

Consolidated Statement of Income

(In millions, except per common share data)

Years ended December 31, 1997

1996

1995

Revenues			
Sales by Company-operated restaurants	\$ 8,136.5	\$ 7,570.7	\$6,863.5
Revenues from franchised and affiliated restaurants	3,272.3	3,115.8	2,931.0
Total revenues	11,408.8	10,686.5	9,794.5
Operating costs and expenses			
Company-operated restaurants			
Food and packaging	2,772.6	2,546.6	2,319.4
Payroll and other employee benefits	2,025.1	1,909.8	1,730.9
Occupancy and other operating expenses	1,851.9	1,706.8	1,497.4
	6,649.6	6,163.2	5,547.7
Franchised restaurants—occupancy expenses	613.9	570.1	514.9
Selling, general and administrative expenses	1,450.5	1,366.4	1,236.3
Other operating (income) expense—net	(113.5)	(45.8)	(105.7)
Total operating costs and expenses	8,600.5	8,053.9	7,193.2
Operating income	2,808.3	2,632.6	2,601.3
Interest expense—net of capitalized interest of \$22.7, \$22.2 and \$22.5	364.4	342.5	340.2
Nonoperating (income) expense—net	36.6	39.1	92.0
Income before provision for income taxes	2,407.3	2,251.0	2,169.1
Provision for income taxes	764.8	678.4	741.8
Net income	\$ 1,642.5	\$ 1,572.6	\$1,427.3
Net income per common share	\$ 2.35	\$ 2.21	\$ 1.97
Net income per common share—diluted	2.29	2.16	1.93
Dividends per common share	\$.32	\$.29	\$.26
Weighted average shares	689.3	698.2	701.5
Weighted average shares—diluted	705.1	716.6	717.7

The accompanying Financial Comments are an integral part of the consolidated financial statements.

Consolidated Balance Sheet

(In millions, except per share data)

December 31, 1997

1996

Assets		
Current assets		
Cash and equivalents	\$ 341.4	\$ 329.9
Accounts and notes receivable	483.5	495.4
Inventories, at cost, not in excess of market	70.5	69.6
Prepaid expenses and other current assets	246.9	207.6
Total current assets	1,142.3	1,102.5
Other assets		
Notes receivable due after one year	67.0	85.3
Investments in and advances to affiliates	634.8	694.0
Intangible assets—net	827.5	747.0
Miscellaneous	608.5	405.1
Total other assets	2,137.8	1,931.4
Property and equipment		
Property and equipment, at cost	20,088.2	19,133.9
Accumulated depreciation and amortization	(5,126.8)	(4,781.8)
Net property and equipment	14,961.4	14,352.1
Total assets	\$18,241.5	\$17,386.0
Liabilities and shareholders' equity		
Current liabilities		
Notes payable	\$ 1,293.8	\$ 597.8
Accounts payable	650.6	638.0
Income taxes	52.5	22.5
Other taxes	148.5	136.7
Accrued interest	107.1	121.7
Other accrued liabilities	396.4	523.1
Current maturities of long-term debt	335.6	95.5
Total current liabilities	2,984.5	2,135.3
Long-term debt	4,834.1	4,830.1
Other long-term liabilities and minority interests	427.5	726.5
Deferred income taxes	1,063.5	975.9
Common equity put options	80.3	
Shareholders' equity		
Preferred stock, no par value; authorized—165.0 million shares; issued, 1997—none; 1996—7.2 thousand		358.0
Common stock—\$.01 par value; authorized—3.5 billion shares; issued—830.3 million	8.3	8.3
Additional paid-in capital	699.2	574.2
Guarantee of ESOP Notes	(171.3)	(193.2)
Retained earnings	12,569.0	11,173.0
Accumulated other comprehensive income	(470.5)	(175.1)
Common stock in treasury, at cost; 144.6 and 135.7 million shares	(3,783.1)	(3,027.0)
Total shareholders' equity	8,851.6	8,718.2
Total liabilities and shareholders' equity	\$18,241.5	\$17,386.0

The accompanying Financial Comments are an integral part of the consolidated financial statements.

Consolidated Statement of Cash Flows

<i>(In millions)</i>	Years ended December 31, 1997	1996	1995
Operating activities			
Net income	\$ 1,642.5	\$ 1,572.6	\$ 1,427.3
Adjustments to reconcile to cash provided by operations			
Depreciation and amortization	793.8	742.9	709.0
Deferred income taxes	(1.1)	32.9	(4.2)
Changes in operating working capital items			
Accounts receivable increase	(57.6)	(77.5)	(49.5)
Inventories, prepaid expenses and other current assets increase	(34.5)	(18.7)	(20.4)
Accounts payable increase	52.8	44.5	52.6
Taxes and other liabilities increase	221.9	121.4	171.3
Refund of U.S. franchisee security deposits	(109.6)		
Other	(65.9)	42.9	10.1
Cash provided by operations	2,442.3	2,461.0	2,296.2
Investing activities			
Property and equipment expenditures	(2,111.2)	(2,375.3)	(2,063.7)
Purchases of restaurant businesses	(113.6)	(137.7)	(110.1)
Sales of restaurant businesses	149.5	198.8	151.6
Property sales	26.9	35.5	66.2
Other	(168.8)	(291.6)	(153.0)
Cash used for investing activities	(2,217.2)	(2,570.3)	(2,109.0)
Financing activities			
Net short-term borrowings (repayments)	1,097.4	228.8	(272.9)
Long-term financing issuances	1,037.9	1,391.8	1,250.2
Long-term financing repayments	(1,133.8)	(841.3)	(532.2)
Treasury stock purchases	(755.1)	(599.9)	(314.5)
Common and preferred stock dividends	(247.7)	(232.0)	(226.5)
Series E preferred stock redemption	(358.0)		
Other	145.7	157.0	63.6
Cash provided by (used for) financing activities	(213.6)	104.4	(32.3)
Cash and equivalents increase (decrease)	11.5	(4.9)	154.9
Cash and equivalents at beginning of year	329.9	334.8	179.9
Cash and equivalents at end of year	\$ 341.4	\$ 329.9	\$ 334.8
Supplemental cash flow disclosures			
Interest paid	\$ 401.7	\$ 369.0	\$ 331.0
Income taxes paid	\$ 650.8	\$ 558.1	\$ 667.6

The accompanying Financial Comments are an integral part of the consolidated financial statements.

