

MCDONALDS CORP

Form 10-Q

August 08, 2017

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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 June 30, 2017

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number 1-5231

McDONALD'S CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

Delaware

(State or Other Jurisdiction of Incorporation or Organization)

36-2361282

(I.R.S. Employer Identification No.)

One McDonald's Plaza

Oak Brook, Illinois

(Address of Principal Executive Offices) (Zip Code)

60523

(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, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

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

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

809,996,613

(Number of shares of common stock outstanding as of June 30, 2017)

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McDONALD'S CORPORATION

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

In millions, except per share data	(unaudited)	
	June 30,	December 31,
	2017	2016
Assets		
Current assets		
Cash and equivalents	\$ 2,392.4	\$ 1,223.4
Accounts and notes receivable	1,457.3	1,474.1
Inventories, at cost, not in excess of market	56.7	58.9
Prepaid expenses and other current assets	597.5	565.2
Assets of businesses held for sale	1,388.6	1,527.0
Total current assets	5,892.5	4,848.6
Other assets		
Investments in and advances to affiliates	779.7	725.9
Goodwill	2,345.2	2,336.5
Miscellaneous	2,078.5	1,855.3
Total other assets	5,203.4	4,917.7
Property and equipment		
Property and equipment, at cost	35,397.9	34,443.4
Accumulated depreciation and amortization	(13,708.6)	(13,185.8)
Net property and equipment	21,689.3	21,257.6
Total assets	\$ 32,785.2	\$ 31,023.9
Liabilities and shareholders' equity		
Current liabilities		
Accounts payable	\$ 536.0	\$ 756.0
Income taxes	212.9	267.2
Other taxes	284.9	266.3
Accrued interest	223.6	247.5
Accrued payroll and other liabilities	948.0	1,159.3
Current maturities of long-term debt	209.9	77.2
Liabilities of businesses held for sale	328.0	694.8
Total current liabilities	2,743.3	3,468.3
Long-term debt	28,150.9	25,878.5
Other long-term liabilities	2,229.9	2,064.3
Deferred income taxes	1,661.7	1,817.1
Shareholders' equity (deficit)		
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	6,916.7	6,757.9
Retained earnings	47,300.6	46,222.7
Accumulated other comprehensive income (loss)	(2,486.4)	(3,092.9)
Common stock in treasury, at cost; 850.6 and 841.3 million shares	(53,748.1)	(52,108.6)
Total shareholders' equity (deficit)	(2,000.6)	(2,204.3)
Total liabilities and shareholders' equity (deficit)	\$ 32,785.2	\$ 31,023.9

See Notes to condensed consolidated financial statements.

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

In millions, except per share data	Quarters Ended		Six Months Ended	
	June 30, 2017	2016	June 30, 2017	2016
Revenues				
Sales by Company-operated restaurants	\$3,569.6	\$3,916.6	\$6,981.5	\$7,670.1
Revenues from franchised restaurants	2,480.1	2,348.4	4,744.1	4,498.8
Total revenues	6,049.7	6,265.0	11,725.6	12,168.9
Operating costs and expenses				
Company-operated restaurant expenses	2,903.3	3,248.1	5,719.7	6,423.4
Franchised restaurants-occupancy expenses	438.0	430.9	868.1	846.0
Selling, general & administrative expenses	525.4	596.1	1,046.7	1,174.1
Other operating (income) expense, net	(112.1)	132.0	(238.0)	87.2
Total operating costs and expenses	3,754.6	4,407.1	7,396.5	8,530.7
Operating income	2,295.1	1,857.9	4,329.1	3,638.2
Interest expense	230.9	223.9	449.5	442.2
Nonoperating (income) expense, net	2.8	(16.2)	10.7	(30.6)
Income before provision for income taxes	2,061.4	1,650.2	3,868.9	3,226.6
Provision for income taxes	666.3	557.3	1,259.0	1,008.9
Net income	\$1,395.1	\$1,092.9	\$2,609.9	\$2,217.7
Earnings per common share-basic	\$1.72	\$1.27	\$3.20	\$2.53
Earnings per common share-diluted	\$1.70	\$1.25	\$3.17	\$2.51
Dividends declared per common share	\$0.94	\$0.89	\$1.88	\$1.78
Weighted-average shares outstanding-basic	811.6	864.0	815.2	876.4
Weighted-average shares outstanding-diluted	819.2	871.2	822.3	883.8

See Notes to condensed consolidated financial statements.

