MCDONALDS CORP
Form 10-Q
August 05, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2011

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 Incorporation or Organization)	(I.R.S. Employer Identification No.)
One McDonald s Plaza **Oak Brook, Illinois**	**60523**
(Address of Principal Executive Offices)	(Zip Code)

(630) 623-3000

(Registrant s Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x 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 x 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 x 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 x

1,031,751,682

(Number of shares of common stock

outstanding as of June 30, 2011)

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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) June 30, 2011	December 31, 2010
Assets		
Current assets		
Cash and equivalents	**$ 2,070.0**	$ 2,387.0
Accounts and notes receivable	**1,249.1**	1,179.1
Inventories, at cost, not in excess of market	**115.0**	109.9
Prepaid expenses and other current assets	**591.3**	692.5
Total current assets	**4,025.4**	4,368.5
Other assets		
Investments in and advances to affiliates	**1,355.6**	1,335.3
Goodwill	**2,725.4**	2,586.1
Miscellaneous	**1,710.8**	1,624.7
Total other assets	**5,791.8**	5,546.1
Property and equipment		
Property and equipment, at cost	**36,229.5**	34,482.4
Accumulated depreciation and amortization	**(13,213.7)**	(12,421.8)
Net property and equipment	**23,015.8**	22,060.6
Total assets	**$ 32,833.0**	$ 31,975.2
Liabilities and shareholders equity		
Current liabilities		
Short-term borrowings	**$ 896.8**	
Accounts payable	**709.9**	$ 943.9
Income taxes	**235.0**	111.3
Other taxes	**310.7**	275.6
Accrued interest	**177.0**	200.7
Accrued payroll and other liabilities	**1,296.8**	1,384.9
Current maturities of long-term debt	**322.6**	8.3
Total current liabilities	**3,948.8**	2,924.7
Long-term debt	**11,062.8**	11,497.0
Other long-term liabilities	**1,548.2**	1,586.9
Deferred income taxes	**1,320.4**	1,332.4
Shareholders equity		
Preferred stock, no par value; authorized 165.0 million shares; issued none		
Common stock, $.01 par value; authorized 3.5 billion shares; issued 1,660.6 million shares	**16.6**	16.6
Additional paid-in capital	**5,362.1**	5,196.4
Retained earnings	**35,165.0**	33,811.7
Accumulated other comprehensive income	**1,544.4**	752.9
Common stock in treasury, at cost; 628.9 and 607.0 million shares	**(27,135.3)**	(25,143.4)
Total shareholders equity	**14,952.8**	14,634.2
Total liabilities and shareholders equity	**$ 32,833.0**	$ 31,975.2

See Notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENT OF INCOME (UNAUDITED)

	Quarters Ended June 30,		Six Months Ended June 30,	
In millions, except per share data	**2011**	2010	**2011**	2010
Revenues				
Sales by Company-operated restaurants	**$ 4,697.4**	$ 4,013.4	**$ 8,850.1**	$ 7,816.5
Revenues from franchised restaurants	**2,208.0**	1,932.1	**4,166.9**	3,739.1
Total revenues	**6,905.4**	5,945.5	**13,017.0**	11,555.6
Operating costs and expenses				
Company-operated restaurant expenses	**3,806.8**	3,214.8	**7,223.5**	6,325.7
Franchised restaurants - occupancy expenses	**373.0**	334.3	**727.3**	673.6
Selling, general & administrative expenses	**588.0**	564.9	**1,151.6**	1,111.2
Impairment and other charges (credits), net	**2.4**	6.8	**2.4**	37.6
Other operating (income) expense, net	**(53.9)**	(20.6)	**(102.8)**	(111.9)
Total operating costs and expenses	**4,716.3**	4,100.2	**9,002.0**	8,036.2
Operating income	**2,189.1**	1,845.3	**4,015.0**	3,519.4
Interest expense	**121.8**	108.1	**241.9**	219.1
Nonoperating (income) expense, net	**0.9**	1.9	**7.8**	8.1
Income before provision for income taxes	**2,066.4**	1,735.3	**3,765.3**	3,292.2
Provision for income taxes	**656.2**	509.5	**1,146.1**	976.6
Net income	**$ 1,410.2**	$ 1,225.8	**$ 2,619.2**	$ 2,315.6
Earnings per common share-basic	**$ 1.36**	$ 1.14	**$ 2.52**	$ 2.16
Earnings per common share-diluted	**$ 1.35**	$ 1.13	**$ 2.49**	$ 2.13
Dividends declared per common share	**$ 0.61**	$ 0.55	**$ 1.22**	$ 1.10
Weighted-average shares outstanding-basic	**1,035.6**	1,072.1	**1,039.0**	1,074.1
Weighted-average shares outstanding-diluted	**1,047.7**	1,085.9	**1,051.4**	1,088.1

See Notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS (UNAUDITED)

	Quarters Ended June 30,		Six Months Ended June 30,	
In millions	**2011**	2010	**2011**	2010
Operating activities				
Net Income	**$ 1,410.2**	$ 1,225.8	**$ 2,619.2**	$ 2,315.6
Adjustments to reconcile to cash provided by operations				
Charges and credits:				
Depreciation and amortization	**350.1**	311.5	**689.2**	629.4
Deferred income taxes	**38.7**	(0.3)	**25.7**	(6.6)
Share-based compensation	**20.1**	18.8	**44.1**	44.7
Impairment and other charges (credits), net	**2.4**	6.8	**2.4**	37.6
Other	**(42.3)**	56.2	**(52.0)**	92.4
Changes in working capital items	**(136.4)**	(370.1)	**(132.7)**	(441.7)
Cash provided by operations	**1,642.8**	1,248.7	**3,195.9**	2,671.4
Investing activities				
Property and equipment expenditures	**(590.4)**	(394.5)	**(1,099.1)**	(796.3)
Sales and purchases of restaurant businesses and property sales	**207.5**	35.9	**198.7**	70.7
Other	**(70.2)**	(32.1)	**(71.9)**	(55.5)
Cash used for investing activities	**(453.1)**	(390.7)	**(972.3)**	(781.1)
Financing activities				
Short-term borrowings and long-term financing issuances and repayments	**86.0**	224.0	**515.3**	273.2
Treasury stock purchases	**(748.0)**	(881.2)	**(2,118.6)**	(1,358.4)
Common stock dividends	**(632.0)**	(589.1)	**(1,267.1)**	(1,181.1)
Proceeds from stock option exercises	**124.2**	95.2	**185.9**	255.9
Excess tax benefit on share-based compensation	**35.6**	22.8	**57.4**	63.7
Other	**8.8**	6.0	**(10.6)**	16.0
Cash used for financing activities	**(1,125.4)**	(1,122.3)	**(2,637.7)**	(1,930.7)
Effect of exchange rates on cash and cash equivalents	**65.8**	(77.5)	**97.1**	(90.1)
Cash and equivalents increase (decrease)	**130.1**	(341.8)	**(317.0)**	(130.5)
Cash and equivalents at beginning of period	**1,939.9**	2,007.3	**2,387.0**	1,796.0
Cash and equivalents at end of period	**$ 2,070.0**	$ 1,665.5	**$ 2,070.0**	$ 1,665.5

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, 2010 Annual Report on Form 10-K. In the opinion of management, all adjustments (consisting of normal recurring accruals) necessary for a fair presentation have been included. The results for the quarter and six months ended June 30, 2011 do not necessarily indicate the results that may be expected for the full year.

