------------|---------------------------------|----------|------------------------------------|----------|
|                                  | 2008                            | 2007     | 2008                               | 2007     |
| Interest income                  | \$ (16.0)                       | \$(32.0) | \$(68.7)                           | \$(82.9) |
| Translation and hedging activity | 8.1                             | (1.6)    | 0.5                                | 1.9      |
| Other expense                    | 1.1                             | 6.9      | 1.7                                | 20.7     |
| Total                            | \$ (6.8)                        | \$(26.7) | \$(66.5)                           | \$(60.3) |

Lower interest rates and average cash balances negatively impacted interest income for the quarter and nine months. Interest income for the nine months included \$11.6 million of interest on the partial recovery of prior years' sales taxes in the U.K.

**Gain on Sale of Investment**

In second quarter 2008, the Company sold its minority ownership interest in U.K.-based Pret A Manger. In connection with the sale, the Company received cash proceeds of \$229.4 million and recognized a nonoperating pretax gain of \$160.1 million.

**Income Taxes**

The following tables present the provision for income taxes, the effective income tax rates and the impact of the Latam transaction for the quarters and nine months ended September 30, 2008 and 2007:

| Quarters ended September 30,   | 2008       | 2007               |                      |                                   |
|--|------------|--------------------|----------------------|-----------------------------------|
|  |            | Reported<br>Amount | Latam<br>Transaction | Excluding<br>Latam<br>Transaction |
| Income (loss) from continuing operations before provision for income taxes | \$ 1,698.9 | \$ 1,453.6         | \$ (45.5)            | \$ 1,499.1                        |
| Provision (benefit) for income taxes                                       | 507.6      | 449.9              | (49.4)               | 499.3                             |
| Income from continuing operations  | \$ 1,191.3 | \$ 1,003.7         | \$ 3.9               | \$ 999.8                          |
| Effective income tax rate  | 29.9%      | 31.0%              | n/m                  | 33.3%                             |
|  |            |                    |                      |                                   |
| Nine months ended September 30,  | 2008       | 2007               |                      |                                   |
|  |            | Reported<br>Amount | Latam<br>Transaction | Excluding<br>Latam<br>Transaction |
| Income (loss) from continuing operations before provision for income taxes | \$ 4,760.9 | \$ 2,287.8         | \$ (1,639.9)         | \$ 3,927.7                        |
| Provision (benefit) for income taxes                                       | 1,433.0    | 1,226.0            | (62.2)               | 1,288.2                           |
| Income (loss) from continuing operations                                   | \$ 3,327.9 | \$ 1,061.8         | \$ (1,577.7)         | \$ 2,639.5                        |
| Effective income tax rate  | 30.1%      | n/m                | n/m                  | 32.8%                             |
| n/m Not meaningful   |            |                    |                      |                                   |

The lower effective income tax rates for the third quarter and nine months of 2008 include tax benefits related to certain international operations.

The third quarter 2007 tax benefit for the Latam transaction was primarily due to the ability to realize additional losses as a result of the capital gain from the sale of Boston Market.

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The nine months 2007 tax benefit for the Latam transaction was minimal due to our inability to utilize most of the capital losses generated by this transaction.

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### **Discontinued Operations**

In August 2007, the Company sold its investment in Boston Market and as a result, Boston Market's results of operations and transaction gain have been reflected in discontinued operations. In connection with the sale, the Company received net proceeds of approximately \$250 million and recorded a gain of \$68.6 million after tax. Boston Market's net loss for the third quarter and nine months 2007 (exclusive of the transaction gain) was \$1.1 million and \$8.5 million, respectively.

### **Cash Flows and Financial Position**

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

Cash provided by operations totaled \$4.4 billion and exceeded capital expenditures by \$3.0 billion for the nine months 2008. Cash provided by operations increased \$855.3 million or 24% compared to the nine months 2007, driven by strong operating results and changes in working capital items, partly due to the receipt of \$142.7 million related to the Internal Revenue Service (IRS) examination completed in fourth quarter 2007.

Cash used for investing activities totaled \$989.0 million for the nine months 2008, an increase of \$597.7 million. Proceeds received in 2007 from the Latam transaction and the disposal of Boston Market were greater than proceeds received from the sale of our investment in Pret A Manger in the second quarter 2008. In addition, capital expenditures increased \$199.9 million for the nine months 2008, primarily driven by increases in Europe and APMEA, partly offset by the elimination of capital expenditures as a result of the Latam transaction. The increase in cash used for investing activities was partly offset by higher proceeds from the sales of restaurant businesses and lower expenditures on purchases of restaurant businesses in conjunction with our overall refranchising strategy.

Cash used for financing activities totaled \$3.9 billion for the nine months, an increase of \$1.5 billion. Financing activities in 2008 reflected higher treasury stock purchases and dividend payments and lower proceeds from stock option exercises, partly offset by 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 September 30, 2008 totaled \$9.9 billion compared with \$9.3 billion at December 31, 2007. The increase in 2008 was primarily due to net issuances of \$737.6 million. As of September 30, 2008, there are no significant maturities of long-term debt within the next 12 months.

### **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.

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### **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. 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;

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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 and promotional initiatives;

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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 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. Certain macroeconomic events, such as the current crisis in the financial markets, could have a more wide-ranging and prolonged impact on the general business environment, which could also adversely affect us. Whether we can manage these risks 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 the impact of governmental actions to manage national economic conditions such as consumer spending, inflation rates and unemployment levels, particularly given the current volatility in the global financial markets;

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;

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.

