Consolidated Statement of Income

(In millions, except per share data) *Years ended December 31,*	**1998**	1997	1996
Revenues			
Sales by Company-operated restaurants	**$ 8,894.9**	$ 8,136.5	$ 7,570.7
Revenues from franchised and affiliated restaurants	**3,526.5**	3,272.3	3,115.8
Total revenues	**12,421.4**	11,408.8	10,686.5
Operating costs and expenses			
Company-operated restaurants			
Food and packaging	**2,997.4**	2,772.6	2,546.6
Payroll and employee benefits	**2,220.3**	2,025.1	1,909.8
Occupancy and other operating expenses	**2,043.9**	1,851.9	1,706.8
	7,261.6	6,649.6	6,163.2
Franchised restaurants—occupancy expenses	**678.0**	613.9	570.1
Selling, general and administrative expenses	**1,458.5**	1,450.5	1,366.4
Made For You costs	**161.6**		
Special charges	**160.0**		72.0
Other operating (income) expense	**(60.2)**	(113.5)	(117.8)
Total operating costs and expenses	**9,659.5**	8,600.5	8,053.9
Operating income	**2,761.9**	2,808.3	2,632.6
Interest expense—net of capitalized interest of $17.9, $22.7 and $22.2	**413.8**	364.4	342.5
Nonoperating (income) expense	**40.7**	36.6	39.1
Income before provision for income taxes	**2,307.4**	2,407.3	2,251.0
Provision for income taxes	**757.3**	764.8	678.4
Net income	**$ 1,550.1**	$ 1,642.5	$ 1,572.6
Net income per common share	**$ 1.14**	$ 1.17	$ 1.11
Net income per common share—diluted	**1.10**	1.15	1.08
Dividends per common share	**$ .18**	$ .16	$ .15
Weighted-average shares	**1,365.3**	1,378.7	1,396.4
Weighted-average shares—diluted	**1,405.7**	1,410.2	1,433.3

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

Consolidated Balance Sheet

(In millions, except per share data)	*December 31,* **1998**	1997
Assets		
Current assets		
Cash and equivalents	**$ 299.2**	$ 341.4
Accounts and notes receivable	**609.4**	483.5
Inventories, at cost, not in excess of market	**77.3**	70.5
Prepaid expenses and other current assets	**323.5**	246.9
Total current assets	**1,309.4**	1,142.3
Other assets		
Notes receivable due after one year	**67.9**	67.0
Investments in and advances to affiliates	**854.1**	634.8
Intangible assets—net	**973.1**	827.5
Miscellaneous	**538.3**	608.5
Total other assets	**2,433.4**	2,137.8
Property and equipment		
Property and equipment, at cost	**21,758.0**	20,088.2
Accumulated depreciation and amortization	**(5,716.4)**	(5,126.8)
Net property and equipment	**16,041.6**	14,961.4
Total assets	**$19,784.4**	$18,241.5
Liabilities and shareholders' equity		
Current liabilities		
Notes payable	**$ 686.8**	$ 1,293.8
Accounts payable	**621.3**	650.6
Income taxes	**94.2**	52.5
Other taxes	**143.5**	148.5
Accrued interest	**132.3**	107.1
Other accrued liabilities	**651.0**	396.4
Current maturities of long-term debt	**168.0**	335.6
Total current liabilities	**2,497.1**	2,984.5
Long-term debt	**6,188.6**	4,834.1
Other long-term liabilities and minority interests	**492.6**	427.5
Deferred income taxes	**1,081.9**	1,063.5
Common equity put options	**59.5**	80.3
Shareholders' equity		
Preferred stock, no par value; authorized—165.0 million shares; issued—none		
Common stock, $.01 par value; authorized—3.5 billion shares; issued—1,660.6 million	**16.6**	16.6
Additional paid-in capital	**989.2**	690.9
Guarantee of ESOP Notes	**(148.7)**	(171.3)
Retained earnings	**13,879.6**	12,569.0
Accumulated other comprehensive income	**(522.5)**	(470.5)
Common stock in treasury, at cost; 304.4 and 289.2 million shares	**(4,749.5)**	(3,783.1)
Total shareholders' equity	**9,464.7**	8,851.6
Total liabilities and shareholders' equity	**$19,784.4**	$18,241.5

