

MCDONALDS CORP
Form 10-Q
November 01, 2012
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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, 2012

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 36-2361282
(State or Other Jurisdiction of (I.R.S. Employer
Incorporation or Organization) Identification No.)

One McDonald's Plaza 60523
Oak Brook, Illinois (Zip Code)
(Address of Principal Executive Offices)
(630) 623-3000
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

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

Large accelerated filer Accelerated filer

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

1,003,976,633
(Number of shares of common stock
outstanding as of September 30, 2012)

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McDONALD'S CORPORATION

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

CONDENSED CONSOLIDATED BALANCE SHEET

In millions, except per share data	(unaudited) September 30, 2012	December 31, 2011
Assets		
Current assets		
Cash and equivalents	\$2,178.5	\$ 2,335.7
Accounts and notes receivable	1,277.3	1,334.7
Inventories, at cost, not in excess of market	109.1	116.8
Prepaid expenses and other current assets	643.0	615.8
Total current assets	4,207.9	4,403.0
Other assets		
Investments in and advances to affiliates	1,460.3	1,427.0
Goodwill	2,744.2	2,653.2
Miscellaneous	1,660.4	1,672.2
Total other assets	5,864.9	5,752.4
Property and equipment		
Property and equipment, at cost	37,320.2	35,737.6
Accumulated depreciation and amortization	(13,568.5)	(12,903.1)
Net property and equipment	23,751.7	22,834.5
Total assets	\$33,824.5	\$ 32,989.9
Liabilities and shareholders' equity		
Current liabilities		
Accounts payable	\$833.6	\$ 961.3
Dividends payable	770.0	—
Income taxes	123.6	262.2
Other taxes	374.6	338.1
Accrued interest	158.1	218.2
Accrued payroll and other liabilities	1,379.3	1,362.8
Current maturities of long-term debt	512.1	366.6
Total current liabilities	4,151.3	3,509.2
Long-term debt	12,752.0	12,133.8
Other long-term liabilities	1,557.1	1,612.6
Deferred income taxes	1,480.0	1,344.1
Shareholders' equity		
Preferred stock, no par value; authorized—165.0 million shares; issued—none	—	—
Common stock, \$.01 par value; authorized—3.5 billion shares; issued 1,660.6 million shares	16.6	16.6
Additional paid-in capital	5,689.0	5,487.3
Retained earnings	37,882.5	36,707.5
Accumulated other comprehensive income	609.5	449.7
Common stock in treasury, at cost; 656.6 and 639.2 million shares	(30,313.5)	(28,270.9)
Total shareholders' equity	13,884.1	14,390.2
Total liabilities and shareholders' equity	\$33,824.5	\$ 32,989.9

See Notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENT OF NET INCOME AND COMPREHENSIVE INCOME
(UNAUDITED)

In millions, except per share data	Quarters Ended		Nine Months Ended	
	September 30, 2012	2011	September 30, 2012	2011
Revenues				
Sales by Company-operated restaurants	\$4,838.4	\$4,855.5	\$13,944.1	\$13,705.6
Revenues from franchised restaurants	2,314.0	2,310.8	6,670.8	6,477.7
Total revenues	7,152.4	7,166.3	20,614.9	20,183.3
Operating costs and expenses				
Company-operated restaurant expenses	3,914.4	3,883.3	11,392.6	11,106.8
Franchised restaurants—occupancy expenses	383.4	376.2	1,134.3	1,103.5
Selling, general & administrative expenses	620.9	580.9	1,830.7	1,732.5
Impairment and other charges (credits), net	6.2	(6.6)	6.2	(4.2)
Other operating (income) expense, net	(59.7)	(62.2)	(155.7)	(165.0)
Total operating costs and expenses	4,865.2	4,771.6	14,208.1	13,773.6
Operating income	2,287.2	2,394.7	6,406.8	6,409.7
Interest expense	128.1	124.0	387.0	365.9
Nonoperating (income) expense, net	5.5	7.5	8.8	15.3
Income before provision for income taxes	2,153.6	2,263.2	6,011.0	6,028.5
Provision for income taxes	698.6	755.9	1,942.3	1,902.0
Net income	\$1,455.0	\$1,507.3	\$4,068.7	\$4,126.5
Earnings per common share-basic	\$1.45	\$1.47	\$4.02	\$3.98
Earnings per common share-diluted	\$1.43	\$1.45	\$3.98	\$3.94
Dividends declared per common share	\$1.47	\$1.31	\$2.87	\$2.53
Weighted average shares outstanding-basic	1,006.1	1,028.8	1,012.7	1,035.5
Weighted average shares outstanding-diluted	1,015.4	1,041.3	1,023.3	1,048.2
Comprehensive income	\$1,779.7	\$511.4	\$4,228.5	\$3,922.1
See Notes to condensed consolidated financial statements.				

