

Analyzing Financial Performance

Consolidated operating results

In this report, all per share amounts have been restated to reflect the two-for-one stock split in March 1999. In addition, all information in constant currencies excludes the effect of foreign currency translation on reported results, except for hyperinflationary economies, such as Russia, whose functional currency is the U.S. dollar.

Operating results

(Dollars in millions, except per share data)	1998		1997		1996
	Amount	% Increase/ (decrease)	Amount	% Increase	Amount
Systemwide sales	\$35,979	7	\$33,638	6	\$31,812
Revenues					
Sales by Company-operated restaurants	\$ 8,895	9	\$ 8,136	7	\$ 7,571
Revenues from franchised and affiliated restaurants	3,526	8	3,273	5	3,116
Total revenues	12,421	9	11,409	7	10,687
Operating costs and expenses					
Company-operated restaurants	7,261	9	6,650	8	6,163
Franchised restaurants	678	10	614	8	570
Selling, general and administrative expenses	1,458	-	1,451	6	1,367
Made For You costs	162	n/m	-	-	-
Special charges	160	n/m	-	n/m	72
Other operating (income) expense	(60)	n/m	(114)	n/m	(118)
Total operating costs and expenses	9,659	12	8,601	7	8,054
Operating income ⁽¹⁾	2,762	(2)	2,808	7	2,633
Interest expense	414	14	364	6	343
Nonoperating (income) expense	41	n/m	37	n/m	39
Income before provision for income taxes ⁽¹⁾	2,307	(4)	2,407	7	2,251
Provision for income taxes ⁽¹⁾	757	(1)	765	13	678
Net income ⁽¹⁾	\$ 1,550	(6)	\$ 1,642	4	\$ 1,573
Net income per common share ⁽¹⁾	\$ 1.14	(3)	\$ 1.17	5	\$ 1.11
Net income per common share-diluted ⁽¹⁾	1.10	(4)	1.15	6	1.08

(1) The 1998 results include \$162 million of Made For You costs and the \$160 million special charge, discussed on page 24, for a pre-tax total of \$322 million (\$219 million after tax or \$0.16 per share). The 1996 results include the \$72 million pre-tax special charge and a \$50 million tax benefit resulting from certain international transactions, discussed on pages 24 and 26.

n/m = not meaningful

Operating results (excluding Made For You costs and special charges)

(Dollars in millions, except per share data)	1998		1997		1996
	Amount	% Increase	Amount	% Increase	Amount
Operating income	\$3,084	10	\$2,808	4	\$2,705
Net income	\$1,769	8	\$1,642	4	\$1,573
Net income per common share	\$ 1.30	11	\$ 1.17	5	\$ 1.11
Net income per common share-diluted	1.26	10	1.15	6	1.08

The spreads between the percent change in net income and net income per common share reflected the positive effects of share repurchases and the absence of preferred dividends in 1998, due to the retirement of our remaining Series E Preferred Stock in December 1997, and lower preferred dividends in 1997 compared with the prior year.

The following table presents the reported and constant currency results for 1998 and 1997, excluding Made For You costs and special charges:

(Dollars in billions, except per share data)	As reported				In constant currency			
	1998		1997		1998		1997	
Systemwide sales	\$36.0	7%	\$33.6	6%	\$37.0	10%	\$35.0	10%
Revenues	12.4	9	11.4	7	12.8	12	11.8	11
Operating income	3.1	10	2.8	4	3.2	12	2.9	8
Net income	1.8	8	1.6	4	1.8	10	1.7	8
Net income per common share	1.30	11	1.17	5	1.33	14	1.21	9
Net income per common share-diluted	1.26	10	1.15	6	1.29	12	1.19	10

Systemwide sales

Systemwide sales include sales by all restaurants, whether operated by the Company, by franchisees or by affiliates operating under joint-venture agreements. Increasing market share through expansion, and customer satisfaction through quality, service, cleanliness and value continue as key strategic initiatives to build sales. Sales increases in 1998 and 1997 were primarily due to restaurant expansion and positive comparable sales (measured on a constant currency basis), partly offset by weaker foreign currencies. At the end of 1998, 86% of Systemwide sales were in the following 11 markets—Australia, Brazil, Canada, England, France, Germany, Hong Kong, Japan, the Netherlands, Taiwan and the U.S. (major markets based on operating income). This is down slightly from 87% in 1997.

Sales increases in the U.S., Europe and Latin America were driven by expansion and positive comparable sales in 1998 and 1997. In the U.S., successful Monopoly, Teenie Beanie

Babies, Get Back With Big Mac and Disney promotions, combined with local market initiatives, contributed to the 1998 increase. In Europe, performances benefited from value campaigns and successful promotions in England, France and Germany. Europe's results were reduced by the difficult economic conditions in Russia in the last half of 1998. In Latin America, Argentina and Brazil accounted for approximately half of this segment's total sales growth in both years, mainly due to expansion.

In Asia/Pacific, sales decreased in 1998 due to weaker foreign currencies and negative comparable sales. Excluding the translation effect of weaker foreign currencies, Japan realized strong sales growth despite experiencing its most difficult economy in decades. In addition, Australia's sales improved due to positive comparable sales in the last half of the year. Difficult economic conditions in Southeast Asia, which began in the latter part of 1997 and continued throughout 1998, negatively impacted consumer spending. In 1997, sales increased primarily due to expansion.