Consolidated Statement of Shareholders' Equity

(In millions, except per share data)	Preferred stock issued*	Common stock issued		Additional paid-in capital	Guarantee of ESOP Notes	Retained earnings	Accumulated other comprehensive income	Common stock in treasury		Total shareholders' equity
	Amount	Shares	Amount					Shares	Amount	
Balance at December 31, 1994	\$ 674.2	830.3	\$ 92.3	\$ 286.0	\$ (234.4)	\$ 8,625.9	\$ (114.9)	(136.6)	\$ (2,443.7)	\$ 6,885.4
Net income						1,427.3				1,427.3
Translation adjustments (including taxes of \$9.0)							27.8			27.8
Comprehensive income										1,455.1
Common stock cash dividends (\$.26 per share)						(181.4)				(181.4)
Preferred stock cash dividends (per share: \$1.01 for Series B, \$1.16 for Series C and \$1.93 for Series E depository share; net of tax benefits of \$1.6)						(40.5)				(40.5)
Preferred stock conversion	(316.2)			25.3				8.8	144.6	(146.3)
ESOP Notes payment					19.0					19.0
Treasury stock acquisitions								(8.8)	(321.0)	(321.0)
Common equity put options expiration									56.2	56.2
Stock option exercises and other (including tax benefits of \$42.2)				76.1	1.2			6.0	57.5	134.8
Balance at December 31, 1995	358.0	830.3	92.3	387.4	(214.2)	9,831.3	(87.1)	(130.6)	(2,506.4)	7,861.3
Net income						1,572.6				1,572.6
Translation adjustments (including tax benefits of \$50.6)							(88.0)			(88.0)
Comprehensive income										1,484.6
Common stock cash dividends (\$.29 per share)						(203.3)				(203.3)
Preferred stock cash dividends (\$1.93 per Series E depository share)						(27.6)				(27.6)
Conversion to \$.01 par value stock			(84.0)	84.0						
ESOP Notes payment					20.2					20.2
Treasury stock acquisitions								(12.9)	(604.8)	(604.8)
Stock option exercises and other (including tax benefits of \$86.4)				102.8	0.8			7.8	84.2	187.8
Balance at December 31, 1996	358.0	830.3	8.3	574.2	(193.2)	11,173.0	(175.1)	(135.7)	(3,027.0)	8,718.2
Net income						1,642.5				1,642.5
Translation adjustments (including tax benefits of \$104.0)							(295.4)			(295.4)
Comprehensive income										1,347.1
Common stock cash dividends (\$.32 per share)						(221.2)				(221.2)
Preferred stock cash dividends (\$1.93 per Series E depository share)						(25.3)				(25.3)
ESOP Notes payment					21.4					21.4
Treasury stock acquisitions								(16.2)	(765.0)	(765.0)
Common equity put options issuance									(80.3)	(80.3)
Series E preferred stock redemption	(358.0)									(358.0)
Stock option exercises and other (including tax benefits of \$79.2)				125.0	0.5			7.3	89.2	214.7
Balance at December 31, 1997	\$ 0.0	830.3	\$ 8.3	\$ 699.2	\$ (171.3)	\$ 12,569.0	\$ (470.5)	(144.6)	\$ (3,783.1)	\$ 8,851.6

*At December 31, 1996 and 1995, 7.2 thousand shares were outstanding. These shares were redeemed in 1997.
The accompanying Financial Comments are an integral part of the consolidated financial statements.

Financial Comments

Summary of significant accounting policies

Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries. Investments in affiliates owned 50% or less are accounted for by the equity method.

Estimates in financial statements

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Foreign currency translation

The functional currency of substantially all operations outside the U.S. is the respective local currency, except for hyperinflationary countries where it is the U.S. Dollar.

Advertising costs

Production costs for radio and television advertising are expensed when the commercials are initially aired. Advertising expenses included in costs of Company-operated restaurants and in selling, general and administrative expenses were (in millions): 1997 – \$548.7; 1996 – \$503.3; 1995 – \$431.0.

Stock options

The Company accounts for stock options as prescribed by APB Opinion No. 25 and includes pro forma information in the Stock options footnote, as permitted by Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation*.

Property and equipment

Property and equipment are stated at cost, with depreciation and amortization provided using the straight-line method over the following estimated useful lives: buildings – up to 40 years; leasehold improvements – lesser of useful lives of assets or lease terms including option periods; and equipment – three to 12 years.

Intangible assets

Intangible assets, primarily franchise rights reacquired from franchisees and affiliates, are amortized using the straight-line method over an average life of about 30 years.

Financial instruments

The Company uses derivatives to manage risk, not for trading purposes. Non-U.S. Dollar financing transactions generally are effective as hedges of either long-term investments in or intercompany loans to foreign subsidiaries and affiliates. Foreign currency translation adjustments from gains and losses on hedges of long-term investments are recorded in shareholders' equity as other comprehensive income. Gains and losses related

to hedges of intercompany loans offset the gains and losses on intercompany loans and are recorded in nonoperating (income) expense – net.