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

In millions	Quarters Ended		Nine Months Ended	
	September 30, 2012	2011	September 30, 2012	2011
Operating activities				
Net income	\$1,455.0	\$1,507.3	\$4,068.7	\$4,126.5
Adjustments to reconcile to cash provided by operations				
Charges and credits:				
Depreciation and amortization	371.9	358.3	1,102.5	1,047.5
Deferred income taxes	84.3	159.7	119.7	185.4
Share-based compensation	22.5	21.2	70.2	65.3
Other	32.0	(1.4)	4.3	(51.0)
Changes in working capital items	33.7	124.5	(249.4)	(8.2)
Cash provided by operations	1,999.4	2,169.6	5,116.0	5,365.5
Investing activities				
Capital expenditures	(753.2)	(692.3)	(2,053.6)	(1,791.4)
Sales and purchases of restaurant businesses and property sales	47.8	54.1	110.7	252.8
Other	(18.3)	(61.6)	(63.8)	(133.5)
Cash used for investing activities	(723.7)	(699.8)	(2,006.7)	(1,672.1)
Financing activities				
Short-term borrowings and long-term financing issuances and repayments	(379.3)	420.2	791.1	935.5
Treasury stock purchases	(651.0)	(874.8)	(2,234.2)	(2,993.4)
Common stock dividends	(703.8)	(627.2)	(2,125.4)	(1,894.3)
Proceeds from stock option exercises	83.3	79.5	233.0	265.4
Excess tax benefit on share-based compensation	33.0	25.8	101.6	83.2
Other	(0.3)	(1.8)	(9.3)	(12.4)
Cash used for financing activities	(1,618.1)	(978.3)	(3,243.2)	(3,616.0)
Effect of exchange rates on cash and cash equivalents	36.3	(172.7)	(23.3)	(75.6)
Cash and equivalents increase (decrease)	(306.1)	318.8	(157.2)	1.8
Cash and equivalents at beginning of period	2,484.6	2,070.0	2,335.7	2,387.0
Cash and equivalents at end of period	\$2,178.5	\$2,388.8	\$2,178.5	\$2,388.8
See Notes to condensed consolidated financial statements.				

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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, 2011 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, 2012 do not necessarily indicate the results that may be expected for the full year.

Restaurant Information

The following table presents restaurant information by ownership type:

Restaurants at September 30,	2012	2011
Conventional franchised	19,673	19,367
Developmental licensed	4,143	3,803
Foreign affiliated	3,654	3,581
Total Franchised	27,470	26,751
Company-operated	6,540	6,393
Systemwide restaurants	34,010	33,144

The results of operations of restaurant businesses purchased and sold in transactions with franchisees were not material either individually or in the aggregate to the condensed consolidated financial statements for the periods prior to purchase and sale.

Comprehensive Income

The following table presents the components of comprehensive income for the quarters and nine months 2012 and 2011:

In millions	Quarters Ended		Nine Months Ended	
	September 30,	September 30,	September 30,	September 30,
	2012	2011	2012	2011
Net income	\$1,455.0	\$1,507.3	\$4,068.7	\$4,126.5
Other comprehensive income (loss):				
Foreign currency translation adjustments, net of hedging	316.1	(992.1)	142.0	(218.5)
Cash flow hedging adjustments	7.8	(4.6)	15.8	(8.6)
Pension liability adjustment	0.8	0.8	2.0	22.7
Total other comprehensive income (loss)	324.7	(995.9)	159.8	(204.4)
Total comprehensive income	\$1,779.7	\$511.4	\$4,228.5	\$3,922.1

In June 2011, the Financial Accounting Standards Board issued an update to Topic 220—Comprehensive Income of the Accounting Standards Codification (ASC). The update is intended to increase the prominence of other comprehensive income in the financial statements. The guidance requires that the Company presents components of comprehensive income in either one continuous statement or two separate consecutive statements and no longer permits the presentation of comprehensive income in the Consolidated statement of shareholders' equity. The Company adopted this new guidance effective January 1, 2012, as required, and included comprehensive income in the Condensed consolidated statement of net income and comprehensive income (unaudited) for interim reporting.