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

In millions	Quarters Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Net income	\$1,395.1	\$1,092.9	\$2,609.9	\$2,217.7
Other comprehensive income (loss), net of tax				
Foreign currency translation adjustments:				
Gain (loss) recognized in accumulated other comprehensive income (AOCI), including net investment hedges	245.7	(275.5)	533.3	204.3
Reclassification of (gain) loss to net income	(4.6)	) —	104.4	18.3
Foreign currency translation adjustments-net of tax benefit (expense) of \$227.6, \$(168.2), \$272.1, and \$(97.3)	241.1	(275.5)	637.7	222.6
Cash flow hedges:				
Gain (loss) recognized in AOCI	(23.2)	) 2.9	(30.3)	) (7.1)
Reclassification of (gain) loss to net income	(2.0)	) (1.2)	(5.9)	) (12.0)
Cash flow hedges-net of tax benefit (expense) of \$14.3, \$(1.1), \$20.5, and \$10.7	(25.2)	) 1.7	(36.2)	) (19.1)
Defined benefit pension plans:				
Gain (loss) recognized in AOCI	—	0.1	(0.3)	) (0.8)
Reclassification of (gain) loss to net income	2.7	1.5	5.3	2.3
Defined benefit pension plans-net of tax benefit (expense) of \$0.0, \$0.0, \$(0.5), and \$0.0	2.7	1.6	5.0	1.5
Total other comprehensive income (loss), net of tax	218.6	(272.2)	606.5	205.0
Comprehensive income (loss)	\$1,613.7	\$820.7	\$3,216.4	\$2,422.7

See Notes to condensed consolidated financial statements.

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

In millions	Quarters Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Operating activities				
Net income	\$1,395.1	\$1,092.9	\$2,609.9	\$2,217.7
Adjustments to reconcile to cash provided by operations				
Charges and credits:				
Depreciation and amortization	339.5	383.3	664.8	767.0
Deferred income taxes	64.6	(190.3)	150.5	(158.7)
Share-based compensation	21.3	27.3	44.0	67.8
Other	(76.0)	238.7	(188.7)	186.2
Changes in working capital items	(531.1)	(303.5)	(523.1)	(86.4)
Cash provided by operations	1,213.4	1,248.4	2,757.4	2,993.6
Investing activities				
Capital expenditures	(368.7)	(352.5)	(796.4)	(744.3)
Purchases of restaurant businesses	(15.0)	(11.6)	(18.1)	(37.0)
Sales of restaurant businesses	304.1	156.0	849.9	316.0
Sales of property	28.8	25.3	94.1	38.4
Other	(96.0)	(20.9)	(138.2)	(32.7)
Cash used for investing activities	(146.8)	(203.7)	(8.7)	(459.6)
Financing activities				
Net short-term borrowings	(9.3)	146.7	(778.5)	(662.9)
Long-term financing issuances	537.1	3,371.4	2,530.1	3,372.1
Long-term financing repayments	(1.4)	(600.4)	(403.5)	(813.9)
Treasury stock purchases	(1,107.7)	(3,380.7)	(1,855.7)	(7,692.4)
Common stock dividends	(761.5)	(759.3)	(1,532.1)	(1,540.1)
Proceeds from stock option exercises	174.4	82.5	290.6	213.8
Other	1.9	3.0	(4.6)	7.9
Cash used for financing activities	(1,166.5)	(1,136.8)	(1,753.7)	(7,115.5)
Effect of exchange rates on cash and cash equivalents	98.7	(90.0)	153.4	24.0
Cash and equivalents increase (decrease)	(1.2)	(182.1)	1,148.4	(4,557.5)
Change in cash balances of businesses held for sale	(18.6)	—	20.6	—
Cash and equivalents at beginning of period	2,412.2	3,310.1	1,223.4	7,685.5
Cash and equivalents at end of period	\$2,392.4	\$3,128.0	\$2,392.4	\$3,128.0

See Notes to condensed consolidated financial statements.

Table of Contents**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****Basis of Presentation**

The accompanying condensed consolidated financial statements should be read in conjunction with the consolidated financial statements contained in the Company's December 31, 2016 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, 2017 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 June 30, 2017	2017	2016
Conventional franchised	21,317	21,329
Developmental licensed	7,263	5,674
Foreign affiliated	3,356	3,364
Total Franchised	31,936	30,367
Company-operated	5,075	6,137
Systemwide restaurants	37,011	36,504

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.

On July 31, 2017, the Company completed the transaction to sell its existing businesses in China and Hong Kong, comprising over 2,700 restaurants, of which about 1,800 were Company-operated restaurants, to a developmental licensee organization. Under the terms of the agreement, the Company will retain a 20% ownership in the business, and as such, will report results for China and Hong Kong as an affiliate post-closing. For further details on the transaction, refer to the Subsequent Events footnote. As of July 31, 2017, over 90% of McDonald's restaurants worldwide are owned and operated by independent local business men and women.

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 7.6 million shares and 7.2 million shares for the quarters 2017 and 2016, respectively, and 7.1 million shares and 7.4 million shares for the six months 2017 and 2016, respectively. Stock options that would have been antidilutive, and therefore were not included in the calculation of diluted weighted-average shares, totaled 0.1 million shares and 4.2 million shares for the quarters 2017 and 2016, respectively, and 4.0 million shares and 3.4 million shares for the six months 2017 and 2016, respectively.