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

Restaurant Information

The following table presents restaurant information by ownership type:

Restaurants at June 30,	**2011**	2010
Conventional franchised	**19,279**	19,059
Developmental licensed	**3,748**	3,327
Foreign affiliated	**3,571**	3,823
Franchised	**26,598**	26,209
Company-operated	**6,345**	6,257
Systemwide restaurants	**32,943**	32,466

Comprehensive Income

The following table presents the components of comprehensive income for the quarters and six months ended June 30, 2011 and 2010:

	Quarters Ended June 30,		**Six Months Ended June 30,**	
In millions	**2011**	2010	**2011**	2010
Net Income	**$ 1,410.2**	$ 1,225.8	**$ 2,619.2**	$ 2,315.6
Other comprehensive income (loss):				
Foreign currency translation adjustments, net of hedging	**289.9**	(806.1)	**773.6**	(1,048.9)
Cash flow hedging adjustments	**(0.5)**	14.3	**(4.0)**	21.8
Pension liability adjustment	**0.8**		**21.9**	0.8
Total other comprehensive income (loss)	**290.2**	(791.8)	**791.5**	(1,026.3)
Total comprehensive income	**$ 1,700.4**	$ 434.0	**$ 3,410.7**	$ 1,289.3

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 12.1 million shares and 13.8 million shares for the second quarter 2011 and 2010, respectively, and 12.4 million shares and 14.0 million shares for the six months ended June 30, 2011 and 2010, respectively. There were no antidilutive stock options excluded in the diluted weighted-average shares calculation for the second quarter and six months ended June 30, 2011 and 2010.

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.

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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**
June 30, 2011				
Cash equivalents	$ 307.5			$ 307.5
Investments	151.8*			151.8
Derivative assets	127.3*	$ 81.0		208.3
Total assets at fair value	**$ 586.6**	**$ 81.0**		**$ 667.6**
Derivative liabilities		$ (15.8)		$ (15.8)
Total liabilities at fair value		**$ (15.8)**		**$ (15.8)**
December 31, 2010				
Cash equivalents	$ 722.5			$ 722.5
Investments	131.6*			131.6
Derivative assets	104.4*	$ 88.5		192.9
Total assets at fair value	$ 958.5	$ 88.5		$ 1,047.0
Derivative liabilities		$ (8.4)		$ (8.4)
Total liabilities at fair value		$ (8.4)		$ (8.4)

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

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

Certain assets and liabilities are measured at fair value on a nonrecurring basis; that is, the assets and liabilities are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (e.g., when there is evidence of impairment). At June 30, 2011, no material fair value adjustments or fair value measurements were required for non-financial assets or liabilities.

Certain Financial Assets and Liabilities not Measured at Fair Value

At June 30, 2011, the fair value of the Company s debt obligations was estimated at $13.4 billion, compared to a carrying amount of $12.3 billion. This fair value was estimated using various pricing models or discounted cash flow analyses that incorporated quoted market prices, and is similar to 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.

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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 exchange agreements, forward foreign currency exchange agreements and foreign currency options. Interest rate exchange agreements are entered into to manage the interest rate risk associated with the Company s fixed and floating- rate borrowings. Forward foreign currency exchange agreements and foreign currency options are entered into to mitigate the risk that forecasted foreign currency cash flows (such as royalties denominated in foreign currencies) will be adversely affected by changes in foreign currency exchange rates. Certain foreign currency denominated debt is used, in part, to protect the value of the Company s investments in certain foreign subsidiaries and affiliates from changes in foreign currency exchange rates.

The Company also enters into certain derivatives that are not designated as hedging instruments. The Company has entered into equity derivative contracts to mitigate market-driven changes in certain of its supplemental benefit plan liabilities. Changes in the fair value of these derivatives are recorded in selling, general & administrative expenses together with the changes in the supplemental benefit plan liabilities. In addition, the Company uses forward foreign currency exchange agreements and foreign currency exchange agreements to mitigate the change in fair value of certain foreign currency denominated assets and liabilities. Since these derivatives are not designated as hedging instruments, the changes in the fair value of these hedges are recognized immediately in nonoperating (income) expense together with the 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 Hedging Strategy section) are undesignated as hedging instruments as the underlying foreign currency royalties are earned.