Per Common Share Information

Diluted earnings per common share is calculated using net income divided by diluted weighted-average shares. Diluted weighted-average shares include weighted-average shares outstanding plus the dilutive effect of share-based compensation, calculated using the treasury stock method, of 9.3 million shares and 12.5 million shares for the quarters 2012 and 2011, respectively, and 10.6 million shares and 12.7 million shares for the nine months 2012 and 2011, respectively. Stock options that would have been antidilutive and therefore were not included in the calculation

of diluted weighted-average shares totaled 4.7 million shares for the quarter and nine months 2012 and none for the quarter and nine months 2011.

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Fair Value Measurements

The Company measures certain financial assets and liabilities at fair value on a recurring basis, and certain non-financial assets and liabilities on a nonrecurring basis. Fair value is defined 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. Fair value disclosures are reflected in a three-level hierarchy, maximizing the use of observable inputs and minimizing the use of unobservable inputs.

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

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

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

Level 3 – inputs to the valuation methodology are unobservable and significant to the fair value measurement of the asset or liability.

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

Certain Financial Assets and Liabilities Measured at Fair Value

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

In millions	Level 1	Level 2	Level 3	Carrying Value
September 30, 2012				
Cash equivalents	\$346.1			\$346.1
Investments	157.0 *			157.0
Derivative assets	137.0 *	\$76.7		213.7
Total assets at fair value	\$640.1	\$76.7		\$716.8
Derivative liabilities		\$(18.0)		\$(18.0)
Total liabilities at fair value		\$(18.0)		\$(18.0)
December 31, 2011				
Cash equivalents	\$581.7			\$581.7
Investments	132.4 *			132.4
Derivative assets	154.5 *	\$71.1		225.6
Total assets at fair value	\$868.6	\$71.1		\$939.7
Derivative liabilities		\$(15.6)		\$(15.6)
Total liabilities at fair value		\$(15.6)		\$(15.6)

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

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

Certain assets and liabilities are measured at fair value on a nonrecurring basis; that is, the assets and liabilities are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (e.g., when there is evidence of impairment). At September 30, 2012, no material fair value adjustments or fair value

measurements were required for non-financial assets or liabilities.

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At September 30, 2012, the fair value of the Company's debt obligations was estimated at \$15.4 billion, compared to a carrying amount of \$13.3 billion. The fair value was based on quoted market prices, Level 2 within the valuation hierarchy. The carrying amount for both cash and equivalents and notes receivable approximate fair value.

Financial Instruments and Hedging Activities

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

The Company documents its risk management objective and strategy for undertaking hedging transactions, as well as all relationships between hedging instruments and hedged items. The Company's derivatives that are designated as hedging instruments consist mainly of interest rate swaps, foreign currency forwards, foreign currency options, cross-currency swaps, and commodity forwards, further explained in the "Fair Value," "Cash Flow" and "Net Investment" hedge sections.

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

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

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

In millions	Derivative Assets		Derivative Liabilities			
	Balance Sheet Classification	September 30, 2012	December 31, 2011	Balance Sheet Classification	September 30, 2012	December 31, 2011
Derivatives designated as hedging instruments						
Foreign currency	Prepaid expenses and other current assets	\$ 6.9	\$ 6.7	Accrued payroll and other liabilities	\$(1.4)	\$(0.3)
Interest rate	Prepaid expenses and other current assets	9.6	9.4			
Commodity	Miscellaneous other assets	13.4	—			
Foreign currency	Miscellaneous other assets	2.3	0.7	Other long-term liabilities	(12.0)	(0.3)
Interest rate	Miscellaneous other assets	39.7	46.0	Other long-term liabilities	—	(14.0)
Total derivatives designated as hedging instruments		\$ 109.9	\$ 62.8		\$(13.4)	\$(14.6)
Derivatives not designated as hedging instruments						
Foreign currency	Prepaid expenses and other current assets	\$ 4.8	\$ 8.3	Accrued payroll and other liabilities	\$(4.6)	\$(1.0)
Equity	Miscellaneous other assets	137.0	154.5			
		\$ 141.8	\$ 162.8		\$(4.6)	\$(1.0)

Total derivatives not designated as hedging
instruments

Total derivatives	\$ 213.7	\$ 225.6	\$ (18.0)	\$ (15.6)
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The following table presents the pretax amounts affecting income and OCI for the nine months 2012 and 2011, respectively:

In millions

Derivatives in Fair Value Hedging Relationships	Gain (Loss) Recognized in Income on Derivative		Hedged Items in Fair Value Hedging Relationships	Gain (Loss) Recognized in Income on Related Hedged Items	
	2012	2011		2012	2011
Interest rate	\$(6.1)	\$(6.8)	Fixed-rate debt	\$6.1	\$6.8