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

Consolidated Statement of Cash Flows

(In millions) *Years ended December 31,*	**1998**	1997	1996
Operating activities			
Net income	**$ 1,550.1**	$ 1,642.5	$ 1,572.6
Adjustments to reconcile to cash provided by operations			
Depreciation and amortization	**881.1**	793.8	742.9
Deferred income taxes	**35.4**	(1.1)	32.9
Changes in operating working capital items			
Accounts receivable	**(29.9)**	(57.6)	(77.5)
Inventories, prepaid expenses and other current assets	**(18.1)**	(34.5)	(18.7)
Accounts payable	**(12.7)**	52.8	44.5
Taxes and other liabilities	**337.5**	221.9	121.4
Refund of U.S. franchisee security deposits		(109.6)	
Other	**22.9**	(65.9)	42.9
Cash provided by operations	**2,766.3**	2,442.3	2,461.0
Investing activities			
Property and equipment expenditures	**(1,879.3)**	(2,111.2)	(2,375.3)
Purchases of restaurant businesses	**(118.4)**	(113.6)	(137.7)
Sales of restaurant businesses	**149.0**	149.5	198.8
Property sales	**42.5**	26.9	35.5
Other	**(142.0)**	(168.8)	(291.6)
Cash used for investing activities	**(1,948.2)**	(2,217.2)	(2,570.3)
Financing activities			
Net short-term borrowings (repayments)	**(604.2)**	1,097.4	228.8
Long-term financing issuances	**1,461.5**	1,037.9	1,391.8
Long-term financing repayments	**(594.9)**	(1,133.8)	(841.3)
Treasury stock purchases	**(1,089.8)**	(755.1)	(599.9)
Common and preferred stock dividends	**(240.5)**	(247.7)	(232.0)
Series E preferred stock redemption		(358.0)	
Other	**207.6**	145.7	157.0
Cash provided by (used for) financing activities	**(860.3)**	(213.6)	104.4
Cash and equivalents increase (decrease)	**(42.2)**	11.5	(4.9)
Cash and equivalents at beginning of year	**341.4**	329.9	334.8
Cash and equivalents at end of year	**$ 299.2**	$ 341.4	$ 329.9
Supplemental cash flow disclosures			
Interest paid	**$ 406.5**	$ 401.7	$ 369.0
Income taxes paid	**$ 545.9**	$ 650.8	$ 558.1

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
		Shares	Amount					Shares	Amount	
Balance at December 31, 1995	$358.0	1,660.6	$184.6	$295.1	$(214.2)	$ 9,831.3	$ (87.1)	(261.2)	$(2,506.4)	$7,861.3
Net income						1,572.6				1,572.6
Translation adjustments (including taxes of $50.6)							(88.0)			(88.0)
Comprehensive income										1,484.6
Common stock cash dividends ($.15 per share)						(203.3)				(203.3)
Preferred stock cash dividends ($1.93 per Series E depositary share)						(27.6)				(27.6)
Conversion to $.01 par value stock			(168.0)	168.0						
ESOP Notes payment					20.2					20.2
Treasury stock acquisitions								(25.8)	(604.8)	(604.8)
Stock option exercises and other (including tax benefits of $86.4)				102.8	0.8			15.6	84.2	187.8
Balance at December 31, 1996	358.0	1,660.6	16.6	565.9	(193.2)	11,173.0	(175.1)	(271.4)	(3,027.0)	8,718.2
Net income						1,642.5				1,642.5
Translation adjustments (including taxes of $104.0)							(295.4)			(295.4)
Comprehensive income										1,347.1
Common stock cash dividends ($.16 per share)						(221.2)				(221.2)
Preferred stock cash dividends ($1.93 per Series E depositary share)						(25.3)				(25.3)
ESOP Notes payment					21.4					21.4
Treasury stock acquisitions								(32.4)	(765.0)	(765.0)
Common equity put options issuance									(80.3)	(80.3)
Preferred stock redemption	(358.0)									(358.0)
Stock option exercises and other (including tax benefits of $79.2)				125.0	0.5			14.6	89.2	214.7
Balance at December 31, 1997	0.0	1,660.6	16.6	690.9	(171.3)	12,569.0	(470.5)	(289.2)	(3,783.1)	8,851.6
Net income						**1,550.1**				**1,550.1**
Translation adjustments (including tax benefits of $84.2)							**(52.0)**			**(52.0)**
Comprehensive income										**1,498.1**
Common stock cash dividends ($.18 per share)						**(239.5)**				**(239.5)**
ESOP Notes payment					**22.5**					**22.5**
Treasury stock acquisitions								**(38.0)**	**(1,161.9)**	**(1,161.9)**
Common equity put options issuance and expiration, net									**20.8**	**20.8**
Stock option exercises and other (including tax benefits of $154.0)				**298.3**	**0.1**			**22.8**	**174.7**	**473.1**
Balance at December 31, 1998	**$ 0.0**	**1,660.6**	**$ 16.6**	**$989.2**	**$(148.7)**	**$13,879.6**	**$(522.5)**	**(304.4)**	**$(4,749.5)**	**$9,464.7**