Fair Value Measurements

The Company measures certain financial assets and liabilities at fair value. Fair value disclosures are reflected in a three-level hierarchy, maximizing the use of observable inputs and minimizing the use of unobservable inputs. The Company did not have any significant changes to the valuation techniques used to measure fair value as described in the Company's December 31, 2016 Annual Report on Form 10-K.

At June 30, 2017, the fair value of the Company's debt obligations was estimated at \$30.3 billion, compared to a carrying amount of \$28.4 billion. The fair value was based upon quoted market prices, Level 2 within the valuation hierarchy. The carrying amounts of cash and equivalents, short-term investments and notes receivable approximate fair value.

Table of Contents**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 hold or issue derivatives for trading purposes.

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

In millions	Derivative Assets		Derivative Liabilities	
	June 30, December 31,		June 30, December 31,	
	2017	2016	2017	2016
Total derivatives designated as hedging instruments	\$2.8	\$ 36.9	\$(31.0)	\$ (3.7)
Total derivatives not designated as hedging instruments	159.5	144.4	(9.2)	(1.9)
Total derivatives	\$162.3	\$ 181.3	\$(40.2)	\$ (5.6)

The following table presents the pretax amounts from derivative instruments affecting income and other comprehensive income ("OCI") for the six months ended June 30, 2017 and 2016, respectively:

In millions	Gain (Loss) Recognized in Accumulated OCI		Gain (Loss) Reclassified into Income from Accumulated OCI		Gain (Loss) Recognized in Income on Derivative	
	2017	2016	2017	2016	2017	2016
	Cash Flow Hedges	\$(47.5)	\$(11.5)	\$9.2	\$18.3	
Net Investment Hedges	\$(1,001.1)	\$19.8	\$8.0	\$(18.3)		
Undesignated derivatives					\$32.4	\$3.1

•Fair Value Hedges

The Company enters into fair value hedges that convert a portion of its fixed-rate debt into floating-rate debt by use of interest rate swaps. At June 30, 2017, \$2.1 billion of the Company's outstanding fixed-rate debt was effectively converted. For the six months ended June 30, 2017, the Company recognized a \$0.5 million loss on fair value interest rate swaps, which was exactly offset by a corresponding gain in the fair value of the hedged debt instruments.

•Cash Flow Hedges

The Company enters into cash flow hedges to reduce the exposure to variability in certain expected future cash flows. 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 to hedge a portion of anticipated exposures. The hedges cover the next 18 months for certain exposures and are denominated in various currencies. As of June 30, 2017, the Company had derivatives outstanding with an equivalent notional amount of \$799.8 million that hedged a portion of forecasted foreign currency denominated royalties.

Based on market conditions at June 30, 2017, the \$13.3 million in cumulative cash flow hedging losses, after tax, is not expected to have a significant effect on earnings over the next 12 months.

•Net Investment Hedges

The Company primarily uses foreign currency denominated debt (third party and intercompany) and foreign currency forwards 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, 2017, \$9.7 billion of the Company's third party foreign currency denominated debt, \$3.6 billion of intercompany foreign currency denominated debt and \$97.1 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 its derivative counterparties. The Company did not have significant exposure to any individual counterparty at June 30, 2017 and has master agreements that contain netting arrangements. For financial reporting purposes, the Company presents gross derivative balances in the financial statements and supplementary data, including for counterparties subject to 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, 2017, the Company was required to post an immaterial amount of collateral due to the negative fair value of certain derivative positions. The Company's counterparties were not required to post collateral on any derivative position, other than on hedges of certain of the Company's supplemental benefit plan liabilities where the counterparties were required to post collateral on their liability positions.

Table of Contents**Businesses Held for Sale**

As of June 30, 2017, assets and liabilities of businesses held for sale on the condensed consolidated balance sheet included total assets related to the businesses in China and Hong Kong of \$1.4 billion, of which \$244 million was current, and total liabilities were \$328 million, most of which was current. In December 2016, the Company's Board of Directors approved an agreement for the Company to sell its existing businesses in China and Hong Kong. Based on this approval, the Company concluded that the China and Hong Kong markets were "Held for Sale" as of December 31, 2016 in accordance with the requirements of ASC 360 "Property, Plant and Equipment." Accordingly, the Company ceased recording depreciation expense with respect to the assets of both markets effective January 1, 2017. On July 31, 2017, the Company completed this transaction. For further details, refer to the Subsequent Events footnote. During the second quarter 2017, the Company completed the transaction to sell its existing businesses in Taiwan to a developmental licensee organization. Cash proceeds upon the completion of the sale were approximately \$150 million. No significant gains or losses were recognized at the close of the transaction.

Segment Information

The Company franchises and operates McDonald's restaurants in the global restaurant industry. The following reporting segments reflect how management reviews and evaluates operating performance.

• U.S. - the Company's largest segment.