Derivatives in Cash flow Hedging Relationships	Gain (Loss) Recognized in Accumulated OCI on Derivative (Effective Portion)		Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)		Gain (Loss) Recognized in Income on Derivative (Amount Excluded from Effectiveness Testing and Ineffective Portion)	
	2012	2011	2012	2011	2012	2011
Commodity	\$13.4	\$—	\$—	\$—	\$—	\$—
Foreign currency	5.1	(4.3)	(7.6)	(3.2)	(10.8)	(6.1)
Interest rate ⁽¹⁾	(4.6)	(10.5)	0.4	1.7	—	—
Total	\$13.9	\$(14.8)	\$(7.2)	\$(1.5)	\$(10.8)	\$(6.1)

Net Investment Hedging Relationships	Gain (Loss) Recognized in Accumulated OCI on Derivative (Effective Portion)		Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)		Derivatives Not Designated as Hedging Instruments	Gain (Loss) Recognized in Income on Derivative	
	2012	2011	2012	2011		2012	2011
Foreign currency denominated debt	\$34.8	\$(73.6)	\$—	\$—	Foreign Currency	\$(9.0)	\$(5.6)
Foreign currency derivatives ⁽²⁾	(9.5)	(9.4)	—	(8.2)	Equity ⁽³⁾	(11.5)	16.9
Total	\$25.3	\$(83.0)	\$—	\$(8.2)	Interest Rate Total	—	1.5
						\$(20.5)	\$12.8

Gains (losses) recognized in income on derivatives are recorded in “Nonoperating (income) expense, net” unless otherwise noted.

(1) The amount of gain (loss) reclassified from accumulated OCI into income is recorded in Interest expense.

(2) The amount of gain (loss) reclassified from accumulated OCI into income is recorded in Impairment and other charges (credits), net.

(3) The amount of gain (loss) recognized in income on the derivatives used to hedge the supplemental benefit plan liabilities is recorded in Selling, general & administrative expenses.

Fair Value Hedges

The Company enters into fair value hedges to reduce the exposure to changes in the fair values of certain liabilities. The fair value hedges the Company enters into consist of interest rate swaps that convert a portion of its fixed-rate debt into floating-rate debt. All of the Company’s interest rate swaps meet the shortcut method requirements.

Accordingly, changes in the fair values of the interest rate swaps are exactly offset by changes in the fair value of the underlying debt. No ineffectiveness has been recorded to net income related to interest rate swaps designated as fair value hedges for the nine months 2012. A total of \$1.9 billion of the Company’s outstanding fixed-rate debt was

effectively converted to floating-rate debt resulting from the use of interest rate swaps.

Cash Flow Hedges

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

The Company periodically uses interest rate swaps to effectively convert a portion of floating-rate debt, including forecasted debt issuances, into fixed-rate debt and the agreements are intended to reduce the impact of interest rate changes on future interest expense. At September 30, 2012, none of the Company's anticipated debt issuances were effectively converted to fixed-rate resulting from the use of interest rate swaps.

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

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

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

The hedges cover the next 18 months for certain exposures and are denominated in various currencies. As of September 30, 2012, the Company had derivatives outstanding with an equivalent notional amount of \$623.1 million that were used to hedge a portion of forecasted foreign currency denominated royalties.

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

The Company uses cross-currency swaps to hedge the risk of cash flows associated with certain foreign-currency denominated debt, including forecasted interest payments, and has elected cash flow hedge accounting. The hedges cover periods up to 54 months and have an equivalent notional amount of \$199.6 million.

The Company manages its exposure to the variability of cash flows for energy-related transactions in certain markets by entering into commodity forwards and has elected cash flow hedge accounting as appropriate. The hedges cover periods up to 22 years and have an equivalent notional amount of \$490.5 million.

The Company recorded after tax adjustments to the cash flow hedging component of accumulated OCI in shareholders' equity. The Company recorded a net increase of \$15.8 million for the nine months 2012 and a net decrease of \$8.6 million for the nine months 2011. Based on interest rates, foreign exchange rates, and commodity prices at September 30, 2012, the \$20.4 million in cumulative cash flow hedging gains, after tax, at September 30, 2012, is not expected to have a significant effect on earnings over the next 12 months.