Interest-rate exchange agreements are designated and effective to modify the Company's interest-rate exposures. Net interest is accrued as either interest receivable or payable with the offset recorded in interest expense. Gains or losses from the early termination of interest-rate exchange agreements are amortized as an adjustment to interest expense over the shorter of the remaining life of the swap or the underlying debt being hedged.

The Company purchases foreign currency options (with little or no initial intrinsic value) which are effective as hedges of anticipated foreign currency royalty and other payments received in the U.S. The premiums paid for these options are amortized over the option life. Any realized gains on exercised options are deferred and recognized in the period in which the related royalty or other payment is received.

Short-term forward foreign exchange contracts are also used to mitigate exposure on foreign currency royalty and other payments received from affiliates and subsidiaries. These contracts are marked to market with the resulting gains or losses recorded in nonoperating (income) expense – net.

If a hedged item matures or is extinguished, or if a hedged anticipated royalty or other payment is no longer probable, the associated derivative is marked to market with the resulting gain or loss recognized immediately. The derivative is then redesignated as a hedge of another item or terminated.

Statement of cash flows

The Company considers short-term, highly liquid investments to be cash equivalents. The impact of fluctuating foreign currencies on cash and equivalents was not material.

Accounting for the impairment of long-lived assets

In 1996, the Company adopted SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of*. This statement requires the Company to recognize impairment losses for long-lived assets, whether these assets are held for disposal or continue to be used in operations, when indicators of impairment are present and the fair value of assets are estimated to be less than carrying amounts. The fair value of assets is based on projected undiscounted future cash flows. The adoption of this standard in 1996 resulted in a \$16.0 million pre-tax charge to operating income related to certain restaurant sites in Mexico.

Net income per common share

In 1997, the Company adopted SFAS No. 128, *Earnings per Share*. This statement requires the Company to disclose diluted net income per common share, which includes the dilutive effect of stock options, in addition to previously reported basic

net income per common share. All net income per share amounts have been presented to conform to the SFAS 128 requirements.

Comprehensive income

In 1997, the Company adopted SFAS No. 130, *Reporting Comprehensive Income*. This statement establishes rules for the reporting of comprehensive income and its components. Comprehensive income consists of net income and foreign currency translation adjustments and is presented in the Consolidated Statement of Shareholders' Equity. The adoption of SFAS 130 had no impact on total shareholders' equity. Prior year financial statements have been reclassified to conform to the SFAS 130 requirements.

Segment disclosures

In 1997, the Company adopted SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*. SFAS 131 establishes standards for reporting information about operating segments and related disclosures about products and services, geographic areas and major customers.

Other operating (income) expense-net

(In millions)	1997	1996	1995
Gains on sales of restaurant businesses	\$ (59.0)	\$(85.2)	\$ (63.9)
Equity in earnings of unconsolidated affiliates	(72.8)	(76.8)	(96.5)
Net losses from property dispositions	29.1	41.1	49.2
Other - net	(10.8)	3.1	5.5
Special charge		72.0	
Other operating (income) expense-net	\$(113.5)	\$(45.8)	\$(105.7)

Net losses from property dispositions in 1996 included \$16.0 million for certain restaurant sites in Mexico, upon the adoption of SFAS 121. The special charge of \$72.0 million in 1996 related primarily to plans to strengthen the U.S. business and reduce ongoing costs by closing approximately 115 low-volume U.S. satellite restaurants, replacing certain restaurant equipment, outsourcing excess property management and implementing other cost efficiencies.

Employee benefit plans

The Company's program for U.S. employees includes profit sharing, 401(k) (McDESOP) and leveraged employee stock ownership (LESOP) features. McDESOP allows participants to make contributions which are partly matched by the Company. Plan assets and contributions made by McDESOP participants can be invested in McDonald's common stock or among several other investment alternatives. The LESOP and Company contributions to McDESOP are invested in McDonald's common stock.

Executives, staff and restaurant managers participate in profit-sharing contributions and shares released under the LESOP, based on their compensation. The profit-sharing contribution is discretionary, and the Company determines the amount each year. Total U.S. costs for the above program were (in millions): 1997 - \$57.6; 1996 - \$59.9; 1995 - \$55.8.

Certain subsidiaries outside the U.S. also offer profit sharing, stock purchase or other similar benefit plans. Total plan costs outside the U.S. were (in millions): 1997 - \$34.1; 1996 - \$30.6; 1995 - \$26.6.

Other postretirement benefits and postemployment benefits were immaterial.

Income taxes

Income before provision for income taxes, classified by source of income, was as follows:

(In millions)	1997	1996	1995
U.S. and Corporate	\$1,004.6	\$ 933.9	\$1,026.2
Outside the U.S.	1,402.7	1,317.1	1,142.9
Income before provision for income taxes	\$2,407.3	\$2,251.0	\$2,169.1

The provision for income taxes, classified by the timing and location of payment, was as follows:

(In millions)	1997	1996	1995
U.S. federal	\$336.3	\$260.0	\$363.7
U.S. state	66.0	49.4	60.5
Outside the U.S.	363.6	336.1	321.8
Current tax provision	765.9	645.5	746.0
U.S. federal	2.5	(13.2)	(17.6)
U.S. state	13.5	1.6	(3.9)
Outside the U.S.	(17.1)	44.5	17.3
Deferred tax provision	(1.1)	32.9	(4.2)
Provision for income taxes	\$764.8	\$678.4	\$741.8

Net deferred tax liabilities consisted of:

(In millions)	December 31, 1997	1996
Property and equipment basis differences	\$1,033.1	\$ 986.2
Other	426.0	236.7
Total deferred tax liabilities	1,459.1	1,222.9
Deferred tax assets before valuation allowance	(493.1)	(348.5)
Valuation allowance	41.7	43.2
Net deferred tax liabilities (1)	\$1,007.7	\$ 917.6

(1) Net of current tax assets (in millions): 1997 - \$55.8; 1996 - \$58.3.