• International Lead Markets - established markets including Australia, Canada, France, Germany, the U.K. and related markets.

• High Growth Markets - markets the Company believes have relatively higher restaurant expansion and franchising potential including China, Italy, Korea, Poland, Russia, Spain, Switzerland, the Netherlands and related markets.

• Foundational Markets & Corporate - the remaining markets in the McDonald's system, each of which the Company believes has the potential to operate under a largely franchised model. Corporate activities are also reported within this segment.

The following table presents the Company's revenues and operating income by segment.

In millions	Quarters Ended		Six Months Ended	
	June 30, 2017	2016	June 30, 2017	2016
Revenues				
U.S.	\$2,048.4	\$2,122.8	\$3,977.4	\$4,142.7
International Lead Markets	1,813.2	1,842.8	3,456.7	3,571.3
High Growth Markets	1,679.2	1,550.6	3,216.4	2,992.8
Foundational Markets & Corporate	508.9	748.8	1,075.1	1,462.1
Total revenues	\$6,049.7	\$6,265.0	\$11,725.6	\$12,168.9
Operating Income				
U.S.	\$1,072.9	\$1,018.9	\$2,020.8	\$1,859.1
International Lead Markets	776.0	718.9	1,442.6	1,373.1
High Growth Markets	349.5	273.7	650.2	494.6
Foundational Markets & Corporate	96.7	(153.6)	215.5	(88.6)
Total operating income	\$2,295.1	\$1,857.9	\$4,329.1	\$3,638.2

Recently Issued Accounting Standards*Intangibles*

In January 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2017-04, "Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment," which removes the requirement to compare the implied fair value of goodwill with its carrying amount as part of step 2 of the goodwill impairment test. As a result, an impairment charge will be recorded based on the excess of a reporting unit's carrying amount over its fair value. ASU 2017-04 is effective for fiscal years beginning after December 15,

2019, with early adoption permitted for annual and interim goodwill impairment testing dates after January 1, 2017. The Company is currently evaluating the impact of ASU 2017-04.

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Income Taxes

In October 2016, the FASB issued ASU 2016-16, "Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory." The goal of this update is to improve the accounting for the income tax consequences of intra-entity transfers of assets other than inventory. ASU 2016-16 is effective for fiscal years beginning after December 15, 2017, including interim periods within those annual reporting periods. The Company anticipates ASU 2016-16 will have a material impact on the consolidated balance sheet, primarily resulting in additional deferred tax assets, but little to no impact on the consolidated statements of income and cash flows.

Lease Accounting

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)," to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with early adoption permitted. The Company anticipates ASU 2016-02 will have a material impact on the consolidated balance sheet. The impact of ASU 2016-02 is non-cash in nature, as such, it will not affect the Company's cash flows. The Company is currently evaluating the impact of ASU 2016-02 on the consolidated statement of income.

Revenue Recognition

In May 2014, the FASB issued guidance codified in Accounting Standards Codification ("ASC") 606, "Revenue Recognition - Revenue from Contracts with Customers," which amends the guidance in former ASC 605, "Revenue Recognition." The core principal of the standard is to recognize revenue when promised goods or services are transferred to customers in an amount that reflects the consideration expected to be received for those goods or services. The standard also calls for additional disclosures around the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The standard will be effective for the Company beginning January 1, 2018, with early adoption permitted.

The standard may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of adoption ("modified retrospective method"). The Company currently expects to apply the modified retrospective method upon adoption.

The Company does not believe the standard will impact its recognition of revenue from company-operated restaurants or its recognition of royalties from restaurants operated by franchisees or licensed to affiliates and developmental licensees, which are based on a percent of sales. Based on recent implementation developments in the area of initial franchise fees, the Company is continuing to evaluate its accounting for initial fees under ASC 606. The Company anticipates that ASC 606 will have no material impact to the Company's consolidated statement of income and consolidated balance sheet, and no impact to the consolidated statement of cash flows.

Subsequent Events

The Company evaluated subsequent events through the date the financial statements were issued and filed with the Securities and Exchange Commission.

On July 31, 2017, the Company completed the sale of its existing businesses in China and Hong Kong, comprising over 2,700 restaurants, to a developmental licensee organization. Under the terms of the agreement, the Company will retain a 20% ownership in the business, and as such, will report results for China and Hong Kong as an affiliate post-closing. The Company expects to record a pre-tax gain of about \$1.0 billion (subject to final working capital adjustments) reflecting the difference between \$1.6 billion of cash proceeds and the net book value of the businesses. The estimated gain also includes an increase to fair value of the retained equity investment.

There were no other 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 37,011 restaurants in 120 countries at June 30, 2017, 31,936 were licensed to franchisees (comprised of 21,317 franchised to conventional franchisees, 7,263 licensed to developmental licensees and 3,356 licensed to foreign affiliates ("affiliates") – primarily in Japan) and 5,075 were operated by the Company.