(In millions)	1998	1997	1996	1995	1994
U.S.	\$18,123	\$17,125	\$16,370	\$15,905	\$14,941
Europe	8,909	7,835	7,377	6,685	5,211
Asia/Pacific	5,579	5,616	5,349	4,835	3,795
Latin America	1,761	1,511	1,273	1,129	794
Other	1,607	1,551	1,443	1,360	1,246
Systemwide sales	\$35,979	\$33,638	\$31,812	\$29,914	\$25,987

Sales by Company-operated restaurants grew at a higher rate than Systemwide sales in 1998 and 1997, primarily due to the higher unit growth rate of Company-operated restaurants outside the U.S. relative to Systemwide restaurants. In addition, the weakened Japanese Yen had a significant negative effect on our Japanese affiliate's sales, which reduced Systemwide sales growth.

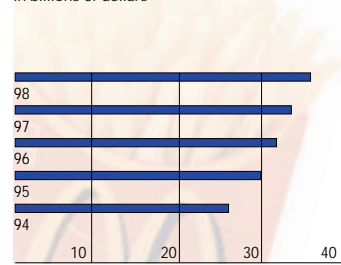
Average annual sales per restaurant⁽¹⁾

(In thousands)	1998	1997	1996
U.S.			
Traditional	\$1,584	\$1,523	\$1,530
Satellite	459	445	425
Outside the U.S.			
Traditional	1,801	1,966	2,262
Satellite	450	457	488

(1) Restaurants in operation at least 13 consecutive months

Average sales are affected by several factors: comparable sales and the size and number of new restaurants. The number of new restaurants affects average sales as new restaurants historically

Systemwide sales
In billions of dollars



have taken a few years to reach long-term volumes. In addition, over the last several years we have opened more restaurants in lower density areas and countries with lower average sales volumes. For these reasons, our focus is primarily on sales-to-investment ratios and building comparable sales, rather than on average sales.

In 1998, positive comparable sales drove the increases in U.S. average annual sales per restaurant. Outside the U.S., foreign currency translation accounted for approximately half of the decreases in average annual sales in both 1998 and 1997. In addition, the significant number of new restaurants outside the U.S. negatively impacted the averages.

Average annual sales per new restaurant⁽¹⁾

(In thousands)	1998	1997	1996
U.S.			
Traditional	\$1,332	\$1,237	\$1,206
Outside the U.S.			
Traditional	1,357	1,431	1,710
Satellite	446	453	517

(1) Restaurants in operation at least 13 months but not more than 25 months

In 1998 and 1997, the increases in sales per new U.S. traditional restaurant were due to a more selective expansion strategy. In addition, in 1998, larger facilities supported higher average sales. The decreases in sales per new restaurant outside the U.S. in 1998 and 1997 were due to foreign currency translation and expansion. Excluding foreign currency translation, the 1998 average annual sales for new international traditional and satellite restaurants increased to \$1,439,000 and \$479,000, respectively. Satellite restaurants generally have significantly lower development costs and sales volumes than traditional restaurants. Average annual sales per new traditional restaurant in major markets outside the U.S., excluding Japan, were approximately \$1.7 million in 1998 and 1997.

Total revenues

Total revenues include sales by Company-operated restaurants and fees from restaurants operated by franchisees and affiliates. These fees include rent, service fees and royalties that are based on a percent of sales with specified minimum payments along with initial fees. Fees vary by type of site and investment by the Company, and also according to local business conditions. These fees, along with occupancy and operating rights, are stipulated in franchise agreements that generally have 20-year terms.

Revenues grow as new restaurants are added and as sales build in existing restaurants. Menu price changes also affect revenues and sales, but it is impractical to quantify their impact because of different pricing structures, new products, promotions and product-mix variations among restaurants and markets.

Revenues increased at a faster rate than Systemwide sales in 1998 and 1997. This was primarily due to the weakened Japanese Yen, which negatively affected sales more than revenues due to our affiliate structure in Japan, and the higher unit growth rate of Company-operated restaurants outside the U.S. relative to Systemwide restaurants.

U.S. revenues increased \$265 million in 1998 and \$13 million in 1997. The increased revenue growth in 1998 was primarily due to strong sales performance for both Company-operated and franchised restaurants driven by positive comparable sales and expansion. Lower initial fees resulting from fewer openings partly offset the increase in revenues. The slower revenue growth in 1997 was primarily because the number of U.S. Company-operated restaurants decreased

compared with the prior year, while the number of franchised and affiliated restaurants increased. Lower initial fees also contributed to the slower revenue growth in 1997.

U.S. operating results

(excluding Made For You costs and special charges)

(In millions)	1998	1997	1996	1995	1994
Revenues					
Sales by Company-operated restaurants	\$2,829	\$2,691	\$2,776	\$2,725	\$2,550
Revenues from franchised and affiliated restaurants	2,039	1,912	1,814	1,749	1,606
Total revenues	4,868	4,603	4,590	4,474	4,156
Operating costs and expenses					
Company-operated restaurants	2,338	2,246	2,317	2,244	2,066
Franchised restaurants	389	361	334	304	270
Selling, general and administrative expenses	750	788	740	682	628
Other operating (income) expense	25	(3)	(17)	(8)	(25)
Total operating costs and expenses⁽¹⁾	3,502	3,392	3,374	3,222	2,939
U.S. operating income⁽¹⁾	\$1,366	\$1,211	\$1,216	\$1,252	\$1,217

(1) The 1998 results exclude \$162 million of Made For You costs and the \$160 million special charge for a pre-tax total of \$322 million. The 1996 results exclude the \$72 million pre-tax special charge.