The statutory U.S. federal income tax rate reconciles to the effective income tax rates as follows:

	1997	1996	1995
Statutory U.S. federal income tax rate	35.0%	35.0%	35.0%
State income taxes, net of related federal income tax benefit	2.1	1.5	1.7
Benefits and taxes related to foreign operations	(5.2)	(6.8)	(2.9)
Other - net	(.1)	.4	.4
Effective income tax rates	31.8%	30.1%	34.2%

Deferred U.S. income taxes have not been provided on basis differences related to investments in certain foreign subsidiaries and affiliates. These basis differences were approximately \$1.8 billion at December 31, 1997, and consisted primarily of undistributed earnings considered permanently invested in the businesses. Determination of the deferred income tax liability on these unremitted earnings is not practicable, since such liability, if any, is dependent on circumstances existing when remittance occurs.

Property and equipment

<i>(In millions)</i>	December 31, 1997	1996
Land	\$ 3,592.2	\$ 3,566.0
Buildings and improvements on owned land	7,289.7	7,038.3
Buildings and improvements on leased land	6,168.3	5,735.5
Equipment, signs and seating	2,345.1	2,148.4
Other	692.9	645.7
Total property and equipment	20,088.2	19,133.9
Accumulated depreciation and amortization	(5,126.8)	(4,781.8)
Net property and equipment	\$14,961.4	\$14,352.1

Depreciation and amortization expense was (in millions): 1997 – \$726.4; 1996 – \$673.4; 1995 – \$619.9. Contractual obligations for the acquisition and construction of property totaled approximately \$175.0 million at December 31, 1997.

Leasing arrangements

At December 31, 1997, the Company was lessee at 4,152 restaurant locations through ground leases (the Company leases land and owns buildings) and at 5,257 restaurant locations through improved leases (the Company leases land and buildings). Lease terms for most restaurants are generally for 20 to 25 years and, in many cases, provide for rent escalations and renewal options with certain leases providing purchase options. For most locations, the Company is obligated for the related occupancy costs including property taxes, insurance and maintenance. In addition, the Company is lessee under noncancelable leases covering offices and vehicles.

Future minimum payments required under operating leases with initial terms of one year or more are:

<i>(In millions)</i>	Restaurant	Other	Total
1998	\$ 512.3	\$ 46.5	\$ 558.8
1999	494.4	39.5	533.9
2000	478.5	31.4	509.9
2001	460.9	26.8	487.7
2002	442.7	22.2	464.9
Thereafter	4,059.3	131.1	4,190.4
Total minimum payments	\$6,448.1	\$297.5	\$6,745.6

Rent expense was (in millions): 1997 – \$641.2; 1996 – \$581.6; 1995 – \$497.6. These amounts included percent rents in excess of minimum rents (in millions): 1997 – \$99.4; 1996 – \$91.4; 1995 – \$73.5.

Segment and geographic information

The Company operates exclusively in the food service industry. Substantially all revenues result from the sale of menu products at restaurants operated by the Company, franchisees or affiliates. The Company's reportable segments are based on geographic area. All intercompany revenues and expenses are eliminated in computing revenues and operating income. Operating income includes the Company's share of operating results of affiliates after interest expense. These amounts are also after income taxes for affiliates outside the U.S. Royalties and other payments received from subsidiaries outside the U.S. were (in millions): 1997 – \$470.6; 1996 – \$419.0; 1995 – \$358.4.

The corporate component of operating income represents corporate selling, general and administrative expenses. Corporate assets include corporate cash, investments, asset portions of financing instruments, deferred tax assets and certain intangibles.

The Other segment includes Canada, Africa and the Middle East.

<i>(In millions)</i>	1997	1996	1995
U.S.	\$ 4,602.7	\$ 4,590.3	\$ 4,473.9
Europe	3,931.5	3,613.8	3,223.1
Asia/Pacific	1,522.8	1,272.8	1,010.8
Latin America	709.2	595.7	506.9
Other	642.6	613.9	579.8
Total revenues	\$11,408.8	\$10,686.5	\$ 9,794.5

U.S.	\$ 404.0	\$ 396.0	\$ 380.0
Europe	229.2	213.4	215.4
Asia/Pacific	82.8	66.4	57.2
Latin America	35.4	29.1	18.9
Other	42.4	38.0	37.5
Total depreciation and amortization	\$ 793.8	\$ 742.9	\$ 709.0

U.S.	\$ 1,210.8	\$ 1,144.0	\$ 1,252.4
Europe	1,007.2	953.8	839.1
Asia/Pacific	369.1	355.1	308.8
Latin America	166.5	113.7	132.7
Other	116.3	118.0	116.5
Corporate	(61.6)	(52.0)	(48.2)
Total operating income	\$ 2,808.3	\$ 2,632.6	\$ 2,601.3

U.S.	\$ 7,753.4	\$ 7,553.5	\$ 7,040.2
Europe	6,005.4	5,925.3	5,023.2
Asia/Pacific	2,125.6	2,111.8	1,815.5
Latin America	1,177.8	900.3	812.5
Other	661.6	622.8	554.6
Corporate	517.7	272.3	168.6
Total assets	\$18,241.5	\$17,386.0	\$15,414.6

U.S.	\$ 584.0	\$ 882.9	\$ 910.0
Europe	929.5	945.8	780.6
Asia/Pacific	277.3	283.1	183.1
Latin America	227.9	172.5	131.5
Other	92.5	91.0	58.5
Total capital expenditures	\$ 2,111.2	\$ 2,375.3	\$ 2,063.7

Total long-lived assets, primarily property and equipment and intangibles were (in millions): 1997 – \$16,706.1; 1996 – \$16,069.8; 1995 – \$14,271.9; U.S.: 1997 – \$7,530.7; 1996 – \$7,234.3; 1995 – \$6,769.5.