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

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

	Derivative Assets			Derivative Liabilities		
In millions	*Balance Sheet Classification*	**June 30, 2011**	December 31, 2010	*Balance Sheet Classification*	**June 30, 2011**	December 31, 2010
Derivatives designated as hedging instruments						
Foreign currency	Prepaid expenses and other current assets	**$ 2.5**	$ 7.5	Accrued payroll and other liabilities	**$ (2.6)**	$ (4.6)
Interest rate	Prepaid expenses and other current assets	**3.0**	0.5			
Foreign currency	Miscellaneous other assets	**0.3**				
Interest rate	Miscellaneous other assets	**56.5**	72.1	Other long-term liabilities	**(1.0)**	(0.3)
Total derivatives designated as hedging instruments		**$ 62.3**	$ 80.1		**$ (3.6)**	$ (4.9)
Derivatives not designated as hedging instruments						
Foreign currency	Prepaid expenses and other current assets	**$ 16.0**	$ 6.0	Accrued payroll and other liabilities	**$ (12.2)**	$ (3.8)
Equity	Prepaid expenses and other current assets	**127.3**	104.4			
Foreign currency	Miscellaneous other assets	**2.7**	2.7			
Total derivatives not designated as hedging instruments		**$ 146.0**	$ 113.1		**$ (12.2)**	$ (3.8)
Total derivatives [1]		**$ 208.3**	$ 193.2		**$ (15.8)**	$ (8.7)

(1) The fair value of derivatives is presented on a gross basis. Accordingly, the 2010 total asset and liability fair values do not agree with the values provided in the Fair Value Measurements note because that disclosure reflects netting adjustments related to specific counterparties of $0.3 million.

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The following table presents the pretax amounts affecting income and OCI for the six months ended June 30, 2011 and 2010, respectively:

In millions

Derivatives in Fair Value Hedging Relationships	(Gain) Loss Recognized in Income on Derivative **2011**	2010	Hedged Items in Fair Value Hedging Relationships	(Gain) Loss Recognized in Income on Related Hedged Items **2011**	2010
Interest rate	**$ 13.8**	$ (15.1)	Fixed-rate debt	**$ (13.8)**	$ 15.1

Derivatives in Cash flow Hedging Relationships	(Gain) Loss Recognized in Accumulated OCI on Derivative (Effective Portion) **2011**	2010	(Gain) Loss Reclassified from Accumulated OCI into Income (Effective Portion) **2011**	2010	(Gain) Loss Recognized in Income on Derivative (Amount Excluded from Effectiveness Testing and Ineffective Portion) **2011**	2010
Foreign currency	**$ 5.4**	$ (40.7)	**$ 0.2**	$ (6.4)	**$ 6.8**	$ 15.4
Interest rate[1]			**(1.1)**	(0.3)		0.4
Total	**$ 5.4**	$ (40.7)	**$ (0.9)**	$ (6.7)	**$ 6.8**	$ 15.8

Net Investment Hedging Relationships	(Gain) Loss Recognized in Accumulated OCI on Derivative (Effective portion) **2011**	2010	(Gain) Loss Reclassified from Accumulated OCI into Income (Effective Portion) **2011**	2010	Derivatives Not Designated as Hedging Instruments	(Gain) Loss Recognized in Income on Derivative **2011**	2010
Foreign currency denominated debt	**$ 266.5**	$ (225.7)			Foreign currency	**$ (0.1)**	$ (14.3)
Foreign currency derivatives[2]	**9.4**	4.3	**$ 8.2**		Equity[3]	**(11.6)**	(5.5)
Total	**$ 275.9**	$ (221.4)	**$ 8.2**	$ -	Total	**$ (11.7)**	$ (19.8)

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

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

(2) The amount of (gain) loss 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 Hedging Strategy