Europe accounted for 36% of consolidated revenues in 1998 and 34% in 1997. This region's revenues grew \$535 million and \$318 million in 1998 and 1997, respectively. The increases were driven by strong sales in England, France and Germany in 1998 and in England, Italy and Russia in 1997.

Asia/Pacific's revenues grew \$110 million in 1998, compared with growth of \$250 million in 1997. In constant currencies, these increases were \$341 million in 1998 and \$318 million in 1997. Due to an increase in ownership, several affiliate markets were consolidated for financial reporting purposes in 1998. This contributed to the revenue increase. The consolidation of Singapore in 1997, along with Taiwan's strong results, helped to advance 1997 revenues. Difficult economic conditions in South-east Asia, which began in the latter part of 1997 and continued throughout 1998, dampened revenue growth in both years.

Operating results outside the U.S.

(In millions)	1998	1997	1996	1995	1994
Revenues					
Sales by Company-operated restaurants	\$6,066	\$5,445	\$4,795	\$4,139	\$3,242
Revenues from franchised and affiliated restaurants	1,487	1,361	1,301	1,182	923
Total revenues	7,553	6,806	6,096	5,321	4,165
Operating costs and expenses					
Company-operated restaurants	4,923	4,404	3,846	3,304	2,579
Franchised restaurants	289	253	236	211	165
Selling, general and administrative expenses	632	601	574	507	408
Other operating (income) expense	(85)	(111)	(101)	(98)	(59)
Total operating costs and expenses	5,759	5,147	4,555	3,924	3,093
Operating income outside the U.S.	\$1,794	\$1,659	\$1,541	\$1,397	\$1,072

Latin America's revenues grew \$105 million in 1998 and \$114 million in 1997. Growth in both years was primarily due to expansion in Brazil and positive comparable sales for the segment.

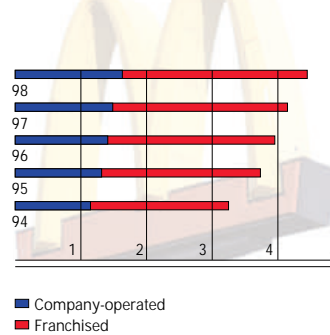
Company-operated margins

Company-operated margin dollars are equal to sales by Company-operated restaurants less the operating costs of these restaurants. Consolidated Company-operated margin dollars increased \$148 million or 10% in 1998 and \$78 million or 6% in 1997. The increases were primarily driven by expansion, partly offset by weaker foreign currencies. In addition, positive comparable sales contributed to the increase in 1998.

Consolidated Company-operated margins were 18.4% of sales in 1998, 18.3% in 1997 and 18.6% in 1996. Operating cost trends as a percent of sales were as follows: food & paper costs decreased in 1998 and increased in 1997; payroll costs were flat in 1998 and decreased in 1997; and occupancy & other operating costs increased in both years.

U.S. Company-operated margins were 17.3% of sales in 1998 and 16.5% in 1997 and 1996. Increased margins as a percent of sales in 1998 were driven by lower food & paper costs related primarily to decreased commodity costs, partly offset by higher payroll costs related to an increase in average hourly rates. Occupancy & other operating costs were flat. U.S.

Combined operating margins
In billions of dollars



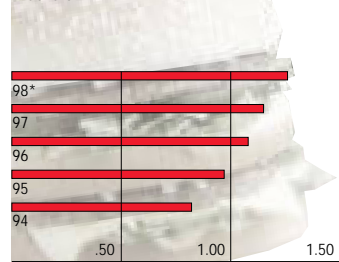
Company-operated margins as a percent of sales in 1997 reflected higher food & paper costs related primarily to the Deluxe Line, lower payroll costs related to labor efficiencies and lower occupancy & other operating costs.

Company-operated margins outside the U.S. were 18.8% of sales in 1998, compared with 19.1% in 1997 and 19.8% in 1996. In 1998, increases in occupancy & other operating costs as a percent of sales were the primary cause of the margin decline as payroll costs and food & paper costs were flat as a percent of sales. The decline in the 1997 margin as a percent of sales was due to increases in food & paper costs as well as occupancy & other operating costs, partly offset by a decrease in payroll costs. Weaker foreign currencies put pressure on margins outside the U.S. in both 1998 and 1997, as food & paper costs were negatively affected in those markets where we imported products.

Franchised margins

Franchised margin dollars are equal to revenues from franchised and affiliated restaurants less the Company's occupancy costs (rent and depreciation) associated with these sites. Franchised margin dollars represented more than 60% of the combined operating margins in both 1998 and 1997. Consolidated franchised margin dollars increased \$189 million or 7% in 1998 and \$113 million or 4% in 1997. The increases were primarily driven by expansion, partly offset by weaker

Net income per common share—diluted
In dollars



*Excludes Made For You costs and special charge.

were 80.6% of revenues in 1998, 81.4% in 1997 and 81.8% in 1996.