Net Investment Hedges

The Company uses foreign currency denominated debt (third party and intercompany) and derivatives to hedge its investments in certain foreign subsidiaries and affiliates. Realized and unrealized translation adjustments from these hedges are included in shareholders' equity in the foreign currency translation component of OCI and offset translation adjustments on the underlying net assets of foreign subsidiaries and affiliates, which are also recorded in OCI. As of September 30, 2012, a total of \$4.1 billion of the Company's foreign currency denominated debt and \$514.9 million million of derivatives were designated to hedge investments in certain foreign subsidiaries and affiliates.

Credit Risk

The Company is exposed to credit-related losses in the event of non-performance by the counterparties to its hedging instruments. The counterparties to these agreements consist of a diverse group of financial institutions. The Company continually monitors its positions and the credit ratings of its counterparties and adjusts positions as appropriate. The Company did not have significant exposure to any individual counterparty at September 30, 2012 and has master agreements that contain netting arrangements. Some of these agreements also require each party to post collateral if credit ratings fall below, or aggregate exposures exceed, certain contractual limits. At September 30, 2012, neither the Company nor its counterparties were required to post collateral on any derivative position, other than on hedges of certain of the Company's supplemental benefit plan liabilities where its counterparties were required to post collateral on their liability positions.

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Segment Information

The Company franchises and operates McDonald's restaurants in the global restaurant 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		Nine Months Ended	
	September 30,		September 30,	
	2012	2011	2012	2011
Revenues				
U.S.	\$2,256.5	\$2,229.9	\$6,601.1	\$6,324.4
Europe	2,793.1	2,904.2	8,069.8	8,166.7
APMEA	1,693.6	1,601.6	4,798.1	4,511.8
Other Countries & Corporate	409.2	430.6	1,145.9	1,180.4
Total revenues	\$7,152.4	\$7,166.3	\$20,614.9	\$20,183.3
Operating Income				
U.S.	\$973.8	\$986.8	\$2,817.2	\$2,731.8
Europe	848.7	917.1	2,355.2	2,425.8
APMEA	443.2	431.2	1,185.9	1,144.8
Other Countries & Corporate	21.5	59.6	48.5	107.3
Total operating income	\$2,287.2	\$2,394.7	\$6,406.8	\$6,409.7
Subsequent Events				

The Company evaluated subsequent events through the date the financial statements were issued and filed with the Securities and Exchange Commission. There were no subsequent events that required recognition or disclosure.

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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 34,010 restaurants in 119 countries at September 30, 2012, 27,470 were licensed to franchisees (including 19,673 franchised to conventional franchisees, 4,143 licensed to developmental licensees and 3,654 licensed to foreign affiliates (affiliates) – primarily Japan) and 6,540 were operated by the Company. Under our conventional franchise arrangement, franchisees provide a portion of the capital required by initially investing in the equipment, signs, seating and décor of their restaurant businesses, and by reinvesting in the business over time. The Company owns the land and building or secures long-term leases for both Company-operated and conventional franchised restaurant sites. This maintains long-term occupancy rights, helps control related costs and assists in alignment with franchisees. In certain circumstances, the Company participates in reinvestment for conventional franchised restaurants. Under our developmental license arrangement, licensees provide capital for the entire business, including the real estate interest, and the Company has no capital invested. In addition, the Company has an equity investment in a limited number of affiliates that invest in real estate and operate and/or franchise restaurants within a market.

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

The Company’s revenues consist of sales by Company-operated restaurants and fees from restaurants operated by franchisees. Revenues from conventional franchised restaurants include rent and royalties based on a percent of sales along with minimum rent payments, and initial fees. Revenues from restaurants licensed to affiliates and developmental licensees include a royalty based on a percent of sales, and generally include initial fees. Fees vary by type of site, amount of Company investment, if any, 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. For the nine months ended September 30, 2012, the U.S., Europe and APMEA segments accounted for 32%, 39% and 23% of total revenues, respectively.

Strategic Direction and Financial Performance

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

McDonald’s customer-focused Plan to Win—which concentrates on being better, not just bigger—provides a common framework for our global business while allowing for local adaptation. Through the execution of multiple initiatives surrounding the five elements of our Plan to Win—People, Products, Place, Price and Promotion—we have enhanced the restaurant experience for customers worldwide and grown comparable sales and customer visits in each of the last eight years. This Plan, combined with financial discipline, has delivered strong results for our shareholders.