Franchise arrangements

Franchise arrangements include a lease and a license and generally provide for payment of initial fees, as well as continuing rent, service fees and royalties to the Company, based upon a percent of sales with minimum rent payments. Franchisees are granted the right to operate a McDonald's restaurant using the McDonald's system as well as the use of a restaurant facility generally for a period of 20 years. Franchisees pay related occupancy costs including property taxes, insurance and maintenance. In addition, franchisees outside the U.S. pay a refundable, noninterest-bearing security deposit. The results of opera-

tions of restaurant businesses purchased and sold in transactions with franchisees and affiliates were not material to the consolidated financial statements for periods prior to purchase and sale.

(In millions)	1997	1996	1995
Minimum rents	\$1,369.7	\$1,350.7	\$1,230.0
Percent rent and service fees	1,836.3	1,689.7	1,638.4
Initial fees	66.3	75.4	62.6
Revenues from franchised and affiliated restaurants	\$3,272.3	\$3,115.8	\$2,931.0

Future minimum rent payments due to the Company under franchise arrangements are:

(In millions)	Owned sites	Leased sites	Total
1998	\$ 854.0	\$ 609.6	\$ 1,463.6
1999	839.3	603.8	1,443.1
2000	825.4	592.9	1,418.3
2001	809.8	582.1	1,391.9
2002	794.0	609.1	1,403.1
Thereafter	7,218.4	5,382.1	12,600.5
Total minimum payments	\$11,340.9	\$8,379.6	\$19,720.5

At December 31, 1997, net property and equipment under franchise arrangements totaled \$8.1 billion (including land of \$2.5 billion) after deducting accumulated depreciation and amortization of \$2.6 billion.

Debt financing

Line of credit agreements

The Company has several line of credit agreements with various banks: a \$675.0 million line which expires on April 19, 2002, with fees of .06% per annum on the total commitment; a \$25.0 million line with a renewable term of 364 days and fees of .07% per annum on the total commitment; and \$800.0 million in additional short-term lines expiring in the first half of 1998 with fees of .04% per annum on the total commitments. All agreements remained unused at December 31, 1997. Borrowings under the agreements bear interest at one of several specified floating rates selected by the Company at the time of borrowing. In addition, certain subsidiaries outside the U.S. had unused lines of credit totaling \$667.1 million at December 31, 1997; these were principally short-term and denominated in various currencies at local market rates of interest. The weighted-average interest rate of short-term borrowings, composed of commercial paper and foreign currency bank line borrowings, was 6.2% and 6.4% at December 31, 1997 and 1996, respectively.

Exchange agreements

The Company has entered into agreements for the exchange of various currencies, certain of which also provide for the periodic exchange of interest payments. These agreements expire through 2004 and relate primarily to the exchange of British Pounds Sterling, French Francs, Deutsche Marks and Japanese Yen. The notional principal is the amount used to calculate interest payments which are exchanged over the life of the swap transaction and is equal to the amount of foreign currency

or U.S. Dollar principal exchanged at maturity. The Company also has entered into interest-rate exchange agreements which expire through 2011 and relate primarily to U.S. Dollars, British Pounds Sterling and French Francs. The net value of each exchange agreement based on its current spot rate was classified as an asset or liability, and any related interest income was netted against interest expense.

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 does not have significant exposure to any individual counterparty and has entered into master agreements that contain netting arrangements.

At December 31, 1997, the Company had purchased foreign currency options outstanding (primarily British Pounds Sterling, Deutsche Marks and Swiss Francs) with a notional amount equivalent to U.S. \$237.9 million. The unamortized premium related to these currency options was \$2.2 million and there were no related deferred gains recorded as of year end. Short-term forward foreign exchange contracts outstanding at December 31, 1997 (primarily French Francs, Deutsche Marks and Australian Dollars) had a U.S. Dollar equivalent of \$85.3 million.

Guarantees

The Company has guaranteed and included in total debt at December 31, 1997, \$118.4 million of 7.3% ESOP Notes Series A and \$63.8 million of 7.0% ESOP Notes Series B issued by the Leveraged Employee Stock Ownership Plan with payments through 2004 and 2006, respectively. The Company has agreed to repurchase the notes upon the occurrence of certain events. The Company has also guaranteed certain affiliate loans totaling \$238.3 million at December 31, 1997.

Fair values

(In millions)	December 31, 1997	
	Carrying amount	Fair value
Liabilities		
Debt	\$5,108.2	\$5,304.8
Notes payable	1,293.8	1,293.8
Foreign currency exchange agreements (1)	61.5	57.1
Interest-rate exchange agreements (2)		18.5
Total liabilities	6,463.5	6,674.2
Assets		
Foreign currency exchange agreements (1)	236.0	158.3
Net debt	\$6,227.5	\$6,515.9
Purchased foreign currency options	\$ 2.2	\$ 7.6

(1) Combined notional amount equivalent to U.S. \$2.1 billion.

(2) Notional amount equivalent to U.S. \$2.4 billion.