Under McDonald's conventional franchise arrangement, franchisees provide a portion of the capital required by initially investing in the equipment, signs, seating and décor of their restaurant business, and by reinvesting in the business over time. The Company generally 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 enabling restaurant performance levels that are among the highest in the industry. In certain circumstances, the Company participates in the reinvestment for conventional franchised restaurants in an effort to accelerate implementation of certain initiatives.

Under McDonald's developmental license arrangement, licensees provide capital for the entire business, including the real estate interest, and the Company generally 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 or franchise restaurants within a market.

McDonald's is primarily a franchisor and believes franchising is paramount to delivering great-tasting food, locally-relevant customer experiences and driving profitability. Franchising enables an individual to be his or her own employer and maintain control over all employment-related matters, marketing and pricing decisions, while also benefiting from the financial strength and global experience of McDonald's. However, directly operating restaurants is important to being a credible franchisor and provides Company personnel with restaurant operations experience. In Company-operated restaurants, and in collaboration with franchisees, McDonald's further develops and refines operating standards, marketing concepts and product and pricing strategies, so that only those that the Company believes are most beneficial are introduced in the restaurants. McDonald's continually reviews its mix of Company-operated and franchised restaurants to help optimize overall performance, with a goal to be approximately 95% franchised over the long term.

The strength of the alignment among the Company, its franchisees and suppliers (collectively referred to as the "System") is key to McDonald's long-term success. By leveraging the System, McDonald's is able to identify, implement and scale ideas that meet customers' changing needs and preferences. McDonald's continually builds on its competitive advantages of System alignment and geographic diversification to deliver consistent, yet locally-relevant restaurant experiences to customers as an integral part of their communities.

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 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 structured into segments that combine markets with similar characteristics and opportunities for growth, and reflect how management reviews and evaluates operating performance. Significant reportable segments include the United States ("U.S."), International Lead Markets and High Growth Markets. In addition, throughout this report we present the Foundational Markets & Corporate segment which includes markets in over 80 countries, as well as Corporate activities. For the six months ended June 30, 2017, the U.S., the International Lead Markets and the High Growth Markets accounted for 34%, 29% and 27% of total revenues, respectively.

Strategic Direction

The Company is focused on delivering long-term growth through execution of its customer-centric growth strategy - the Velocity Growth Plan. This plan outlines actions to drive sustainable guest count growth, a reliable long-term measure of the Company's strength that is vital to growing sales and shareholder value.

The actions include efforts to retain existing customers, regain lapsed customers and convert casual customers to committed customers by serving quality food and providing good value, while offering convenience on the customers' terms. The Company is building upon its food and value foundation with the following accelerators, which provide more ways for customers to experience McDonald's:

•**Experience of the Future ("EOTF")**. Focuses on restaurant modernization and technology, in order to transform the restaurant service experience and drive incremental customer visits and higher average check. The Company's priority with this initiative is to have EOTF deployed in about 2,500 restaurants in the U.S. by the end of 2017, with the goal to complete the modernization by 2020.

•**Digital**. Places renewed emphasis on improving the Company's existing service model (i.e., eat in, take out, or drive-thru) and strengthens its relationships with customers by evolving its technology platforms to simplify how customers order, pay and are served through additional functionality on its global mobile app and self-order kiosks, as well as table service and curbside pick-up. Mobile order and pay will be launched in 20,000 restaurants in some of our largest markets, including 14,000 restaurants in the U.S., by the end of 2017.

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•**Delivery.** Offers a platform with added convenience, bringing McDonald's food to customers on their terms. The Company is encouraged by the initial results and is strategically scaling this initiative worldwide while applying learnings from the Company's best performing markets. The Company is leveraging its global brand and extensive restaurant footprint to optimize this growth opportunity.

These initiatives are resonating with customers, and the Company expects the growth associated with these efforts to build over time as awareness increases and customer behavior changes.

Financial Performance

Financial performance in the second quarter reflected broad-based strength and momentum across the entire business, including the Company's strongest global comparable sales and guest counts in more than five years. Global comparable sales increased 6.6% for the quarter and 5.4% for the six months. The Company continues to enhance the strength and stability of its business by evolving to a more heavily franchised structure. The refranchising strategy has been a key part of transforming McDonald's into a more purposeful, more stable and more efficient organization focused on continuing to grow top-line sales.

U.S. comparable sales increased 3.9% for the quarter and 2.8% for the six months, reflecting the national cold beverage value promotion and the launch of the Signature Crafted premium sandwich platform. The U.S. continues to build momentum as it executes strategies to enhance convenience, strengthen value and innovate around the menu to bring more customers to McDonald's more often.

Comparable sales for the International Lead segment increased 6.3% for the quarter and 4.6% for the six months, led by continued momentum in the U.K., strong performance in Canada and Germany and positive results across all other markets.