The 1998 and 1997 declines reflected a higher proportion of leased sites, and in the U.S. also reflected lower initial fees resulting from fewer openings. By leasing a higher proportion of new sites over the past few years, we have reduced initial capital requirements, but negatively affected franchised margins as a percent of applicable revenues. This is because financing costs implicit in the lease are included in rent expense, which affects these margins; for owned sites, financing costs are reflected in interest expense, which does not affect these margins. Also, our decision to increase our ownership in several affiliate markets in 1998 and 1997 shifted revenues from franchised and affiliated restaurants to Company-operated restaurants, reducing the franchised restaurant margins outside the U.S.

Selling, general and administrative expenses

Consolidated selling, general and administrative expenses were relatively flat in 1998 and decreased to 4.1% of sales from 4.3% of sales in 1997 and 1996. In 1998, U.S. selling, general and administrative expenses decreased primarily due to lower advertising costs and savings realized from the home office productivity initiative, partly offset by higher performance-based incentive compensation. Outside the U.S., selling, general and administrative expenses increased, due to support of restaurant development and to a lesser extent, from the consolidation of several affiliate markets for financial reporting purposes, partly offset by weaker foreign currencies. In 1997, consolidated selling, general and administrative expenses increased primarily due to continued investment in developing countries and the support of special marketing efforts and new food initiatives in the U.S., partly offset by weaker foreign currencies.

As a result of the home office productivity initiative, the Company expects to save about \$100 million of selling, general and administrative expenses per year, beginning in 2000, with about two-thirds of the annual savings expected to be realized by the end of 1999. About \$15 million of these savings were realized in 1998.

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

foreign currencies. In addition, positive comparable sales contributed to the increase in 1998.

Consolidated franchised margins were 80.8% of applicable revenues in 1998, 81.2% in 1997 and 81.7% in 1996. Franchised margins in the U.S. were 80.9% of revenues in 1998, 81.1% in 1997 and 81.6% in 1996. Outside the U.S., franchised margins

installed in virtually all restaurants in the U.S. and Canada by the end of 1999. Through advances in equipment and technology, the new system allows us to serve fresher, better-tasting food at the speed of McDonald's. The system also supports future growth through product development because it can more easily accommodate an expanded menu. 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 is also making additional payments in special cases where the conversion to Made For You is more extensive.

In 1998, the Company incurred \$162 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. The Company expects the total costs related to the implementation of Made For You to approximate \$190 million. The remaining costs are expected to be incurred by the end of 1999, and are comprised of about \$15 million of incentive payments and \$15 million of accelerated depreciation.

Special charges

In second quarter 1998, the Company recorded a \$160 million pre-tax special charge related to the results of 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. No significant adjustments have been made to the original plan approved by management in second quarter 1998. The Company expects to use cash provided by operations to fund the remaining severance payments and other cash costs related to the productivity initiative.

In 1996, the Company recorded a \$72 million pre-tax special charge related primarily to plans to strengthen the U.S. business and reduce ongoing costs by closing 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.

Other operating (income) expense

Other operating (income) expense includes gains on sales of restaurant businesses, equity in earnings of unconsolidated affiliates, net gains or losses from property dispositions and other transactions related to the food service business.

Gains on sales of restaurant businesses include gains from sales of Company-operated restaurants as well as gains from exercises of purchase options by franchisees with business facilities lease arrangements (arrangements where the Company leases the businesses, including equipment, to owner/operators who have options to purchase the businesses). The Company's purchases and sales of businesses with its franchisees and affiliates are aimed at achieving an optimal ownership mix in each market. These transactions are an integral part of our franchising business and resulting gains are recorded in operating income.

Equity in earnings of unconsolidated affiliates—businesses the Company actively participates in, but does not control—is reported after interest expense and income taxes, except for U.S. restaurant partnerships, which are reported before income taxes.

Net gains or losses from property dispositions result from disposals of properties due to restaurant closings, relocations and other transactions.

Other operating (income) expense decreased in 1998, primarily due to higher provisions for property dispositions that reflected an increased number of restaurant closings. These expenses were partly offset by higher gains on sales of restaurant businesses and increased equity in earnings of unconsolidated affiliates, due to strong performances in Japan and the U.S. The slight decline in other operating (income) expense in 1997 was primarily due to lower equity in earnings of unconsolidated affiliates and lower gains on sales of restaurant businesses, partly offset by lower provisions for property dispositions.

Operating income

Excluding Made For You costs and the special charges, operating income increased \$276 million or 10% to \$3.1 billion in 1998, and \$103 million or 4% to \$2.8 billion in 1997. In constant currencies, these increases were 12% in 1998 and 8% in 1997. The increases in 1998 and 1997 were primarily due to higher combined operating margin dollars, partly offset by weaker foreign currencies and lower other operating (income) expense. In addition, higher selling, general and administrative expenses negatively affected the 1997 increase. Including Made For You costs and the special charges, operating income decreased 2% in 1998 and increased 7% in 1997.

Operating income in 1998 and 1997 from the major markets accounted for 92% of total operating income, excluding 1998 Made For You costs and the special charge.

U.S. operating income rose \$155 million or 13% in 1998 and was flat in 1997, excluding Made For You costs and special charges. In 1998, higher U.S. combined operating margin dollars and lower selling, general and administrative expenses were offset in part by lower other operating (income) expense. In 1997, higher U.S. franchised margin dollars were offset by lower Company-operated margin dollars and higher selling, general and administrative expenses. Including Made For You costs and special charges, U.S. operating income decreased \$167 million

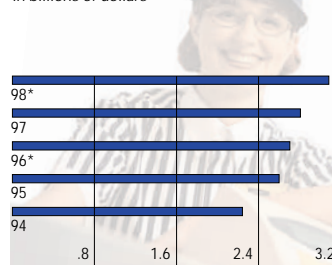
or 14% in 1998 and increased \$67 million or 6% in 1997.