The carrying amounts for cash and equivalents, notes receivable and short-term forward foreign exchange contracts approximated fair value. No fair value was provided for noninterest-bearing security deposits by franchisees as these deposits are an integral part of the overall franchise arrangements.

The fair value of the debt and notes payable obligations (excluding capital leases), the currency and interest-rate exchange agreements and the foreign currency options was estimated using quoted market prices, various pricing models or discounted cash flow analyses. The Company has no current plans to retire a significant amount of its debt prior to maturity. Given the market value of its common stock and its significant real estate holdings, the Company believes that the fair value of total assets was higher than their carrying value at December 31, 1997.

Debt obligations

The Company has incurred debt obligations principally through public and private offerings and bank loans. The terms of most debt obligations contain restrictions on Company and subsidiary mortgages and long-term debt of certain subsidiaries. Under certain agreements, the Company has the option to retire debt prior to maturity, either at par or at a premium over par. The following table summarizes these debt obligations, including the effects of currency and interest-rate exchange agreements.

Debt obligations

(In millions of U.S. Dollars)	Maturity dates	Interest rates (1) December 31		Amounts outstanding December 31		Aggregate maturities by currency for 1997 balances														
		1997	1996	1997	1996	1998	1999	2000	2001	2002	Thereafter									
Fixed—original issue (2)		7.2%	7.2%	\$ 2,487.6	\$ 2,610.8															
Fixed—converted via exchange agreements (3)		6.1	6.0	(1,869.7)	(2,249.6)															
Floating		5.6	5.6	646.5	206.4															
Total U.S. Dollars	1998-2037			1,264.4	567.6	\$ 240.1	\$(240.4)	\$ 55.3	\$(303.3)	\$ (32.6)	\$ 1,545.3									
Fixed		8.2	7.2	475.0	940.5															
Floating		4.1	3.9	497.8	136.4															
Total French Francs	1998-2006			972.8	1,076.9	202.1	154.5	63.7	84.2	117.1	351.2									
Fixed		5.8	5.7	361.8	737.6															
Floating		4.0	3.8	582.6	390.2															
Total Deutsche Marks	1998-2007			944.4	1,127.8	417.6	166.9	120.8	126.3	56.9	55.9									
Fixed		9.2	9.9	541.2	304.4															
Floating		6.5	6.2	255.3	256.4															
Total British Pounds Sterling	1998-2005			796.5	560.8	442.8		90.8	74.3	24.7	163.9									
Fixed		3.9	4.5	343.6	387.2															
Floating		0.6	0.8	203.0	51.8															
Total Japanese Yen	1998-2023			546.6	439.0	95.7	46.0	38.3	99.6	76.6	190.4									
Fixed		9.4	9.4	114.7	141.7															
Floating		5.1	6.7	124.2	94.0															
Total Australian Dollars	1998-2003			238.9	235.7	233.5	1.5	3.4	0.3	0.1	0.1									
Fixed		10.9	9.4	1.5	56.5															
Floating		4.1	3.1	215.6	73.0															
Total Canadian Dollars	1998-2021			217.1	129.5	14.9	0.2	0.2	(71.1)	272.2	0.7									
Fixed		8.0	7.3	573.0	780.2															
Floating		6.8	7.6	673.8	560.8															
Total other currencies (4)	1998-2016			1,246.8	1,341.0	616.6	174.0	142.3	144.6	52.6	116.7									
Debt obligations including the net effects of currency and interest-rate exchange agreements				6,227.5	5,478.3	2,263.3	302.7	514.8	154.9	567.6	2,424.2									
Short-term obligations supported by long-term line of credit agreement						(675.0)				675.0										
Net asset positions of currency exchange agreements (included in miscellaneous other assets)				236.0	45.1	41.1	67.6	30.0	48.0	21.1	28.2									
Total debt obligations				\$ 6,463.5	\$ 5,523.4	\$ 1,629.4	\$ 370.3	\$ 544.8	\$ 202.9	\$ 1,263.7	\$ 2,452.4									

(1) Weighted-average effective rate, computed on a semi-annual basis.

(2) Includes \$500 million of debentures with maturities in 2027, 2036 and 2037 which are subordinated to senior debt and which provide for the ability to defer interest payments up to five years under certain conditions.

(3) A portion of U.S. Dollar fixed-rate debt effectively has been converted into other currencies and/or into floating-rate debt through the use of exchange agreements. The rates shown reflect the fixed rate on the receivable portion of the exchange agreements. All other obligations in this table reflect the net effects of these and other exchange agreements.

(4) Consists of debt obligations denominated in 24 other foreign currencies.

Stock options

At December 31, 1997, the Company had three stock-based compensation plans, two for employees and one for non-employee directors. Options to purchase common stock are granted at the fair market value of the stock on date of grant. Therefore, no compensation cost has been recognized in the consolidated financial statements for these plans.

Substantially all of the options become exercisable in four equal installments, beginning a year from the date of the grant, and expiring 10 years from the grant date. At December 31, 1997, the number of shares of common stock reserved for issuance under the plans was 90.0 million, including 11.8 million available for future grants.

A summary of the status of the Company's plans as of December 31, 1997, 1996 and 1995, and changes during the years then ended is presented below:

Options	1997		1996		1995	
	Shares (in millions)	Weighted- average exercise price	Shares (in millions)	Weighted- average exercise price	Shares (in millions)	Weighted- average exercise price
Outstanding at beginning of year	72.7	\$29.46	68.1	\$23.86	62.3	\$21.02
Granted	15.1	47.06	15.0	49.14	13.7	33.24
Exercised	(7.2)	19.25	(7.8)	17.75	(6.0)	15.76
Forfeited	(2.4)	35.55	(2.6)	32.31	(1.9)	24.55
Outstanding at end of year	78.2	\$33.58	72.7	\$29.46	68.1	\$23.86
Options exercisable at end of year	30.2		26.7		24.4	

Options granted each year were about 2% of average common shares outstanding for 1997, 1996 and 1995, respectively, representing grants to approximately 11,000, 10,300 and 8,500 employees in those three years. When stock options are exercised, shares are issued from treasury stock.