The Company enters into fair value hedges to reduce the exposure to changes in the fair value of certain liabilities. The fair value hedges the Company enters into consist of interest rate exchange agreements which convert a portion of its fixed-rate debt into floating-rate debt. All of the Company s interest rate exchange agreements meet the shortcut method requirements. Accordingly, changes in the fair value of the interest rate exchange agreements are exactly offset by changes in the fair value of the underlying debt. No ineffectiveness has been recorded to net income related to interest rate exchange agreements designated as fair value hedges for the six month period ended June 30, 2011. A total of $2.1 billion of the Company s outstanding fixed-rate debt was effectively converted to floating-rate debt resulting from the use of interest rate exchange agreements.

Cash Flow Hedging Strategy

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

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

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

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

The hedges cover the next 18 months for certain exposures and are denominated in various currencies. As of June 30, 2011, the Company had derivatives outstanding with an equivalent notional amount of $305.4 million that were used to hedge a portion of forecasted foreign currency denominated royalties.

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

The Company recorded after tax adjustments related to cash flow hedges to the deferred hedging adjustment component of accumulated OCI in shareholders equity. The Company recorded a net decrease of $4.0 million for the six months ended June 30, 2011 and a net increase of $21.8 million for the six months ended June 30, 2010. Based on interest rates and foreign currency exchange rates at June 30, 2011, no significant amount of the $11.0 million in cumulative deferred hedging gains, after tax, at June 30, 2011, will be recognized in earnings over the next 12 months as the underlying hedged transactions are realized.

Hedge of Net Investment in Foreign Operations Strategy

The Company primarily uses foreign currency denominated debt (third party and intercompany) to hedge its investments in certain foreign subsidiaries and affiliates. Realized and unrealized translation adjustments from these hedges are included in shareholders equity in the foreign currency translation component of OCI and offset translation adjustments on the underlying net assets of foreign subsidiaries and affiliates, which also are recorded in OCI. As of June 30, 2011, a total of $5.1 billion of the Company s outstanding foreign currency denominated debt was designated to hedge investments in certain foreign subsidiaries and affiliates.

Credit Risk

The Company is exposed to credit-related losses in the event of non-performance by the counterparties to its hedging instruments. The counterparties to these agreements consist of a diverse group of financial institutions. The Company continually monitors its positions and the credit ratings of its counterparties and adjusts positions as appropriate. The Company did not have significant exposure to any individual counterparty at June 30, 2011 and has master agreements that contain netting arrangements. Some of these agreements also require each party to post collateral if credit ratings fall below, or aggregate exposures exceed, certain contractual limits. At June 30, 2011, 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.

Impairment and Other Charges (Credits), Net

The Company recorded after tax impairment charges of $35.3 million for the six months ended June 30, 2010 related to its share of strategic restaurant closing costs in Japan. These charges primarily consisted of asset writeoffs and lease termination costs.

Recently Issued Accounting Standards

In May 2011, the Financial Accounting Standards Board (FASB) issued an update to Topic 820 - Fair Value Measurements and Disclosures of the Accounting Standards Codification. This update provides guidance on how fair value accounting should be applied where its use is already required or permitted by other standards and does not extend the use of fair value accounting. The Company will adopt this guidance effective January 1, 2012 as required and does not expect the adoption to have a significant impact to its consolidated financial statements.

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In June 2011, the FASB issued an update to Topic 220 - Comprehensive Income of the Accounting Standards Codification. 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 but consecutive statements and no longer permits the presentation of comprehensive income in the Consolidated statement of shareholders equity. The Company will adopt this new guidance effective January 1, 2012, as required.

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.