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): 1998–$486.3; 1997–$548.7; 1996–$503.3.

Stock-based compensation

The Company accounts for stock options as prescribed by APB Opinion No. 25 and includes pro forma information in the Stock options footnote, as provided 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.

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 interest-rate agreement or the underlying debt being hedged.

The Company purchases foreign currency options (with little or no initial intrinsic value) that 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 and are recorded as nonoperating expense. Any realized gains on exercised options are deferred and recognized in the period in which the related royalty or other payment is received.

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. In addition, forward foreign exchange contracts are used to hedge long-term investments in foreign subsidiaries and affiliates. These contracts are marked to market with the resulting gains or losses recorded in shareholders' equity as other comprehensive income.

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.

In June 1998, the Financial Accounting Standards Board issued SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, which is required to be adopted in years beginning after June 15, 1999. The Statement will require the Company to recognize all derivatives on the balance sheet at fair value. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of derivatives will either be offset against the change in fair value of the hedged item through earnings, or recognized in other comprehensive income until the hedged item is recognized in earnings. The Company expects to adopt the new Statement effective January 1, 2000. Management does not anticipate that the adoption will have a material effect on the Company's results of operations or financial position.

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) of $25.3 million in 1997 and $27.6 million in 1996. The Company retired its remaining Series E Preferred Stock in December 1997. Diluted net income per common share includes the dilutive effect of stock options.

On January 26, 1999, the Board of Directors declared a two-for-one stock split of the Company's common stock, effected in the form of a stock dividend paid on March 5, 1999. As a result of this action, 830.3 million shares were issued to share-

holders of record as of February 12, 1999. Par value of the stock remains at $.01 per share and accordingly, $8.3 million were transferred from additional paid-in capital to common stock. All references to the number of common shares and per common share amounts have been restated to give retroactive effect to the stock split for all periods presented.

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.

Other operating (income) expense

(In millions)	1998	1997	1996
Gains on sales of restaurant businesses	$ (60.7)	$ (59.0)	$ (85.2)
Equity in earnings of unconsolidated affiliates	(88.7)	(72.8)	(76.8)
Net losses from property dispositions	71.1	29.1	41.1
Other	18.1	(10.8)	3.1
Other operating (income) expense	$ (60.2)	$(113.5)	$(117.8)
Made For You costs	$161.6		
Special charges	$160.0		$ 72.0

Other operating (income) expense

Net losses from property dispositions in 1996 included $16.0 million for certain restaurant sites in Mexico, upon the adoption of SFAS No. 121, and in 1998 reflected an increased number of restaurant closings.

Made For You costs

In 1998, the Company announced the introduction of Made For You, a new food preparation system that is expected to be installed in virtually all restaurants in the U.S. and Canada by the end of 1999. As part of the plan to introduce this system, the Company is providing financial incentives of up to $12,500 per restaurant to owner/operators to defray the cost of equipment made obsolete as a result of converting to the new system. The Company also is making additional payments in special cases where the conversion to Made For You is more extensive.

In 1998, the Company incurred $161.6 million in Made For You costs, which primarily consisted of nonrefundable incentive payments made to owner/operators as well as accelerated depreciation on equipment being replaced in Company-operated restaurants.

Special charges

In second quarter 1998, the Company recorded a $160.0 million pre-tax special charge related to the Company's home office productivity initiative. This initiative is designed to improve staff alignment, focus and productivity and reduce ongoing selling, general and administrative expenses. As a result, the Company is reducing home office staffing by approximately 525 positions, consolidating certain home office facilities and reducing other expenditures in a variety of areas. The special charge was comprised of $85.8 million of employee severance and outplacement costs, $40.8 million of lease cancellation and other facilities-related costs, $18.3 million of costs for the write-off of capitalized technology made obsolete as a result of the productivity initiative, and $15.1 million of other cash payments made in 1998. Employee severance is paid in semi-monthly installments over a period of up to one year after termination.