In the High Growth segment, comparable sales increased 7.0% for the quarter and 5.5% for the six months, led by strong performance in China and positive results across the entire segment.

Results for the quarter and six months reflected stronger operating performance and G&A savings across all segments and improved performance in Japan. Both periods also benefited from lower depreciation expense, primarily in China and Hong Kong, that in accordance with Held for Sale accounting rules, ceased recording depreciation. Additionally, the six months benefited from a gain on the strategic sale of a restaurant property in the U.S.

Results for both periods also benefited from comparison to the prior year's strategic charges of approximately \$230 million, consisting primarily of non-cash impairment charges related to the Company's ongoing refranchising initiatives, as well as the decision to relocate the Company's headquarters.

Second Quarter and Six Months 2017 Highlights:

• Global comparable sales increased 6.6% for the quarter and 5.4% for the six months, reflecting positive guest counts in all segments

• Consolidated revenues decreased 3% (2% in constant currencies) for the quarter and 4% (3% in constant currencies) for the six months, due to the impact of the Company's strategic refranchising initiative

• Systemwide sales increased 8% in constant currencies for the quarter and 6% in constant currencies for the six months, due to strong comparable sales performance and restaurant expansion

• Consolidated operating income increased 24% (26% in constant currencies) for the quarter and 19% (21% in constant currencies) for the six months, both of which included a benefit from the prior year's strategic charges of approximately \$230 million

• Diluted earnings per share of \$1.70 increased 36% (38% in constant currencies) for the quarter and \$3.17 for the six months increased 26% (29% in constant currencies). Excluding the impact of the current quarter and prior year strategic charges of \$0.03 and \$0.20 per share, respectively, diluted earnings per share increased 19% (21% in constant currencies) for the quarter and 19% (20% in constant currencies) for the six months

• Returned \$1.8 billion to shareholders through share repurchases and dividends for the quarter

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 percentage point to 2017 Systemwide sales growth (in constant

currencies).

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 change in comparable sales for either the U.S. or the International Lead segment would change annual diluted earnings per share by about 4 to 5 cents.

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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 2017, costs for the total basket of goods are expected to increase about 0.5-1.5% in the U.S. and increase about 2.0% in the International Lead segment.

The Company expects full-year 2017 selling, general and administrative expenses to decrease about 7-8% in constant currencies with fluctuations expected between the quarters.

Based on current interest and foreign currency exchange rates, the Company expects interest expense for the full-year 2017 to increase about 5% compared with 2016 due to higher average debt balances.

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 70% 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 25 cents.

The Company expects the effective income tax rate for the full-year 2017 to be in the 31-33% range. Some volatility may result in a quarterly tax rate outside of the annual range.

The Company expects capital expenditures for 2017 to be approximately \$1.7 billion, about one-third of which will be used to open new restaurants. The Company expects to open about 900 restaurants, including about 500 restaurants in affiliated and developmental licensee markets where the Company generally does not fund any capital expenditures.

The Company expects net additions of about 400 restaurants. The remaining two-thirds of capital will be used to reinvest in existing locations, including about 650 reimages in the U.S. When combined with previously modernized restaurants that will be updated with EOTF elements in 2017, we expect to have about 2,500 EOTF restaurants in the U.S. by the end of 2017.

On July 31, 2017, the Company completed the sale of its existing businesses in China and Hong Kong to a developmental licensee organization. This marks the achievement of the Company's target to rebrand about 4,000 restaurants by the end of 2017, with the other major transactions being Singapore and Malaysia (fourth quarter 2016), Sweden, Denmark, Norway and Finland (first quarter 2017) and Taiwan (second quarter 2017). The Company plans to use transaction proceeds to repurchase shares, the result of which will limit the long-term impact of these transactions on earnings per share. However, we expect a negative impact of a few cents per quarter on earnings per share through third quarter 2018, due to the nature of the weighted average shares outstanding calculation.

In addition, the Company has other long-term targets that are detailed in its Form 10-K for the year ended December 31, 2016.

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. Typically, pricing has a greater impact on average check than 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.

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Dollars in millions, except per share data	Quarter Ended			Six Months Ended		
	June 30, 2017			June 30, 2017		
	Amount	Increase/ (Decrease)		Amount	Increase/ (Decrease)	
Revenues						
Sales by Company-operated restaurants	\$3,569.6	(9)%		\$6,981.5	(9)%	
Revenues from franchised restaurants	2,480.1	6		4,744.1	5	
Total revenues	6,049.7	(3)		11,725.6	(4)	
Operating costs and expenses						
Company-operated restaurant expenses	2,903.3	(11)		5,719.7	(11)	
Franchised restaurants-occupancy expenses	438.0	2		868.1	3	
Selling, general & administrative expenses	525.4	(12)		1,046.7	(11)	
Other operating (income) expense, net	(112.1)	n/m		(238.0)	n/m	
Total operating costs and expenses	3,754.6	(15)		7,396.5	(13)	
Operating income	2,295.1	24		4,329.1	19	
Interest expense	230.9	3		449.5	2	
Nonoperating (income) expense, net	2.8	n/m		10.7	n/m	
Income before provision for income taxes	2,061.4	25		3,868.9	20	
Provision for income taxes	666.3	20		1,259.0	25	
Net income	\$1,395.1	28 %		\$2,609.9	18 %	
Earnings per common share-basic	\$1.72	35 %		\$3.20	26 %	
Earnings per common share-diluted	\$1.70	36 %		\$3.17	26 %	
n/m Not meaningful						