Outside the U.S., operating income rose \$135 million or 8% in 1998 and \$118 million or 8% in 1997. In constant currencies, these increases were 12% in 1998 and 15% in 1997. This growth was driven by higher combined operating margin dollars resulting from expansion in both years and slightly positive comparable sales in 1998. In both years, weaker foreign currencies and higher selling, general and administrative expenses partly offset these increases. In 1998, the Australian Dollar, Brazilian Real, Canadian Dollar, Japanese Yen and Russian Ruble, as well as the Southeast Asian currencies, were the primary currencies negatively affecting results.

Europe accounted for 41% and 36% of consolidated operating income in 1998 and 1997, respectively. Europe's operating income grew \$133 million in 1998 compared with \$54 million

in 1997. Weaker currencies offset this region's operating income increase in 1998 by only 1% or \$6 million, and by 9% or \$82 million in 1997. Strong operating results in England, France, Germany, Italy and Spain drove the increase in operating income in 1998. The region's results were negatively affected by the difficult economic conditions in Russia, which are

Operating income
In billions of dollars



*Excludes Made For You costs and special charges.

expected to continue in 1999. England, France and Germany accounted for 77% of Europe's operating income in both 1998 and 1997.

Asia/Pacific's operating income declined \$18 million in 1998 compared with an increase of \$14 million in 1997. The decline in 1998 was primarily due to weaker foreign currencies. On a constant currency basis, Asia/Pacific's operating income would have increased \$29 million in 1998 and \$38 million in 1997. In 1998, Japan and Hong Kong had strong operating results despite the difficult economic conditions that were experienced by much of the region beginning in the latter part of 1997 and continuing throughout 1998. In addition, this segment benefited in both years from the financial reporting consolidation of several affiliate markets. Australia, Hong Kong, Japan and Taiwan contributed about 90% of Asia/Pacific's operating income in both years.

Latin America's operating income increased \$18 million in 1998 and \$53 million in 1997. Argentina, Brazil and Venezuela led this region's increase in 1998. Continued expansion and positive comparable sales drove improved results across this segment in 1998 and 1997. Brazil accounted for about 70% of Latin America's operating income in both years. The recent economic turmoil in Brazil is expected to negatively impact operating results in 1999. The Latin America segment represented 7% of consolidated operating income in 1998.

Interest expense

Higher average debt levels, partly offset by weaker foreign currencies and lower average interest rates, accounted for the 1998 and 1997 increases in interest expense.

Nonoperating (income) expense

Nonoperating (income) expense includes miscellaneous income and expense items such as interest income and gains and losses related to other investments, financings and translation. Results in 1998 reflected translation losses compared with translation gains in 1997, while in 1997 interest income and translation gains were lower than in 1996.

Provision for income taxes

The effective income tax rate was 32.8% for 1998, compared with 31.8% for 1997 and 30.1% for 1996. A \$50 million tax benefit resulting from certain international transactions was primarily responsible for the unusually low tax rate in 1996. The Company expects its 1999 effective income tax rate to be in the range of 32.5% to 33.5%.

Consolidated net deferred tax liabilities included tax assets, net of valuation allowance, of \$516 million in 1998 and \$451 million in 1997. Substantially all of the tax assets arose in the U.S. and other profitable markets, and a majority of them are expected to be realized in future U.S. income tax returns.

Restaurants

McDonald's continues to focus on managing capital outlays more effectively through prudent and strategic expansion. In 1998, the Company added 1,668 restaurants Systemwide, compared with 2,110 in 1997 and 2,642 in 1996. In 1999, the Company expects to add about 1,750 restaurants, with a continued emphasis on traditional restaurants primarily in locations outside the U.S.

	1998	1997	1996	1995	1994
U.S.	12,472	12,380	12,094	11,368	10,238
Europe	4,421	3,886	3,283	2,595	2,159
Asia/Pacific	5,055	4,456	3,633	2,735	2,168
Latin America	1,405	1,091	837	665	505
Other	1,447	1,319	1,175	1,017	880
Systemwide restaurants	24,800	23,132	21,022	18,380	15,950

The U.S. net additions declined in 1998 and 1997, primarily due to the closing of low-volume satellite locations and a more stringent restaurant selection process.

Asia/Pacific's percent of total restaurants has grown primarily due to Japan's significant expansion. Japan added 415 restaurants in 1998, 433 in 1997 and 522 in 1996, representing 25% of Systemwide restaurant additions in 1998 and about 20% in 1997 and 1996. Approximately 60% of Japan's restaurant additions in 1998 and 1997, and about 70% in 1996, were satellites. Therefore, these additions affected unit growth more than sales growth.

At the end of 1998, 84% of Systemwide restaurants were in the major markets, compared with 85% in 1997. In 1998, 65% of restaurant additions were in these major markets, and we anticipate a similar percent for 1999. Longer term, markets like China, Italy and Mexico are expected to represent a growing proportion of restaurant additions.