The Company’s growth priorities under the Plan to Win include: optimizing the menu with the right food and beverage offerings, modernizing the customer experience by upgrading nearly every aspect of our restaurants from service to designs, and broadening our accessibility through continued convenience and value initiatives. The combination of all of these efforts drove increases in comparable sales and customer visits in many countries despite global economic and competitive challenges and a relatively flat or contracting Informal Eating Out (IEO) market. Overall results also

reflected sales and cost pressures, some of which were the result of planned strategic decisions, including actions taken to enhance our value platforms, and invest in technology and our Olympic sponsorship.

We expect our revenues and operating income will remain under pressure at least for the next few quarters. Our near-term focus is on increasing guest counts and market share by emphasizing exceptional value across the menu, including products offered at an affordable entry price point that may negatively impact average check. We plan to build on this foundation by featuring premium products and promotions that encourage purchases of higher margin products and generate a higher average check.

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Every area of the world contributed to global comparable sales, which increased 1.9% and 4.1% for the quarter and nine months 2012, respectively. On a consolidated basis, comparable guest counts increased 2.2% for the nine months 2012. Comparable sales are driven by changes in guest counts and average check, which is affected by changes in pricing and product mix. Generally, our goal is to achieve a balanced contribution from both guest counts and average check.

U.S. comparable sales increased 1.2% for the quarter and 4.4% for the nine months amid broad competitive activity. During both periods, the U.S. showcased beverages, breakfast and classic core favorites; featured everyday value; and continued to upgrade McDonald's existing restaurant base with fresh, modern designs. Ongoing U.S. initiatives include optimizing the menu with premium product additions; modernizing our restaurants through reimaging and technology enhancements; and broadening accessibility with all-day everyday value and expanded operating hours. Europe's emphasis on everyday affordability, premium product innovation and restaurant reimaging contributed to 1.8% comparable sales growth for the quarter and 3.4% for the nine months. Europe's strategic priorities include increasing local relevance by providing value across the menu complemented by a variety of promotional food events; enhancing the customer experience through ongoing restaurant reimaging and technology initiatives; and reducing our impact on the environment with energy management tools.

APMEA's comparable sales increase of 1.4% for the quarter and 2.5% for the nine months reflected the segment's unique value platforms, menu variety and convenience strategies. APMEA will continue efforts to become our customers' first choice for eating out by providing compelling value and menu variety and by focusing on the restaurant experience through convenience initiatives, such as expanding delivery service and extended operating hours. In addition, APMEA will grow by opening approximately 750 new restaurants, reimaging existing restaurants and elevating customer service and operations to drive efficiencies.

Highlights from the Quarter and Nine Months 2012 Included:

- Global comparable sales increased 1.9% for the quarter and 4.1% for the nine months, with positive comparable sales in each geographic segment.

- Consolidated revenues were flat (up 4% in constant currencies) for the quarter and increased 2% (6% in constant currencies) for the nine months.

- Consolidated operating income decreased 4% (flat in constant currencies) for the quarter and were flat (increased 4% in constant currencies) for the nine months.

Diluted earnings per share were \$1.43 for the quarter and \$3.98 for the nine months, decreased 1% (increased 4% in constant currencies) and up 1% (5% in constant currencies), respectively. Foreign currency translation negatively impacted diluted earnings per share by \$0.08 for the quarter and \$0.16 for the nine months.

- For the nine months, the Company repurchased 24.1 million shares for \$2.3 billion and paid total dividends of \$2.1 billion.

- The quarterly cash dividend increased 10% to \$0.77 per share - the equivalent of \$3.08 annually - effective for the fourth quarter 2012.

Outlook

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

Changes in Systemwide sales are driven by comparable sales and net restaurant unit expansion. The Company expects net restaurant additions to add approximately 2 percentage points to 2012 Systemwide sales growth (in constant currencies), most of which will be due to the 872 net traditional restaurants added in 2011.

The Company does not generally provide specific guidance on changes in comparable sales. However, as a perspective, assuming no change in cost structure, a 1 percentage point increase in comparable sales for either the U.S. or Europe would increase annual diluted earnings per share by about 3-4 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 2012, the total basket of goods cost is expected to increase 3.5-4.5% in the U.S. and 2.5-3.5% in Europe.

- The Company expects full-year 2012 selling, general & administrative expenses to increase approximately 6% in constant currencies, driven by certain technology investments, primarily to accelerate future restaurant capabilities,

and costs related to the 2012 Worldwide Owner/Operator Convention in the second quarter and the 2012 London Olympics in the third quarter. The Company expects the magnitude of the increase to be confined to 2012.

Based on current interest and foreign currency exchange rates, the Company expects interest expense for the full year 2012 to increase between 4% and 6% compared with 2011.