As of December 31, 1998, the Company had reduced home office staffing by approximately 400 positions and expects the remaining positions to be eliminated by year-end 1999. The remaining accrual, primarily related to employee severance, was approximately $105 million at December 31, 1998 and is included in Other accrued liabilities in the Consolidated Balance Sheet. No significant adjustments have been made to the original plan approved by management in second quarter 1998.

In 1996, the Company recorded a $72.0 million pre-tax special charge related primarily to plans to strengthen the U.S. business and reduce ongoing costs by closing certain low-volume U.S. satellite restaurants, outsourcing excess property management and implementing other cost efficiencies. The actions required by this plan were completed in 1997 and resulted in no significant adjustments to the original cost estimate.

Franchise arrangements

Franchise arrangements generally include a lease and a license and provide for payment of initial fees, as well as continuing rent, service fees and royalties to the Company, based upon a percentage 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. Beginning in 1998, franchisees in the U.S. generally have the option to own new restaurant facilities while leasing the land from McDonald's. In addition, franchisees outside the U.S. pay a refundable, noninterest-bearing security deposit. The results of operations 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)	1998	1997	1996
Minimum rents	$1,440.9	$1,369.7	$1,350.7
Percent rent and service fees	2,026.9	1,836.3	1,689.7
Initial fees	58.7	66.3	75.4
Revenues from franchised and affiliated restaurants	$3,526.5	$3,272.3	$3,115.8

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

(In millions)	Owned sites	Leased sites	Total
1999	$ 905.0	$ 670.6	$ 1,575.6
2000	887.8	660.3	1,548.1
2001	872.2	651.6	1,523.8
2002	854.1	638.0	1,492.1
2003	835.8	625.4	1,461.2
Thereafter	7,412.1	5,774.0	13,186.1
Total minimum payments	$11,767.0	$9,019.9	$20,786.9

At December 31, 1998, net property and equipment under franchise arrangements totaled $8.7 billion (including land of

$2.6 billion) after deducting accumulated depreciation and amortization of $2.9 billion.

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): 1998–$526.0; 1997–$470.6; 1996–$419.0.

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.

(In millions)	1998	1997	1996
U.S.	$ 4,868.1	$ 4,602.7	$ 4,590.3
Europe	4,466.7	3,931.5	3,613.8
Asia/Pacific	1,633.2	1,522.8	1,272.8
Latin America	814.7	709.2	595.7
Other	638.7	642.6	613.9
Total revenues	$12,421.4	$11,408.8	$10,686.5
U.S.	$ 432.3	$ 404.0	$ 396.0
Europe	268.0	229.2	213.4
Asia/Pacific	97.3	82.8	66.4
Latin America	42.9	35.4	29.1
Other	40.6	42.4	38.0
Total depreciation and amortization	$ 881.1	$ 793.8	$ 742.9
U.S.	$ 1,043.9(1)	$ 1,210.8	$ 1,144.0(2)
Europe	1,139.8	1,007.2	953.8
Asia/Pacific	351.4	369.1	355.1
Latin America	184.7	166.5	113.7
Other	118.2	116.3	118.0
Corporate	(76.1)	(61.6)	(52.0)
Total operating income	$ 2,761.9(1)	$ 2,808.3	$ 2,632.6(2)
U.S.	$ 7,795.4	$ 7,753.4	$ 7,553.5
Europe	6,932.1	6,005.4	5,925.3
Asia/Pacific	2,659.7	2,125.6	2,111.8
Latin America	1,339.6	1,177.8	900.3
Other	678.7	661.6	622.8
Corporate	378.9	517.7	272.3
Total assets	$19,784.4	$18,241.5	$17,386.0
U.S.	$ 445.5	$ 584.0	$ 882.9
Europe	870.2	929.5	945.8
Asia/Pacific	224.0	277.3	283.1
Latin America	236.8	227.9	172.5
Other	102.8	92.5	91.0
Total capital expenditures	$ 1,879.3	$ 2,111.2	$ 2,375.3

(1) Includes $161.6 million of Made For You costs and $160.0 million special charge related to the home office productivity initiative.

(2) Includes $72.0 million special charge related primarily to plans to strengthen the U.S. business and reduce ongoing costs.