More than 75% of Company-operated restaurants and more than 85% of franchised restaurants were located in the major markets in 1998. Franchisees and affiliates operated 78% of

restaurants at year-end 1998. That percentage has remained relatively constant over the past three years.

Financial position and capital resources

Total assets and capital expenditures

Total assets grew \$1.5 billion or 8% in 1998 and \$856 million or 5% in 1997. In 1998 and 1997, about 80% of consolidated assets were located in our major markets excluding our affiliate in Japan. Net property and equipment rose \$1.1 billion in 1998 and represented 81% of total assets at year end.

Capital expenditures decreased \$232 million or 11% in 1998 and decreased \$264 million or 11% in 1997, reflecting fewer restaurant additions, the new building program in the U.S. in 1998 that gave owner/operators the option to own new restaurant facilities, and more leased sites, combined with weaker foreign currencies.

U.S. capital expenditures declined \$139 million or 24% in 1998 and declined \$300 million or 34% in 1997, primarily due to a more selective expansion strategy and the new building program. About 70% of the qualifying new traditional restaurant buildings opened in 1998 are owned by owner/operators. In addition, the Company leased the land for over 90% of the new traditional restaurants opened in the U.S. in 1998. These programs saved the Company approximately \$155 million in capital outlays in 1998.

Capital expenditures outside the U.S. decreased \$93 million or 6%, due to fewer restaurant additions and weaker foreign currencies in 1998. Capital expenditures outside the U.S. increased slightly in 1997.

In 1998, 76% of capital expenditures was invested in markets outside the U.S., compared with 72% in 1997 and 63% in 1996. Approximately 70% was invested in our major markets excluding Japan in 1998, compared with 73% in 1997 and 78% in 1996.

(In millions)	1998	1997	1996	1995	1994
New restaurants	\$ 1,357	\$ 1,531	\$ 1,799	\$ 1,550	\$ 1,181
Existing restaurants	398	433	350	355	211
Other properties	124	147	226	159	147
Capital expenditures	\$ 1,879	\$ 2,111	\$ 2,375	\$ 2,064	\$ 1,539
Total assets	\$19,784	\$18,242	\$17,386	\$15,415	\$13,592

Expenditures for existing restaurants were made to achieve higher levels of customer satisfaction, including technology to improve service and food quality, and to enhance older facilities. Other properties primarily included expenditures for office buildings and related computer equipment and furnishings.

The Company's expenditures for new restaurants in the U.S. were minimal as a result of the programs previously discussed. However, we continue to focus on the System's average development costs (land, building and equipment) to ensure an appropriate return on investment for the System. Average development costs for the U.S. System were \$1.4 million in 1998 and \$1.3 million in 1997. The increase was primarily due to the construction of larger facilities to support higher average sales volumes.

Average development costs for traditional restaurants in our major markets outside the U.S., excluding Japan, were approximately \$1.8 million in both 1998 and 1997. Average development costs vary widely by market depending on the types of restaurants built and the real estate and construction costs within each market. These costs are managed through the use of right-sized restaurants, construction and design efficiencies, standardization and global sourcing. Average development costs for satellite restaurants located in Brazil, Canada and Japan, which comprise over 90% of all satellites outside the U.S., were approximately \$200,000 in both years. The utilization of these small, often limited-menu restaurants has allowed expansion into areas that would otherwise not have been feasible.

Including affiliates, total land ownership was 44% and 45% of total restaurant sites at year-end 1998 and 1997, respectively.

Capital expenditures by affiliates, which were not included in consolidated amounts, were approximately \$295 million in 1998, compared with \$360 million in 1997. The decrease was primarily due to increased ownership in the Philippines, South Korea and Thailand, which converted them from affiliates to majority-owned subsidiaries in 1998, and to a lesser extent, weaker foreign currencies.

Cash provided by operations

The Company generates significant cash from operations and has substantial borrowing capacity to meet its operating and discretionary spending requirements. Free cash flow (cash from operations less capital expenditures) grew to \$887 million in 1998, compared with \$331 million in 1997. Cash provided by operations was reduced by approximately \$135 million of Made For You incentive payments made in 1998 and \$110 million of U.S. franchisee security deposit refunds in 1997. Cash provided by operations, along with other sources of cash such as borrowings, was used for capital expenditures, share repurchase, dividends and debt repayments. The Company generated positive free cash flow in 1998 for the eighth consecutive year. This trend is expected to continue. In 1998, operations outside the U.S. generated positive free cash flow for the first time in our history, and this is expected to continue into the foreseeable future.

<i>(Dollars in millions)</i>	1998	1997	1996	1995	1994
Cash provided by operations	\$2,766	\$2,442	\$2,461	\$2,296	\$1,926
Free cash flow	887	331	86	232	387
Cash provided by operations as a percent of capital expenditures	147%	116%	104%	111%	125%
Cash provided by operations as a percent of average total debt	41	41	48	49	48

In addition to its free cash flow, the Company can meet short-term needs through commercial paper borrowings and line of credit agreements. Accordingly, the Company strategically maintains a relatively low current ratio — .52 at year-end 1998.

Financings and market risk

The Company is exposed to the impact of interest-rate changes and foreign currency fluctuations. McDonald's strives to minimize these risks by financing with debt in the currencies in which assets are denominated and employing established policies and procedures to manage this exposure. See Summary of significant accounting policies on page 37 for additional information regarding our use of financial instruments and the impact of the new accounting standard on derivatives.