The average per share cost of treasury stock issued for option exercises was: 1997—\$12.93; 1996—\$13.07; 1995—\$9.56. The average option exercise price has consistently exceeded the average cost of treasury stock issued for option exercises. This is because the Company prefunds the program through share repurchase. Thus, stock option exercises have generated additional capital, since cash received from employees has exceeded the Company's average acquisition cost of treasury stock. In addition, stock option exercises generated \$207.8 million of tax benefits for the Company during the three years ended December 31, 1997.

Range of exercise prices	December 31, 1997					
	Options outstanding			Options exercisable		
	Number of options (in millions)	Weighted-average contractual life (in years)	Weighted-average exercise price	Number of options (in millions)	Weighted-average exercise price	
\$11 to 15	6.8	2.1	\$14.36	6.8	\$14.36	
16 to 22	12.6	4.2	19.52	8.5	19.58	
23 to 36	30.3	6.4	30.07	11.2	29.36	
37 to 52	28.5	9.0	48.10	3.7	49.05	
\$11 to 52	78.2	6.6	\$33.58	30.2	\$25.67	

Pro forma net income and net income per common share were determined as if the Company had accounted for its employee stock options under the fair value method of SFAS 123 and are presented in the table below:

	1997	1996	1995
Net income—pro forma (in millions)	\$1,589.3	\$1,538.3	\$1,414.0
Net income per common share—pro forma			
Basic	2.27	2.16	1.95
Diluted	2.22	2.11	1.91
Weighted-average fair value of options granted	16.80	16.88	13.07

For pro forma disclosures, the options' estimated fair value was amortized over their expected seven-year life. These pro forma amounts are not indicative of anticipated future disclosures because SFAS 123 does not apply to grants before 1995. Therefore, the pro forma disclosures do not include a full seven years of grants. The fair value for these options was estimated at the date of grant using an option pricing model. The model was designed to estimate the fair value of exchange-traded options which, unlike employee stock options, can be traded at any time and are fully transferable. In addition, such models require the input of highly subjective assumptions, including the expected volatility of the stock price. Therefore, in management's opinion, the existing models do not provide a reliable single measure of the value of employee stock options. The following weighted-average assumptions were used to estimate the fair value of these options:

	1997	1996	1995
Expected dividend yield	.65%	.65%	.65%
Expected stock price volatility	21.3%	19.4%	20.9%
Risk-free interest rate	6.61%	6.14%	7.39%
Expected life of options (in years)	7	7	7

Capital stock

Per common share information

Income used in the computation of per common share information was reduced by preferred stock cash dividends (net of applicable tax benefits). In 1995, income was also reduced by \$3.9 million for the one-time effect of the Company's exchange of its Series E 7.72% Cumulative Preferred Stock for subordinated debt securities, and by an additional \$.4 million for the effect of the Company's repurchase of additional Series E preferred stock.

Preferred stock

In December 1992, the Company issued \$500.0 million of Series E 7.72% Cumulative Preferred Stock with a liquidation preference of \$50,000 per share. One preferred share was equal to 2,000 depositary shares and was entitled to one vote under certain circumstances. In 1995, the Company completed an exchange of depositary shares equaling 2,600 shares of this preferred stock for subordinated debt securities and repurchased depositary shares equaling approximately 250 shares. The Company redeemed the remaining Series E shares for cash in December 1997.

In September 1989 and April 1991, respectively, the Company

sold \$200.0 million of Series B and \$100.0 million of Series C ESOP Convertible Preferred Stock to the LESOP. The LESOP financed the purchase by issuing notes guaranteed by the Company and included in long-term debt, with an offsetting reduction in shareholders' equity. In 1992 and 1995, this preferred stock was converted into a total of 15.1 million common shares.

Change in par value

In May 1996, Company shareholders approved an increase in the number of authorized shares of Common Stock from 1.25 billion with no par value to 3.5 billion with \$.01 par value. The change in par value did not affect any of the existing rights of shareholders and was recorded as an adjustment to additional paid-in capital and common stock.

Common equity put options

In 1997, the Company sold 5.3 million common equity put options, of which 1.8 million options were outstanding at December 31, 1997. The options expire at various dates through May 1998. At December 31, 1997, the \$80.3 million exercise price of these outstanding options was classified in common equity put options, and the related offset was recorded in common stock in treasury, net of premiums received.

Shareholder rights plan

In December 1988, the Company declared a dividend of one

Preferred Share Purchase Right (Right) on each outstanding share of common stock. Under certain conditions, each Right may be exercised to purchase one four-hundredth of a share of Series A Junior Participating Preferred Stock at an exercise price of \$62.50 (which may be adjusted under certain circumstances). The Right is transferable apart from the common stock 10 days following a public announcement that a person or group has acquired beneficial ownership of 20% or more of the outstanding common shares, or 10 business days following the commencement or announcement of an intention to make a tender or exchange offer resulting in beneficial ownership by a person or group exceeding the threshold. The threshold may be reduced by the Board of Directors to as low as 10%.

Once the threshold has been exceeded, or if the Company is acquired in a merger or other business combination transaction, each Right will entitle the holder, other than such person or group, to purchase at the then current exercise price, stock of the Company or the acquiring company having a market value of twice the exercise price.