Total long-lived assets, primarily property and equipment and intangibles, were (in millions): Consolidated 1998–$18,244.4; 1997–$16,706.1; 1996–$16,069.8. U.S. 1998–$7,533.2; 1997–$7,530.7; 1996–$7,234.3.

Income taxes

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

(In millions)	1998	1997	1996
U.S. and Corporate	$ 804.3	$1,004.6	$ 933.9
Outside the U.S.	1,503.1	1,402.7	1,317.1
Income before provision for income taxes	$2,307.4	$2,407.3	$2,251.0

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

(In millions)	1998	1997	1996
U.S. federal	$267.8	$336.3	$260.0
U.S. state	71.4	66.0	49.4
Outside the U.S.	382.7	363.6	336.1
Current tax provision	721.9	765.9	645.5
U.S. federal	32.8	2.5	(13.2)
U.S. state	(6.9)	13.5	1.6
Outside the U.S.	9.5	(17.1)	44.5
Deferred tax provision (benefit)	35.4	(1.1)	32.9
Provision for income taxes	$757.3	$764.8	$678.4

Net deferred tax liabilities consisted of:

(In millions)	December 31, 1998	1997
Property and equipment basis differences	$1,121.5	$1,033.1
Other	355.2	426.0
Total deferred tax liabilities	1,476.7	1,459.1
Deferred tax assets before valuation allowance(1)	(561.8)	(493.1)
Valuation allowance	45.5	41.7
Net deferred tax liabilities(2)	$ 960.4	$1,007.7

(1) Includes tax effects of loss carryforwards (in millions): 1998–$67.1; 1997–$51.9 and foreign tax credit carryforwards: 1998–$38.5; 1997–$109.9.

(2) Net of current tax assets included in Prepaid expenses and other current assets in the Consolidated Balance Sheet (in millions): 1998–$121.5; 1997–$55.8.

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

	1998	1997	1996
Statutory U.S. federal income tax rate	35.0%	35.0%	35.0%
State income taxes, net of related federal income tax benefit	1.8	2.1	1.5
Benefits and taxes related to foreign operations	(3.3)	(5.2)	(6.8)
Other–net	(.7)	(.1)	.4
Effective income tax rates	32.8%	31.8%	30.1%

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 $2.2 billion at December 31, 1998, 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 practi-

cable, since such liability, if any, is dependent on circumstances existing if and when remittance occurs.

Debt financing

Line of credit agreements

The Company has several line of credit agreements with various banks: a $975.0 million line expiring on February 27, 2003, 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 a $500.0 million short-term line expiring in the first half of 1999 with fees of .04% per annum on the total commitment. All agreements remained unused at December 31, 1998. 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 $452.4 million at December 31, 1998; 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% at December 31, 1998 and 1997.

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 2008 and relate primarily to the exchange of Deutsche Marks, French Francs, Japanese Yen and British Pounds Sterling. The notional principal is equal to the amount of foreign currency or U.S. Dollar principal exchanged at maturity and is used to calculate interest payments that are exchanged over the life of the transaction. The Company has also entered into interest-rate exchange agreements that expire through 2011 and relate primarily to U.S. Dollars, British Pounds Sterling and Dutch Guilders. The net value of each exchange agreement based on its current spot rate was classified as an asset or liability. Net interest is accrued as either interest receivable or payable, with the offset recorded in 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. The Company's current policy regarding agreements with certain counterparties is to require collateral in the event credit ratings fall below A- or in the event that aggregate exposures exceed limits as defined by contract. At December 31, 1998, no collateral was required of counterparties, nor was the Company required to collateralize any of its obligations.

At December 31, 1998, the Company had purchased foreign currency options outstanding (primarily Deutsche Marks, British Pounds Sterling and French Francs) with a notional amount equivalent to U.S. $115.8 million. The unamortized premium related to these currency options was $2.0 million and there were no related deferred gains recorded as of year end. Forward foreign exchange contracts outstanding at December 31, 1998 (primarily British Pounds Sterling, Hong Kong Dollars and Italian Lira) had a U.S. Dollar equivalent of $1,037.9 million.

Guarantees

The Company has guaranteed and included in total debt at December 31, 1998, $102.9 million of 7.2% ESOP Notes Series A and $56.8 million of 7.1% 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 also has guaranteed certain affiliate loans totaling $285.3 million at December 31, 1998.