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While changes in foreign currency exchange rates affect reported results, McDonald's mitigates exposures, where practical, by purchasing goods and services in local currencies, financing in local currencies and hedging certain foreign-denominated cash flows. Management reviews and analyzes business results excluding the effect of foreign currency translation and bases incentive compensation plans on these results, because the Company believes this better represents 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 June 30,	2017	2016	2017
Revenues	\$6,049.7	\$6,265.0	\$ (75.7)
Company-operated margins	666.3	668.5	(10.4)
Franchised margins	2,042.1	1,917.5	(34.7)
Selling, general & administrative expenses	525.4	596.1	4.9
Operating income	2,295.1	1,857.9	(42.7)
Net income	1,395.1	1,092.9	(25.5)
Earnings per share-diluted	\$1.70	\$1.25	\$ (0.03)

			Currency Translation Benefit/ (Cost)
Six Months Ended June 30,	2017	2016	2017
Revenues	\$11,725.6	\$12,168.9	\$ (118.5)
Company-operated margins	1,261.8	1,246.7	(19.2)
Franchised margins	3,876.0	3,652.8	(59.4)
Selling, general & administrative expenses	1,046.7	1,174.1	8.2
Operating income	4,329.1	3,638.2	(74.4)
Net income	2,609.9	2,217.7	(43.6)
Earnings per share-diluted	\$3.17	\$2.51	\$ (0.06)

The impact of foreign currency translation on consolidated operating results for the quarter and six months primarily reflected the weaker British Pound and Euro.

Net Income and Diluted Earnings per Common Share

For the quarter, net income increased 28% (30% in constant currencies) to \$1,395.1 million, and diluted earnings per share increased 36% (38% in constant currencies) to \$1.70. Foreign currency translation had a negative impact of \$0.03 on diluted earnings per share.

For the six months, net income increased 18% (20% in constant currencies) to \$2,609.9 million, and diluted earnings per share increased 26% (29% in constant currencies) to \$3.17. Foreign currency translation had a negative impact of \$0.06 on diluted earnings per share.

Results for the quarter and six months reflected stronger operating performance and G&A savings across all segments and improved performance in Japan. Both periods also benefited from lower depreciation expense, primarily in China and Hong Kong, that in accordance with Held for Sale accounting rules, ceased recording depreciation. Additionally, the six months benefited from a gain on the strategic sale of a restaurant property in the U.S.

Results for both periods also benefited from comparison to the prior year's strategic charges of approximately \$230 million, consisting primarily of non-cash impairment charges related to the Company's ongoing refranchising initiatives, as well as the decision to relocate the Company's headquarters. Excluding the impact of the current quarter and prior year strategic charges, diluted earnings per share increased 19% (21% in constant currencies) for the quarter, and 19% (20% in constant currencies) for the six months.

Diluted earnings per share benefited from a decrease in diluted weighted-average shares outstanding due to share repurchases. During the quarter, the Company repurchased 7.3 million shares of stock for \$1,017.9 million, bringing total purchases for the six months to 13.5 million shares or \$1,813.6 million. In addition, the Company paid a quarterly dividend of \$0.94 per share, or \$761.4 million, bringing the total dividends paid for the six months to \$1,532.1 million.

Table of Contents**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 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.

The Company has accelerated the pace of refranchising to optimize its restaurant ownership mix, generate more stable and predictable revenue and cash flow streams, and operate with a less resource-intensive structure. The shift to a greater percentage of franchised restaurants negatively impacts consolidated revenues as Company-operated sales are replaced by franchised sales, where the Company receives rent and/or royalty revenue based on a percentage of sales.