	Quarters Ended June 30,		**Six Months Ended June 30,**	
In millions	**2011**	2010	**2011**	2010
Revenues				
U.S.	**$ 2,168.7**	$ 2,076.9	**$ 4,094.5**	$ 3,953.6
Europe	**2,822.5**	2,326.1	**5,262.5**	4,571.5
APMEA	**1,509.7**	1,211.2	**2,910.2**	2,402.5
Other Countries & Corporate	**404.5**	331.3	**749.8**	628.0
Total	**$ 6,905.4**	$ 5,945.5	**$ 13,017.0**	$ 11,555.6
Operating Income				
U.S.	**$ 952.0**	$ 895.1	**$ 1,745.0**	$ 1,704.5
Europe	**833.4**	673.6	**1,508.7**	1,274.6
APMEA	**365.6**	273.5	**713.6**	545.6
Other Countries & Corporate	**38.1**	3.1	**47.7**	(5.3)
Total	**$ 2,189.1**	$ 1,845.3	**$ 4,015.0**	$ 3,519.4

Debt Financing

Short-term borrowings consist of commercial paper and outstanding balances on line of credit agreements at certain subsidiaries outside the U.S., denominated in various currencies at local market rates of interest. At December 31, 2010, Short-term borrowings and Current maturities of long-term debt included a reclassification to Long-term debt of $1.2 billion as they were supported by a line of credit agreement expiring in March 2012, more than 12 months from the balance sheet date. As of June 30, 2011, this reclassification can no longer be made since the line of credit expires within 12 months of the balance sheet date. This line of credit remained unused at June 30, 2011 and December 31, 2010.

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 32,943 restaurants in 117 countries at June 30, 2011, 26,598 were licensed to franchisees (including 19,279 franchised to conventional franchisees, 3,748 licensed to developmental licensees and 3,571 licensed to foreign affiliates (affiliates) primarily Japan) and 6,345 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. The U.S., Europe and APMEA segments account for 31%, 40% and 22% of total revenues, respectively.

Strategic Direction and Financial Performance

The strength of the alignment among 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 deliver consistent, 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 yet allows for local adaptation. Through the focus on 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 seven 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 successfully resonated with consumers, driving increases in comparable sales and customer visits in most countries despite a challenging global economy and a relatively flat Informal Eating Out (IEO) market. As a result, every area of the world contributed to global comparable sales, which increased 5.6% for the quarter and 4.9% for the six months 2011.

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Growth in comparable sales is driven by the System s ability to optimize guest count growth, product mix shifts and menu price changes. Pricing actions reflect local market conditions, with a view to preserving margins, while continuing to drive guest counts and market share gains. The goal is to achieve comparable sales growth with a balanced contribution from guest counts and average check, which is affected by changes in pricing and product mix. In the current economic environment, our menu pricing strategy is focused on increasing prices in a manner that seeks to maintain guest count momentum while mitigating some of the impact of the inflationary cost increases affecting our Company-operated restaurants.

U.S. comparable sales increased 4.5% for the quarter and 3.7% for the six months driven by the McCafé line-up, featuring the new Frozen Strawberry Lemonade, classic core offerings, including Chicken McNuggets and the Big Mac, and breakfast, supported by the new Fruit & Maple Oatmeal. Ongoing U.S. priorities include building key categories from chicken and beef to beverages and breakfast, a focus on operational excellence and modernizing our restaurants with interior and exterior reimaging, as well as expanded hours and everyday value.

Europe s focus on premium menu offerings and unique food events, as well as the segment s ongoing restaurant modernization efforts, contributed to comparable sales growth of 5.9% for the quarter and 5.8% for the six months. Europe s strategic priorities include increasing local relevance by complementing our tiered menu with a variety of limited-time food events as well as new snack and dessert options, upgrading the customer and employee experience through service initiatives and ongoing restaurant reimaging and building brand transparency. While we have not seen any significant changes in consumer behavior as a result of government-initiated austerity measures, we continue to closely monitor consumer reactions and remain confident that our business model will continue to drive profitable growth.