The Company uses major capital markets and various techniques to meet its financing requirements and reduce interest expense. For example, currency exchange agreements in conjunction with borrowings help obtain desired currencies at attractive rates and maturities. Interest-rate exchange agreements effectively convert fixed-rate to floating-rate debt, or vice versa. The Company also manages the level of fixed-rate debt to take advantage of changes in interest rates.

The Company uses foreign currency debt and derivatives to hedge intercompany financings and long-term investments in foreign subsidiaries and affiliates. This reduces the impact of fluctuating foreign currencies on net income and shareholders' equity. Total foreign-denominated debt, including the effects of currency exchange agreements, was \$5.2 billion and \$5.0 billion at year-end 1998 and 1997, respectively.

<i>(As a percent)</i>	1998	1997	1996	1995	1994
Fixed-rate debt as a percent of total debt	67%	49%	68%	67%	64%
Weighted-average annual interest rate of total debt	6.6	6.8	7.1	7.9	8.4
Foreign currency-denominated debt as a percent of total debt	75	80	90	89	92
Total debt as a percent of total capitalization (total debt and total shareholders' equity)	43	42	39	38	39

Moody's and Standard & Poor's have rated McDonald's debt Aa2 and AA, respectively, since 1982. Duff & Phelps began rating the debt in 1990 and currently rates it AA+. These strong ratings are important to the Company because of global development plans. The Company has not experienced, nor does it expect to experience, difficulty in obtaining financing or refinancing existing debt. At year-end 1998, the Company and its subsidiaries had \$1.5 billion available under committed line of credit agreements, \$1.0 billion under a Euro medium-term note program and \$.9 billion under shelf registrations for future debt issuance.

The Company manages its debt portfolio in response to changes in interest rates and foreign currency rates by periodically retiring, redeeming and repurchasing debt; terminating exchange agreements; and using derivatives. Gains of approximately \$24 million, related to the early termination of interest-rate exchange agreements in 1998, were deferred and are being amortized as an adjustment to interest expense over various periods through 2002. The Company does not use derivatives with a level of complexity or with a risk higher than the exposures to be hedged and does not hold or issue derivatives for trading purposes. All exchange agreements are over-the-counter instruments.

The Company actively hedges selected currencies to minimize the effect of fluctuating foreign currencies on reported results and to minimize the cash exposure of foreign currency royalty and other payments received in the U.S. In addition, where practical, McDonald's restaurants purchase goods and services in local currencies resulting in natural hedges, and the Company typically finances in local currencies, creating economic hedges.

The Company's exposure is diversified among a broad basket of currencies. At year-end 1998 and 1997, assets in hyperinflationary markets were principally financed in U.S. Dollars. The Company's largest net asset exposures (defined as foreign currency assets less foreign currency liabilities) were as follows:

<i>(In millions of U.S. Dollars)</i>	December 31, 1998	1997
Canadian Dollars	\$749	\$528
Deutsche Marks	456	88
British Pounds Sterling	447	590
Australian Dollars	322	298
Brazilian Reals	302	281
French Francs	196	194
Austrian Schillings	116	91
Japanese Yen	116	37

The Company prepared sensitivity analyses of its financial instruments to determine the impact of hypothetical changes in interest rates and foreign currency exchange rates on the Company's results of operations, cash flows and the fair value of its financial instruments. The interest-rate analysis assumed a one percentage point adverse change in interest rates on all financial instruments but did not consider the effects of the reduced level of economic activity that could exist in such an environment. The foreign currency rate analysis assumed that each foreign currency rate would change by 10% in the same direction relative to the U.S. Dollar on all financial instruments; however, the analysis did not include the potential impact on sales levels or local currency prices or the effect of fluctuating currencies on the Company's anticipated foreign currency royalties and other payments received in the U.S. Based on the results of these analyses of the Company's financial instruments, neither a one percentage point adverse change in interest rates from year-end 1998 levels nor a 10% adverse change in foreign currency rates from year-end 1998 levels would materially affect the Company's results of operations, cash flows or the fair value of its financial instruments.

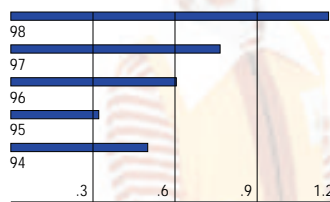
Total shareholders' equity

Total shareholders' equity rose \$613 million or 7% in 1998, and represented 48% of total assets at year end. Weaker foreign currencies decreased shareholders' equity by \$52 million in 1998.

The Company uses free cash flow and debt capacity to repurchase shares because we believe this enhances shareholder value. Over the past 10 years, the Company has invested \$4.8 billion to buy back 306 million shares at an average price of approximately \$16, while maintaining a strong equity base. At year-end 1998, the Company held 304 million shares in treasury with a market value of \$11.7 billion.

In September 1998, the Company announced plans to

Share repurchases
In billions of dollars



repurchase \$3.5 billion of its common stock by year-end 2001. During the third quarter 1998, the Company completed its \$2 billion, three-year share repurchase program begun in 1996. In 1998, the Company repurchased a total of 38 million shares for nearly \$1.2 billion, \$320 million of which related to the new \$3.5 billion program. The

Company uses common equity put options in connection with its share repurchase program. In 1998, the Company sold 7.3 million common equity put options, of which 1.0 million options were outstanding at December 31, 1998. These options expired unexercised in February 1999.