Fair values

(In millions)	December 31, 1998 Carrying amount	Fair value
Liabilities		
Debt	$6,249.7	$6,581.8
Notes payable	686.8	686.8
Foreign currency exchange agreements(1)	106.9	120.1
Interest-rate exchange agreements(2)		20.8
Total liabilities	7,043.4	7,409.5
Assets		
Foreign currency exchange agreements(1)	113.4	40.6
Net debt	$6,930.0	$7,368.9

(1) Combined notional amount equivalent to U.S. $2.9 billion.
(2) Notional amount equivalent to U.S. $1.7 billion.

The carrying amounts for cash and equivalents, notes receivable, purchased foreign currency options and 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, notes payable obligations (excluding capital leases) and the currency and interest-rate exchange agreements were estimated using various pricing models or discounted cash flow analyses that incorporated quoted market prices. 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 substantially higher than their carrying value at December 31, 1998.

Debt obligations

The Company has incurred debt obligations 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 1998	Interest rates(1) December 31 1997	Amounts outstanding December 31 1998	Amounts outstanding December 31 1997	Aggregate maturities by currency for 1998 balances 1999	2000	2001	2002	2003	Thereafter
Fixed–original issue(2)		6.9%	7.2%	$ 3,452.6	$ 2,487.6						
Fixed–converted via exchange agreements(3)		6.3	6.1	(2,072.7)	(1,869.7)						
Floating		5.3	5.6	357.2	646.5						
Total U.S. Dollars	1999–2037			1,737.1	1,264.4	$ 235.5	$(210.5)	$(302.5)	$ (61.8)	$ (78.1)	$2,154.5
Fixed		6.2	7.2	1,771.6	1,107.7						
Floating		4.0	4.3	849.9	1,422.1						
Total Euro-based currencies	1999–2007			2,621.5	2,529.8	606.3	467.8	342.1	267.1	311.0	627.2
Fixed		7.7	9.2	529.4	541.2						
Floating		5.6	6.5	212.3	255.3						
Total British Pounds Sterling	1999–2008			741.7	796.5	129.4	91.2		24.9	164.7	331.5
Fixed		7.9	7.8	157.4	120.3						
Floating		2.1	6.0	137.9	107.1						
Total other European currencies(4)	1999–2003			295.3	227.4	165.2	76.0	15.6		38.5	
Fixed		3.8	3.9	387.5	343.6						
Floating		0.5	0.6	322.5	203.0						
Total Japanese Yen	1999–2023			710.0	546.6	53.0	88.4	159.0	79.5	84.8	245.3
Fixed		8.8	9.1	393.2	286.5						
Floating		6.8	7.8	337.6	344.5						
Total other Asia/Pacific currencies(5)	1999–2008			730.8	631.0	582.1	20.1	23.9	25.9	44.4	34.4
Fixed		7.4	9.5	9.3	11.5						
Floating		8.9	4.6	84.3	220.3						
Total other currencies	1999–2021			93.6	231.8	19.5	65.8	0.5	0.4	5.1	2.3
Debt obligations including the net effects of currency and interest-rate exchange agreements				6,930.0	6,227.5	1,791.0	598.8	238.6	336.0	570.4	3,395.2
Short-term obligations supported by long-term line of credit agreement						(975.0)				975.0	
Net asset positions of currency exchange agreements (included in miscellaneous other assets)				113.4	236.0	38.8	11.0	22.1	10.6	9.7	21.2
Total debt obligations				$ 7,043.4	$ 6,463.5	$ 854.8	$ 609.8	$ 260.7	$346.6	$1,555.1	$3,416.4

(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) Primarily consists of Swiss Francs

(5) Primarily consists of Australian Dollars and New Taiwan Dollars

Leasing arrangements

At December 31, 1998, the Company was lessee at 4,734 restaurant locations through ground leases (the Company leases the land and the Company or franchisee owns the building) and at 5,714 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:

(In millions)	Restaurant	Other	Total
1999	$ 570.4	$ 54.8	$ 625.2
2000	553.6	44.4	598.0
2001	539.9	37.5	577.4
2002	519.1	30.6	549.7
2003	494.9	26.5	521.4
Thereafter	4,688.0	152.3	4,840.3
Total minimum payments	$7,365.9	$346.1	$7,712.0

Rent expense was (in millions): 1998–$723.0; 1997–$641.2; 1996–$581.6. These amounts included percent rents in excess of minimum rents (in millions): 1998–$116.7; 1997–$99.4; 1996–$91.4.