**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:*

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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, including potential constraints on access to capital by existing or prospective franchisees.



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

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

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 increasing costs and other effects of compliance with existing and possible future U.S. federal, state and local regulations regarding immigration and evolving enforcement standards under those regulations, as well as compliance with other U.S. and overseas labor regulations, including regulations relating to wage and hour practices, job classification, mandatory healthcare benefits and unlawful workplace discrimination;

Whether the impact of the current financial crisis on unemployment levels and consumer confidence is prolonged or economic conditions deteriorate further, despite initiatives to stabilize the markets, and the effect of the crisis and related initiatives or potential regulation in the financial services industry on the cost and availability of funding for the Company and its franchisees, inflation and foreign exchange rates;

Disruptions in our operations or price volatility in a market that can result from governmental actions, such as price 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;

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

The impact of changes in financial reporting requirements, accounting principles or practices, related legal or regulatory interpretations or our critical accounting estimates, changes in tax accounting or tax laws (or interpretations thereof), and the impact of settlements 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:*

The current financial crisis, which has caused unprecedented market volatility worldwide;

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

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Trading activity in our common stock or related instruments, which can reflect market commentary or expectations about our business (including commentary that may be unreliable or incomplete in some cases), 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 or on other factors that affect our results and prospects, such as commodity costs. Our receipt of proceeds under any insurance we maintain with respect to certain of these risks may be delayed or the proceeds may be insufficient to offset our losses fully.*

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

There were no material changes to the disclosure made in our Annual Report on Form 10-K for the year ended December 31, 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 September 30, 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 September 30, 2008 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, 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 September 30, 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> |
|----------------------|---|-------------------------------------|---|--|
| July 1-31, 2008      | 8,815,097                               | \$58.62                             | 8,815,097   | \$5,089,317,000  |
| August 1-31, 2008    | 8,152,085                               | \$62.00                             | 8,152,085   | 4,583,863,000  |
| September 1-30, 2008 | 23,945                                  | \$57.55                             | 23,945  | 4,582,485,000  |
| Total                | 16,991,127                              | \$60.24                             | 16,991,127  | \$4,582,485,000  |

\* 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 September 30, 2008, the maximum dollar amount that may yet be purchased under the new program was \$4,582,485,000.

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 5. Other Information**

In July 2008, the Compensation Committee of the Company's Board of Directors approved revisions to the Company's Change of Control Employment Agreements in order to comply with Section 409A of the Internal Revenue Code of 1986, as amended. The revised Change of Control Employment Agreements are not materially different from and do not enhance the benefits previously contained in the Company's Change of Control Employment Agreements. The Company's executives who were previously party to a Change of Control Employment Agreement executed revised agreements. The Company's Form of Tier I Change of Control Employment Agreement, incorporating the revisions described above, is included at Exhibit 10(i) hereto.

On November 5, 2008, Peter J. Bensen, who was not previously party to a Change of Control Employment Agreement, entered into a Tier I Change of Control Employment Agreement with the Company.



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**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.</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, as amended and restated July 8, 2008, incorporated herein by reference from Form 10-Q, for the quarter ended June 30, 2008.** <ul style="list-style-type: none"> <li>(i) First Amendment to the McDonald's Excess Benefit and Deferred Bonus Plan, effective as of October 21, 2008, filed herewith.**</li> </ul> </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> |

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- (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, effective July 1, 2008, incorporated herein by reference from Form 10-Q, for the quarter ended June 30, 2008.\*\*
- (i) Form of McDonald's Corporation Tier I Change of Control Employment Agreement, filed herewith.\*\*
- (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) Form of Stock Option Grant Notice, incorporated herein by reference from Form 10-Q, for the quarter ended June 30, 2005.\*\*
- (l) Form of Restricted Stock Unit Award Notice, incorporated herein by reference from Form 10-Q, for the quarter ended June 30, 2005.\*\*
- (m) McDonald's Corporation Severance Plan, effective January 1, 2008, incorporated by reference from Form 8-K, dated November 28, 2007.\*\*
  - (i) First Amendment of McDonald's Corporation Severance Plan, effective as of October 1, 2008, filed herewith.\*\*
- (n) Employment Contract between Denis Hennequin and the Company, dated February 26, 2007, incorporated herein by reference from Form 10-K, for the year ended December 31, 2006.\*\*
- (o) Amended Assignment Agreement between Timothy Fenton and the Company, dated January 2008, incorporated herein by reference from Form 10-Q, for the quarter ended March 31, 2008.\*\*
- (p) 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.\*\*
- (q) Description of Restricted Stock Units granted to Andrew J. McKenna, incorporated herein by reference from Form 10-Q, for the quarter ended June 30, 2008.\*\*
- (r) Terms of the Restricted Stock Units granted pursuant to the Company's Amended and Restated 2001 Omnibus Stock Ownership Plan, incorporated herein by reference from Form 10-Q, for the quarter ended June 30, 2008.\*\*
- (s) McDonald's Corporation Target Incentive Plan, effective as of January 1, 2008, incorporated herein by reference from Form 8-K, dated January 23, 2008.\*\*
- (t) Terms of equity compensation awards granted in the European Union pursuant to the Company's Amended and Restated 2001 Omnibus Stock Ownership Plan, incorporated herein by reference from Form 10-Q, for the quarter ended March 31, 2008.\*\*

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- (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.



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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.

McDONALD S CORPORATION

(Registrant)

November 6, 2008

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