APMEA s continued commitment to branded affordability, convenience initiatives, such as drive-thru, delivery and extended hours, and innovative marketing tie-ins contributed to comparable sales growth of 5.2% for the quarter and 4.2% for the six months. In addition, breakfast contributed to the results through a combination of compelling value and a focus on strong menu offerings. APMEA will continue to execute initiatives that best support our goal to be customers first choice for eating out by focusing on menu variety, value, restaurant experience and convenience.

Operating Highlights Included:

- Global comparable sales increased 5.6% for the quarter and 4.9% for the six months.

- Consolidated operating income increased 19% (11% in constant currencies) for the quarter and 14% (9% in constant currencies) for the six months.

- Diluted earnings per share were $1.35 for the quarter and $2.49 for the six months, up 19% (11% in constant currencies) and 17% (11% in constant currencies), respectively. Foreign currency translation positively impacted diluted earnings per share $0.10 for the quarter and $0.12 for the six months.

- For the six months ended June 30, 2011, the Company repurchased 27.6 million shares for $2.1 billion and paid total dividends of $1.22 per share or $1.3 billion.

Outlook

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

- Changes in Systemwide sales are driven by comparable sales and net restaurant unit expansion. The Company expects net restaurant additions to add approximately 1.5 percentage points to 2011 Systemwide sales growth (in constant currencies), most of which will be due to the 541 net traditional restaurants added in 2010.

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

With about 75% of McDonald s grocery bill comprised of 10 different commodities, a basket of goods approach is the most comprehensive way to look at the Company s commodity costs. For the full year 2011, the total basket of goods cost is expected to increase 4-4.5% in the U.S. and Europe.

The Company expects full-year 2011 selling, general & administrative expenses to decrease about 2% in constant currencies. In addition, fluctuations will be experienced between quarters due in part to certain items in 2010, such as the Vancouver Winter Olympics in February, the biennial Worldwide Owner/Operator Convention in April and higher incentive compensation primarily recorded in the second half of 2010 based on performance.

Based on current interest and foreign currency exchange rates, the Company expects interest expense for the full year 2011 to increase approximately 8-10% compared with 2010.

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A significant part of the Company s operating income is generated outside the U.S., and about 45% 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 20 cents.

The Company expects the effective income tax rate for the full-year 2011 to be 31% to 32%. 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 2011 to be approximately $2.5 billion. About half of this amount will be used to open new restaurants. The Company expects to open about 1,100 restaurants including approximately 400 restaurants in foreign affiliated and developmental licensed markets, such as Japan and Latin America, where the Company does not fund any capital expenditures. The Company expects net additions of about 750 restaurants. The remaining capital will be used for reinvestment in existing restaurants. Over half of this reinvestment will be used to reimage approximately 2,200 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 reimaging 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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CONSOLIDATED OPERATING RESULTS

	Quarter Ended		Six Months Ended	
Dollars in millions, except per share data	**June 30, 2011**		**June 30, 2011**	
	Amount	**% Increase/ (Decrease)**	**Amount**	**% Increase/ (Decrease)**
Revenues				
Sales by Company-operated restaurants	$ 4,697.4	17	$ 8,850.1	13
Revenues from franchised restaurants	2,208.0	14	4,166.9	11
Total revenues	6,905.4	16	13,017.0	13
Operating costs and expenses				
Company-operated restaurant expenses	3,806.8	18	7,223.5	14
Franchised restaurants occupancy expenses	373.0	12	727.3	8
Selling, general & administrative expenses	588.0	4	1,151.6	4
Impairment and other charges (credits), net	2.4	(65)	2.4	(94)
Other operating (income) expense, net	(53.9)	n/m	(102.8)	8
Total operating costs and expenses	4,716.3	15	9,002.0	12
Operating income	2,189.1	19	4,015.0	14
Interest expense	121.8	13	241.9	10
Nonoperating (income) expense, net	0.9	(51)	7.8	(3)
Income before provision for income taxes	2,066.4	19	3,765.3	14
Provision for income taxes				