Given the Company's returns on equity and assets, management believes it is prudent to reinvest a significant portion of earnings back into the business and use free cash flow for share repurchase. Accordingly, the common stock dividend yield is modest. However, the Company has paid 92 consecutive quarterly dividends on common stock through first quarter 1999 and has increased the dividend amount at least once every year. Additional dividend increases will be considered after reviewing returns to shareholders, profitability expectations and financing needs.

Returns

Operating income is used to compute return on average assets, while net income less preferred stock dividends (net of tax) is used to calculate return on average common equity. Month-end balances are used to compute both average assets and average common equity.

<i>(As a percent)</i>	1998	1997	1996	1995	1994
Return on average assets ⁽¹⁾	16.4%	16.0%	16.8%	17.9%	17.6%
Return on average common equity ⁽¹⁾	19.5	19.0	19.5	19.9	19.4

(1) Computed excluding Made For You costs and special charges. Including Made For You costs and special charges, return on average assets was 14.7% in 1998 and 16.3% in 1996; return on average common equity was 17.1% in 1998.

The increases in the 1998 returns are due to strong operating results, enhanced by the Company's continued focus on more efficient capital deployment. This included the closing of a number of low-volume satellite restaurants, a more stringent site selection process, the new building program in the U.S. and the use of free cash flow for share repurchase.

Other matters

Effects of changing prices — inflation

The Company has demonstrated an ability to manage inflationary cost increases effectively. This is because of rapid inventory turnover, the ability to adjust prices, cost controls and substantial property holdings — many of which are at fixed costs and partly financed by debt made cheaper by inflation. In hyperinflationary markets, menu board prices are typi-

cally adjusted to keep pace with inflation, mitigating the effect on reported results.

Year 2000

The Company has assessed its computerized systems to determine their ability to correctly identify the Year 2000 and is devoting the necessary internal and external resources to replace, upgrade or modify all significant systems which do not correctly identify the Year 2000. Substantially all necessary modifications and testing of the Company's significant systems have been completed. The last necessary replacement of a significant system is expected to be completed in third quarter 1999.

In addition, the Company has determined the extent to which its operations may be affected by the compliance efforts of its significant suppliers and is taking the necessary steps to minimize potential problems. The Company has implemented a Systemwide supply chain compliance monitoring program, which encompasses supplier risk assessment and compliance validation for significant suppliers.

Management does not expect Year 2000 issues relating to internal systems and suppliers to pose significant operational or financial difficulties for the Company; however, in the unlikely event McDonald's or a significant number of its key suppliers are unable to resolve an issue in a timely manner, such matters could have a material impact on the Company's results of operations. In addition, failures related to Year 2000 issues by providers of infrastructure services could have a material adverse effect on results of operations. Contingency plans are being developed, to the extent feasible, to address unexpected Year 2000 issues that might arise either internally, within the supply chain or by infrastructure service providers. These plans are expected to be completed well before the end of 1999.

Modification and testing costs are expensed as incurred, while the costs of new systems are capitalized. The Company expects its total costs related to modification and testing as well as costs associated with supply chain risk assessment and contingency planning to be less than \$35 million, of which approximately \$23 million was incurred through December 31, 1998. In addition, the Company expects to capitalize approximately \$55 million of costs for ongoing development of significant new systems that are replacing non-Year 2000 compliant systems. About \$40 million of these costs were capitalized at December 31, 1998. The total Year 2000 costs have not and are not expected to have a material adverse impact on the Company's financial position, results of operations or cash flows.

All Year 2000 statements contained herein are designated as "Year 2000 Readiness Disclosures" pursuant to the Year 2000 Information and Readiness Disclosure Act of 1998.

Euro conversion

On January 1, 1999, 11 member countries of the European Union established fixed conversion rates between their existing currencies ("legacy currencies") and one common currency, the Euro. The Euro is now trading on currency exchanges and may be used in certain transactions such as electronic payments. Beginning in January 2002, new Euro-denominated notes and coins will be issued, and legacy currencies will be withdrawn

from circulation. The conversion to the Euro has eliminated currency exchange rate risk for transactions between the member countries, which for the Company, primarily consist of payments to suppliers. In addition, as the Company uses foreign-denominated debt and derivatives to meet its financing requirements and to minimize its foreign currency risks, certain of these financial instruments will be redenominated into Euros.

The Company has restaurants located in all member countries and has been preparing for the introduction of the Euro for the past several years. The Company is currently addressing the issues involved with the new currency, which include converting information technology systems, recalculating currency risk, recalibrating derivatives and other financial instruments and revising processes for preparing accounting and taxation records. Based on the work to date, the Company does not believe the Euro conversion will have a significant impact on the Company's financial position, results of operations or cash flows.

Forward-looking statements

Certain forward-looking statements are included in this report. They use such words as "may," "will," "expect," "believe," "plan" and other similar terminology. These statements reflect management's current expectations and involve a number of risks and uncertainties. Actual results could differ materially due to the success of operating initiatives, advertising and promotional efforts, Year 2000 compliance efforts and Euro conversion efforts, as well as changes in: global and local business and economic conditions; currency exchange and interest rates; food, labor and other operating costs; political or economic instability in local markets; competition; consumer preferences, spending patterns and demographic trends; availability and cost of land and construction; legislation and governmental regulation; and accounting policies and practices.