Property and equipment

(In millions)	December 31, 1998	1997
Land	$ 3,812.1	$ 3,592.2
Buildings and improvements on owned land	7,665.8	7,289.7
Buildings and improvements on leased land	6,910.4	6,168.3
Equipment, signs and seating	2,728.8	2,345.1
Other	640.9	692.9
	21,758.0	20,088.2
Accumulated depreciation and amortization	(5,716.4)	(5,126.8)
Net property and equipment	$16,041.6	$14,961.4

Depreciation and amortization expense was (in millions): 1998–$808.0; 1997–$726.4; 1996–$673.4.

Employee benefit plans

The Company's benefits program for U.S. employees includes profit sharing, 401(k) (McDESOP) and leveraged employee stock ownership (LESOP) features. McDESOP allows participants to make contributions that 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, McDESOP 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): 1998–$63.3; 1997–$57.6; 1996–$59.9.

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): 1998–$37.5; 1997–$34.1; 1996–$30.6.

Other postretirement benefits and postemployment benefits, excluding severance benefits related to the home office productivity initiative, were immaterial.

Stock options

At December 31, 1998, the Company had three stock option 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 the 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 expire 10 years from the grant date. At December 31, 1998, the number of shares of common stock reserved for issuance under the plans was 187.0 million, including 23.0 million available for future grants.

A summary of the status of the Company's plans as of December 31, 1998, 1997 and 1996, and changes during the years then ended is presented in the following table.

	1998		1997		1996	
Options	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	156.3	$16.79	145.5	$14.73	136.2	$11.93
Granted	33.7	25.90	30.2	23.53	30.0	24.57
Exercised	(22.8)	12.00	(14.6)	9.63	(15.6)	8.88
Forfeited	(3.2)	21.06	(4.8)	17.78	(5.1)	16.16
Outstanding at end of year	164.0	$19.32	156.3	$16.79	145.5	$14.73
Options exercisable at end of year	64.4		60.5		53.3	

Options granted each year were about 2% of average common shares outstanding for 1998, 1997 and 1996, representing grants to approximately 11,500, 11,000 and 10,300 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: 1998–$7.00; 1997–$6.47; 1996–$6.53. 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 resulted in $319.6 million of tax benefits for the Company during the three years ended December 31, 1998.

	December 31, 1998				
	Options outstanding			Options exercisable	
Range of exercise prices	Number of options *(in millions)*	Weighted-average remaining contractual life *(in years)*	Weighted-average exercise price	Number of options *(in millions)*	Weighted-average exercise price
$ 7 to 9	14.3	2.2	$ 7.77	14.3	$ 7.77
10 to 15	44.6	4.6	13.38	26.5	13.14
16 to 23	45.9	7.4	20.45	16.0	19.38
24 to 34	59.2	8.5	25.69	7.6	24.75
$ 7 to 34	164.0	6.6	$19.32	64.4	$14.87

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 No. 123 and are presented in the table below.

	1998	1997	1996
Net income–pro forma *(in millions)*	$1,474.0	$1,589.3	$1,538.3
Net income per common share–pro forma			
Basic	1.08	1.13	1.08
Diluted	1.05	1.11	1.05
Weighted-average fair value per option granted	8.75	8.41	8.44

For pro forma disclosures, the options' estimated fair value was amortized over their expected seven-year life. SFAS No. 123 does not apply to grants before 1995. Therefore, the pro forma disclosures in the table above do not include a full seven years of grants and therefore, may not be indicative of anticipated future disclosures. The fair value for these options was esti-

mated 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:

	1998	1997	1996
Expected dividend yield	.65%	.65%	.65%
Expected stock price volatility	18.0%	18.1%	18.2%
Risk-free interest rate	5.56%	6.61%	6.14%
Expected life of options *(in years)*	7	7	7

Capital stock

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

At December 31, 1997, 1.8 million common equity put options were outstanding, all of which expired unexercised in 1998. In 1998, the Company sold 7.3 million common equity put options, of which 1.0 million options were outstanding at December 31, 1998. The options expire at various dates through February 1999. At December 31, 1998, the $59.5 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 nonvoting Preferred Share Purchase Right (Right) on each outstanding share of common stock. Under certain conditions related to a potential change in control of the Company, each Right entitled certain holders 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. All Rights expired on December 28, 1998.