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A significant part of the Company's operating income is generated outside the U.S., and about 35% of its total debt is denominated in foreign currencies. Accordingly, earnings are affected by changes in foreign currency exchange rates, particularly the Euro, British Pound, Australian Dollar and Canadian Dollar. Collectively, these currencies represent approximately 65% of the Company's operating income outside the U.S. If all four of these currencies moved by 10% in the same direction, the Company's annual diluted earnings per share would change by about 24 cents.

The Company expects the effective income tax rate for the full-year 2012 to be 31% to 33%. Some volatility may be experienced between the quarters resulting in a quarterly tax rate that is outside the annual range.

The Company expects capital expenditures for 2012 to be approximately \$2.9 billion. About half of this amount will be used to open new restaurants. The Company expects to open more than 1,300 restaurants including about 450 restaurants in affiliated and developmental licensee markets, such as Japan and Latin America, where the Company does not fund any capital expenditures. The Company expects net additions of about 900 restaurants. The remaining capital will be used for reinvestment in existing restaurants. Nearly half of this reinvestment will be used to reimage more than 2,400 locations worldwide, some of which will require no capital investment from the Company.

The Following Definitions Apply to these Terms as Used Throughout this Form 10-Q:

Information in constant currency is calculated by translating current year results at prior year average exchange rates.

Management reviews and analyzes business results excluding the effect of foreign currency translation and bases incentive compensation plans on these results because they believe this better represents the Company's underlying business trends.

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

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

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Dollars in millions, except per share data	Quarter Ended September 30, 2012		Nine Months Ended September 30, 2012	
	Amount	% Increase/ (Decrease)	Amount	% Increase/ (Decrease)
Revenues				
Sales by Company-operated restaurants	\$4,838.4	0	\$13,944.1	2
Revenues from franchised restaurants	2,314.0	0	6,670.8	3
Total revenues	7,152.4	0	20,614.9	2
Operating costs and expenses				
Company-operated restaurant expenses	3,914.4	1	11,392.6	3
Franchised restaurants—occupancy expenses	383.4	2	1,134.3	3
Selling, general & administrative expenses	620.9	7	1,830.7	6
Impairment and other charges (credits), net	6.2	n/m	6.2	n/m
Other operating (income) expense, net	(59.7)	4	(155.7)	6
Total operating costs and expenses	4,865.2	2	14,208.1	3
Operating income	2,287.2	(4)	6,406.8	0
Interest expense	128.1	3	387.0	6
Nonoperating (income) expense, net	5.5	(25)	8.8	(42)
Income before provision for income taxes	2,153.6	(5)	6,011.0	0
Provision for income taxes	698.6	(8)	1,942.3	2
Net income	\$1,455.0	(3)	\$4,068.7	(1)
Earnings per common share-basic	\$1.45	(1)	\$4.02	1
Earnings per common share-diluted	\$1.43	(1)	\$3.98	1
n/m Not meaningful				

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Impact of Foreign Currency Translation

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

IMPACT OF FOREIGN CURRENCY TRANSLATION

Dollars in millions, except per share data

			Currency Translation Benefit/ (Cost)
Quarters Ended September 30,	2012	2011	2012
Revenues	\$7,152.4	\$7,166.3	\$ (317.0)
Company-operated margins	924.0	972.2	(44.5)
Franchised margins	1,930.6	1,934.6	(84.0)
Selling, general & administrative expenses	620.9	580.9	17.1
Operating income	2,287.2	2,394.7	(111.5)
Net income	1,455.0	1,507.3	(73.9)
Earnings per share-diluted	1.43	1.45	(0.08)

			Currency Translation Benefit/ (Cost)
Nine Months Ended September 30,	2012	2011	2012
Revenues	\$20,614.9	\$20,183.3	\$ (724.9)
Company-operated margins	2,551.5	2,598.8	(99.2)
Franchised margins	5,536.5	5,374.2	(185.8)
Selling, general & administrative expenses	1,830.7	1,732.5	40.4
Operating income	6,406.8	6,409.7	(244.7)
Net income	4,068.7	4,126.5	(167.5)
Earnings per share-diluted	3.98	3.94	(0.16)

Foreign currency translation had a negative impact on consolidated operating results for the quarter and nine months primarily due to the weaker Euro, along with most other currencies.

Net Income and Diluted Earnings per Common Share

For the quarter, net income decreased 3% (increased 1% in constant currencies) to \$1,455.0 million and diluted earnings per share decreased 1% (increased 4% in constant currencies) to \$1.43. Foreign currency translation had a negative impact of \$0.08 per share on diluted earnings per share.