Each Right is nonvoting and expires on December 28, 1998, unless redeemed by the Company, at a price of \$.0025, at any time prior to the public announcement that a person or group has exceeded the threshold. At December 31, 1997, 2.1 million shares of the Series A Junior Participating Preferred Stock were reserved for issuance under this plan.

Quarterly Results (unaudited)

<i>(In millions, except per common share data)</i>	Quarters ended December 31		September 30		June 30		March 31	
	1997	1996	1997	1996	1997	1996	1997	1996
Systemwide sales	\$8,530.4	\$8,284.5	\$8,799.7	\$8,286.1	\$8,475.1	\$7,932.0	\$7,833.1	\$7,309.5
Revenues								
Sales by Company-operated restaurants	\$2,110.7	\$2,005.5	\$2,158.5	\$1,965.6	\$2,014.1	\$1,885.8	\$1,853.2	\$1,713.8
Revenues from franchised and affiliated restaurants	841.9	816.1	847.5	808.2	818.5	779.3	764.4	712.2
Total revenues	2,952.6	2,821.6	3,006.0	2,773.8	2,832.6	2,665.1	2,617.6	2,426.0
Operating costs and expenses								
Company-operated restaurants	1,726.3	1,638.7	1,756.1	1,582.1	1,640.1	1,523.1	1,527.1	1,419.3
Franchised restaurants	160.6	150.0	153.9	142.2	151.1	140.7	148.3	137.2
Selling, general and administrative expenses	393.8	381.0	375.5	347.9	347.2	326.3	334.0	311.2
Other operating (income) expense-net	(23.3)	37.9 ⁽¹⁾	(34.9)	(42.4)	(49.3)	(37.1)	(6.0)	(4.2)
Total operating costs and expenses	2,257.4	2,207.6	2,250.6	2,029.8	2,089.1	1,953.0	2,003.4	1,863.5
Operating income	695.2	614.0	755.4	744.0	743.5	712.1	614.2	562.5
Interest expense	94.1	90.2	94.1	84.7	86.2	82.8	90.0	84.8
Nonoperating (income) expense-net	11.7	0.3	2.2	9.4	14.2	3.8	8.5	25.6
Income before provision for income taxes	589.4	523.5	659.1	649.9	643.1	625.5	515.7	452.1
Provision for income taxes	178.5	113.5 ⁽²⁾	210.2	209.3	204.9	205.1	171.2	150.5
Net income	\$ 410.9	\$ 410.0	\$ 448.9	\$ 440.6	\$ 438.2	\$ 420.4	\$ 344.5	\$ 301.6
Net income per common share ⁽³⁾	\$.59	\$.58	\$.64	\$.62	\$.63	\$.59	\$.49	\$.42
Net income per common share-diluted ⁽³⁾	.58	.57	.63	.61	.61	.58	.48	.41
Dividends per common share	\$.0825	\$.0750	\$.0825	\$.0750	\$.0825	\$.0750	\$.0750	\$.0675
Weighted average shares	687.6	695.5	688.5	697.8	689.7	699.1	691.6	700.5
Weighted average shares-diluted	701.8	712.4	704.4	715.6	707.3	718.0	707.5	721.1

(1) Includes the \$72 million special charge.

(2) Includes a \$50 million tax benefit as a result of certain international transactions.

(3) Net income per common share data is presented in conformity with SFAS 128.

Management's Report

Management is responsible for the preparation, integrity and fair presentation of the consolidated financial statements and Financial Comments appearing in this annual report. The financial statements were prepared in accordance with generally accepted accounting principles and include certain amounts based on management's judgment and best estimates. Other financial information presented in the annual report is consistent with the financial statements.

The Company maintains a system of internal control over financial reporting including safeguarding of assets against unauthorized acquisition, use or disposition, which is designed to provide reasonable assurance to the Company's management and Board of Directors regarding the preparation of reliable published financial statements and such asset safeguarding. The system includes a documented organizational structure and appropriate division of responsibilities; established policies and procedures which are communicated throughout the Company; careful selection, training, and development of our people; and utilization of an internal audit program. Policies and procedures prescribe that the Company and all employees are to maintain high standards of proper business practices throughout the world.

There are inherent limitations in the effectiveness of any system of internal control, including the possibility of human error and the circumvention or overriding of controls. Accordingly, even an effective internal control system can provide only reasonable assurance with respect to financial statement preparation and safeguarding of assets. Furthermore, the effectiveness of an internal control system can change with circumstances. The Company believes that at December 31, 1997, it maintained an effective system of internal control over financial reporting and safeguarding of assets against unauthorized acquisition, use or disposition.

The consolidated financial statements have been audited by independent auditors, Ernst & Young LLP, who were given unrestricted access to all financial records and related data. The audit report of Ernst & Young LLP is presented herein.

The Board of Directors, operating through its Audit Committee composed entirely of independent Directors, provides oversight to the financial reporting process. Ernst & Young LLP has independent access to the Audit Committee and periodically meets with the Committee to discuss accounting, auditing and financial reporting matters.

McDONALD'S CORPORATION
Oak Brook, Illinois
January 22, 1998

Report of Independent Auditors

The Board of Directors and Shareholders
McDonald's Corporation
Oak Brook, Illinois

We have audited the accompanying consolidated balance sheet of McDonald's Corporation as of December 31, 1997 and 1996, and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 1997. These financial statements are the responsibility of McDonald's Corporation management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of McDonald's Corporation at December 31, 1997 and 1996, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1997, in conformity with generally accepted accounting principles.

ERNST & YOUNG LLP
Chicago, Illinois
January 22, 1998