REVENUES

Dollars in millions

Quarters Ended June 30,	2017	2016	Inc/ (Dec)	Inc/ (Dec)	Excluding	Currency	Translation
<i>Company-operated sales</i>							
U.S.	\$849.5	\$975.3	(13	)%	(13)%	
International Lead Markets	1,021.4	1,100.3	(7	)	(2)	
High Growth Markets	1,459.3	1,357.2	8		6		
Foundational Markets & Corporate	239.4	483.8	(51	)	(51)	
Total	\$3,569.6	\$3,916.6	(9	)%	(8)%	
<i>Franchised revenues</i>							
U.S.	\$1,198.9	\$1,147.5	4	%	4	%	
International Lead Markets	791.8	742.5	7		11		
High Growth Markets	219.9	193.4	14		16		
Foundational Markets & Corporate	269.5	265.0	2		4		
Total	\$2,480.1	\$2,348.4	6	%	7	%	
<i>Total revenues</i>							
U.S.	\$2,048.4	\$2,122.8	(4	)%	(4)%	
International Lead Markets	1,813.2	1,842.8	(2	)	3		
High Growth Markets	1,679.2	1,550.6	8		7		
Foundational Markets & Corporate	508.9	748.8	(32	)	(32)	
Total	\$6,049.7	\$6,265.0	(3	)%	(2)%	
Six Months Ended June 30,	2017	2016	Inc/ (Dec)	Inc/ (Dec)	Excluding	Currency	Translation
<i>Company-operated sales</i>							
U.S.	\$1,685.1	\$1,941.7	(13	)%	(13)%	
International Lead Markets	1,962.6	2,151.9	(9	)	(4)	
High Growth Markets	2,804.6	2,622.0	7		5		
Foundational Markets & Corporate	529.2	954.5	(45	)	(46)	
Total	\$6,981.5	\$7,670.1	(9	)%	(8)%	
<i>Franchised revenues</i>							
U.S.	\$2,292.3	\$2,201.0	4	%	4	%	
International Lead Markets	1,494.1	1,419.4	5		9		
High Growth Markets	411.8	370.8	11		13		
Foundational Markets & Corporate	545.9	507.6	8		10		

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Total	\$4,744.1	\$4,498.8	5	%	7	%
<i>Total revenues</i>						
U.S.	\$3,977.4	\$4,142.7	(4)%	(4)%
International Lead Markets	3,456.7	3,571.3	(3)	1	
High Growth Markets	3,216.4	2,992.8	7		6	
Foundational Markets & Corporate	1,075.1	1,462.1	(26)	(26)
Total	\$11,725.6	\$12,168.9	(4)%	(3)%

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• **Revenues:** Revenues decreased 3% (2% in constant currencies) for the quarter and decreased 4% (3% in constant currencies) for the six months.

• **U.S.:** Revenues decreased for both periods due to the impact of refranchising, partly offset by positive comparable sales.

• **International Lead Markets:** Revenues decreased for both periods due to negative foreign currency translation. In constant currencies, revenues increased for both periods led by continued momentum in the U.K., strong performance in Canada and positive results across all other markets, partly offset by the impact of refranchising.

• **High Growth Markets:** Revenues increased for both periods due to positive comparable sales across all markets and expansion in China.

Comparable Sales and Guest Counts

The following table presents the percent change in comparable sales for the quarters and six months ended June 30, 2017 and 2016:

COMPARABLE SALES

	Increase/ (Decrease)			
	Quarters Ended		Six Months Ended	
	June 30, 2017	2016	June 30, 2017	2016
U.S.	3.9 %	1.8 %	2.8 %	3.5 %
International Lead Markets	6.3	2.6	4.6	3.8
High Growth Markets	7.0	1.6	5.5	2.6
Foundational Markets & Corporate	13.0	7.7	11.9	9.3
Total	6.6 %	3.1 %	5.4 %	4.6 %

On a consolidated basis, comparable guest counts (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) increased 1.8% and 0.3% for the six months ended 2017 and 2016, respectively.

Systemwide Sales and Franchised Sales

The following table presents the percent change in Systemwide sales for the quarter and six months ended June 30, 2017:

SYSTEMWIDE SALES

	Quarter Ended		Six Months Ended		
	June 30, 2017		June 30, 2017		
	Inc/ (Dec)	Inc/ (Dec)	Inc/ (Dec)	Inc/ (Dec)	
		Excluding Currency Translation	Excluding Currency Translation		
U.S.	4 %	4 %	3 %	3 %	%
International Lead Markets	3	8	2	6	
High Growth Markets	11	11	10	10	
Foundational Markets & Corporate	12	15	12	14	
Total	6 %	8 %	5 %	6 %	%

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Franchised sales are not recorded as revenues by the Company, but are the basis on which the Company calculates and records franchised revenues and are indicative of the health of the franchisee base. The following table presents Franchised sales and the related increases/(decreases):

FRANCHISED SALES

Dollars in millions

Quarters Ended June 30,	2017	2016	Inc/ (Dec)	Inc/ (Dec) Excluding Currency Translation	
U.S.	\$8,726.4	\$8,255.4	6	% 6	%
International Lead Markets	4,568.5	4,321.5	6	10	
High Growth Markets	1,388.6	1,205.8	15	17	
Foundational Markets & Corporate	4,352.4	3,615.7	20	24	
Total*	\$19,035.9	\$17,398.4	9	% 11	%

Six Months Ended June 30,	2017	2016	Inc/ (Dec)	Inc/ (Dec) Excluding Currency Translation	
U.S.	\$16,705.6				