For the nine months, net income decreased 1% (increased 3% in constant currencies) to \$4,068.7 million and diluted earnings per share increased 1% (5% in constant currencies) to \$3.98. Foreign currency translation had a negative impact of \$0.16 per share on diluted earnings per share.

For the quarter and nine months, net income and diluted earnings per share growth in constant currencies were positively impacted by franchised margin dollars and a decrease in diluted weighted average shares outstanding, partly offset by higher selling, general and administrative expenses. The quarter also benefited from a lower effective income tax rate, while the nine months were negatively impacted by a higher effective income tax rate.

During the quarter, the Company repurchased 6.7 million shares of its stock for \$596.8 million, bringing total repurchases for the nine months to 24.1 million shares or \$2.3 billion. In addition, the Company paid a quarterly dividend of \$0.70 per share or \$703.8 million, bringing the total dividends paid for the nine months to \$2.1 billion. The Company also declared a fourth quarter 2012 dividend of \$0.77 per share, reflecting an increase of 10%, and expects total cash returned to shareholders to be at least \$5.5 billion for 2012.

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Revenues

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

REVENUES

Dollars in millions

Quarters Ended September 30,	2012	2011	% Inc/ (Dec)	% Inc/ (Dec) Excluding Currency Translation
Company-operated sales				
U.S.	\$1,152.6	\$1,153.7	0	0
Europe	2,029.4	2,088.0	(3)	7
APMEA	1,423.6	1,353.6	5	6
Other Countries & Corporate	232.8	260.2	(11)	(9)
Total	\$4,838.4	\$4,855.5	0	4
Franchised revenues				
U.S.	\$1,103.9	\$1,076.2	3	3
Europe	763.7	816.2	(6)	4
APMEA	270.0	248.0	9	11
Other Countries & Corporate	176.4	170.4	4	10
Total	\$2,314.0	\$2,310.8	0	5
Total revenues				
U.S.	\$2,256.5	\$2,229.9	1	1
Europe	2,793.1	2,904.2	(4)	6
APMEA	1,693.6	1,601.6	6	7
Other Countries & Corporate	409.2	430.6	(5)	(2)
Total	\$7,152.4	\$7,166.3	0	4
Nine Months Ended September 30,				
	2012	2011	% Inc/ (Dec)	% Inc/ (Dec) Excluding Currency Translation
Company-operated sales				
U.S.	\$3,394.6	\$3,285.0	3	3
Europe	5,858.6	5,895.0	(1)	8
APMEA	4,032.5	3,809.3	6	6
Other Countries & Corporate	658.4	716.3	(8)	(6)
Total	\$13,944.1	\$13,705.6	2	5
Franchised revenues				
U.S.	\$3,206.5	\$3,039.4	5	5
Europe	2,211.2	2,271.7	(3)	6
APMEA	765.6	702.5	9	10

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Other Countries & Corporate	487.5	464.1	5	11
Total	\$6,670.8	\$6,477.7	3	6
Total revenues				
U.S.	\$6,601.1	\$6,324.4	4	4
Europe	8,069.8	8,166.7	(1) 7
APMEA	4,798.1	4,511.8	6	6
Other Countries & Corporate	1,145.9	1,180.4	(3) 1
Total	\$20,614.9	\$20,183.3	2	6

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Consolidated revenues were flat (increased 4% in constant currencies) for the quarter and increased 2% (6% in constant currencies) for the nine months. The constant currency growth was driven primarily by positive comparable sales and expansion.

In the U.S., revenues increased for the quarter and nine months due to positive comparable sales. Everyday value offerings, menu variety and the enhanced customer experience provided by reimaged restaurants contributed to results, despite broad competitive activity.

In Europe, the constant currency increases in revenues for the quarter and nine months were primarily driven by strong comparable sales in Russia (which is entirely Company-operated) and the U.K., as well as expansion in Russia. France also contributed to the increase in revenues for both periods.

In APMEA, the constant currency increases in revenues for the quarter and nine months were primarily driven by comparable sales increases in China, Australia and many other markets, as well as expansion in China.

The following table presents the percent change in comparable sales for the quarters and nine months 2012 and 2011:
COMPARABLE SALES

	% Increase			
	Quarters Ended		Nine Months Ended	
	September 30, 2012	2011	September 30, 2012	2011 *
U.S.	1.2	4.4	4.4	4.0
Europe	1.8	4.9	3.4	5.5
APMEA	1.4	3.4	2.5	3.9
Other Countries & Corporate	5.5	11.4	8.5	