Quarterly Results

(unaudited)

	Quarters ended December 31		September 30		June 30		March 31	
(In millions, except per share data)	1998	1997	1998	1997	1998	1997	1998	1997
Systemwide sales	$9,316.0	$8,530.4	$9,246.2	$8,799.7	$9,247.6	$8,475.1	$8,169.7	$7,833.1
Revenues								
Sales by Company-operated restaurants	$2,304.5	$2,110.7	$2,305.7	$2,158.5	$2,270.4	$2,014.1	$2,014.3	$1,853.2
Revenues from franchised and affiliated restaurants	916.2	841.9	909.3	847.5	910.4	818.5	790.6	764.4
Total revenues	3,220.7	2,952.6	3,215.0	3,006.0	3,180.8	2,832.6	2,804.9	2,617.6
Company-operated margin	418.2	384.4	437.5	402.4	426.7	374.0	350.9	326.1
Franchised margin	734.8	681.3	737.3	693.6	743.9	667.4	632.5	616.1
Operating income(1)	637.2	695.2	835.2	755.4	646.8(2)	743.5	642.7	614.2
Net income(1)	$ 348.5	$ 410.9	$ 482.2	$ 448.9	$ 357.2(2)	$ 438.2	$ 362.2	$ 344.5
Net income per common share(1)(3)	$ .26	$ .30	$ .35	$ .32	$ .26(2)	$ .31	$ .26	$ .24
Net income per common share—diluted(1)(3)	.25	.29	.34	.31	.25(2)	.30	.26	.24
Dividends per common share(3)	$ .04500	$ .04125	$ .04500	$ .04125	$ .04500	$ .04125	$ .04125	$ .03750
Weighted-average shares(3)	1,354.3	1,375.3	1,362.1	1,377.0	1,372.1	1,379.5	1,372.8	1,383.2
Weighted-average shares—diluted(3)	1,399.1	1,403.6	1,404.7	1,408.9	1,415.1	1,414.6	1,403.9	1,415.0
Market price per common share(3)								
High	$ 39 3/4	$24 13/16	$ 37 1/2	$27 3/8	$ 35	$ 27 7/16	$ 30 1/8	$24 11/16
Low	28 1/8	21 1/16	26 3/4	22 7/8	28 9/16	23 3/8	22 5/16	21 1/4
Close	38 7/16	23 7/8	29 7/8	23 13/16	34 1/2	24 3/16	30	23 5/8

(1) Includes Made For You costs in 1998 of $5.0 million ($3.4 million after tax) in second quarter; $10.6 million ($7.1 million after tax or $0.01 per share) in third quarter; and $146.0 million ($98.6 million after tax or $0.07 per share) in fourth quarter

(2) Includes $160.0 million special charge related to the home office productivity initiative ($110.0 million after tax or $0.08 per share)

(3) Restated for two-for-one stock split in March 1999

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 controls 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 that 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 it maintains 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.

McDONALD'S CORPORATION
January 26, 1999

Audit Committee's Report

The Audit Committee is responsible for overseeing the financial reporting process, financial policies and internal controls on behalf of the Board of Directors. In this regard, it helps to ensure the independence of the Company's auditors, the integrity of management and the adequacy of disclosure to shareholders. Representatives of the internal audit function, independent auditors and financial management each have unrestricted access to the Committee and each periodically meet privately with the Committee.

In conformity with its charter, in 1998, among other things, the Committee recommended the selection of the Company's independent auditors to the Board of Directors; reviewed the scope and fees for the annual audit and the internal audit program; reviewed fees for non-audit services provided by the independent auditors; reviewed the annual financial statements and the results of the annual audit with financial management and the independent auditors; consulted with financial management and the independent auditors regarding risk management; reviewed the adequacy of certain financial policies and internal controls; and reviewed significant legal developments.

The Audit Committee, which met five times during 1998, is comprised of three independent Directors: Gordon C. Gray, Chairman, Walter E. Massey and B. Blair Vedder, Jr. Donald G. Lubin serves as secretary in a non-voting capacity.

AUDIT COMMITTEE OF THE
BOARD OF DIRECTORS
OF McDONALD'S CORPORATION
January 26, 1999

Report of Independent Auditors

The Board of Directors and Shareholders
McDonald's Corporation

We have audited the accompanying consolidated balance sheet of McDonald's Corporation as of December 31, 1998 and 1997, and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 1998. 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, 1998 and 1997, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles.

ERNST & YOUNG LLP
Chicago, Illinois
January 26, 1999