2001 Financial Information

11-year summary

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* Management's discussion and analysis is excerpted from our 2001 Annual Report on Form 10-K, as filed with the Securities and Exchange Commission on March 25, 2002.

CAUTION: CONTENTS HOT!

DOLLARS IN MILLIONS, EXCEPT PER SHARE DATA	**2001**	2000	1999	1998	1997	1996	1995	1994	1993	1992	1991
Franchised sales	**$24,838**	24,463	23,830	22,330	20,863	19,969	19,123	17,146	15,756	14,474	12,959
Company-operated sales	**$11,040**	10,467	9,512	8,895	8,136	7,571	6,863	5,793	5,157	5,103	4,908
Affiliated sales	**$ 4,752**	5,251	5,149	4,754	4,639	4,272	3,928	3,048	2,674	2,308	2,061
Total Systemwide sales	**$40,630**	40,181	38,491	35,979	33,638	31,812	29,914	25,987	23,587	21,885	19,928
Total revenues	**$14,870**	14,243	13,259	12,421	11,409	10,687	9,795	8,321	7,408	7,133	6,695
Operating income	**$ 2,697**(1)	3,330	3,320	2,762(3)	2,808	2,633	2,601	2,241	1,984	1,862	1,679
Income before taxes	**$ 2,330**(2)	2,882	2,884	2,307(3)	2,407	2,251	2,169	1,887	1,676	1,448	1,299
Net income	**$ 1,637**(2)	1,977	1,948	1,550(3)	1,642	1,573	1,427	1,224	1,083	959	860
Cash provided by operations	**$ 2,688**	2,751	3,009	2,766	2,442	2,461	2,296	1,926	1,680	1,426	1,423
Capital expenditures	**$ 1,906**	1,945	1,868	1,879	2,111	2,375	2,064	1,539	1,317	1,087	1,129
Free cash flow	**$ 782**	806	1,141	887	331	86	232	387	363	339	294
Treasury stock purchases	**$ 1,090**	2,002	933	1,162	765	605	321	500	628	92	117
Financial position at year end											
Total assets	**$22,535**	21,684	20,983	19,784	18,242	17,386	15,415	13,592	12,035	11,681	11,349
Total debt	**$ 8,918**	8,474	7,252	7,043	6,463	5,523	4,836	4,351	3,713	3,857	4,615
Total shareholders' equity	**$ 9,488**	9,204	9,639	9,465	8,852	8,718	7,861	6,885	6,274	5,892	4,835
Shares outstanding *IN MILLIONS*	**1,280.7**	1,304.9	1,350.8	1,356.2	1,371.4	1,389.2	1,399.5	1,387.4	1,414.7	1,454.1	1,434.5
Per common share											
Net income	**$ 1.27**(2)	1.49	1.44	1.14(3)	1.17	1.11	.99	.84	.73	.65	.59
Net income–diluted	**$ 1.25**(2)	1.46	1.39	1.10(3)	1.15	1.08	.97	.82	.71	.63	.57
Dividends declared	**$ .23**	.22	.20	.18	.16	.15	.13	.12	.11	.10	.09
Market price at year end	**$ 26.47**	34.00	40.31	38.41	23.88	22.69	22.56	14.63	14.25	12.19	9.50
Franchised restaurants	**17,395**	16,795	15,949	15,086	14,197	13,374	12,186	10,944	9,918	9,237	8,735
Company-operated restaurants	**8,378**	7,652	6,059	5,433	4,887	4,294	3,783	3,216	2,733	2,551	2,547
Affiliated restaurants	**4,320**	4,260	4,301	3,994	3,844	3,216	2,330	1,739	1,476	1,305	1,136
Total Systemwide restaurants	**30,093**	28,707	26,309	24,513	22,928	20,884	18,299	15,899	14,127	13,093	12,418

(1) Includes $378 million of pretax special operating charges primarily related to the U.S. business reorganization and other global change initiatives, and the closing of 163 underperforming restaurants in international markets discussed on page 29.

(2) Includes the $378 million of pretax special operating charges noted above and $125 million of net pretax special nonoperating income items primarily related to a gain on the initial public offering of McDonald's Japan, for a net pretax expense of $253 million ($143 million after tax or $0.11 per share). Net income also reflects an effective tax rate of 29.8 percent, primarily due to the one-time benefit of tax law changes in certain international markets ($147 million). See page 29 for further details.

(3) Includes $162 million of Made For You costs and the $160 million special charge related to the home office productivity initiative for a pretax total of $322 million ($219 million after tax or $0.16 per share).

Management's discussion and analysis of financial condition and results of operations

Nature of business

The Company operates in the food service industry and primarily operates quick-service restaurant businesses under the McDonald's brand. Approximately 80% of McDonald's restaurants and more than 80% of the Systemwide sales of McDonald's restaurants are in eight markets: Australia, Brazil, Canada, France, Germany, Japan, the United Kingdom and the United States. Throughout this discussion, McDonald's restaurant businesses in these eight markets collectively are referred to as "major markets."

To capture additional meal occasions, the Company also operates other restaurant concepts under its Partner Brands: Aroma Café, Boston Market, Chipotle and Donatos Pizzeria. In addition, the Company has a minority ownership in Pret A Manger. In fourth quarter of 2001, the Company approved a plan to dispose of its Aroma Café business in the U.K., and expects to complete the sale in the first half of 2002.

The segments presented in all tables and related discussion reflect the Company's current management structure. Previously, McDonald's restaurant operations in Canada, the Middle East and Africa, as well as the Partner Brands were included in the Other segment. The new APMEA segment includes results for McDonald's restaurant operations in Asia/Pacific, the Middle East and Africa, while Canada and the Partner Brands are now presented as individual operating segments. In addition, U.S. and Corporate selling, general & administrative expenses reflect a realignment of certain home office departments' responsibilities, for all years presented.

Consolidated operating results

Operating results

DOLLARS IN MILLIONS, EXCEPT PER SHARE DATA	**2001**		2000		1999
	Amount	Increase/(decrease)	Amount	Increase/(decrease)	Amount
Systemwide sales	**$40,630**	**1%**	$40,181	4%	$38,491
Revenues					
Sales by Company-operated restaurants	**$11,041**	**5%**	$10,467	10%	$ 9,512
Revenues from franchised and affiliated restaurants	**3,829**	**1**	3,776	1	3,747
Total revenues	**14,870**	**4**	14,243	7	13,259
Operating costs and expenses					
Company-operated restaurants	**9,454**	**8**	8,750	12	7,829
Franchised restaurants	**800**	**4**	772	5	738
Selling, general & administrative expenses	**1,662**	**5**	1,587	7	1,477
Special charge–global change initiatives	**200**	**nm**	–	–	–
Other operating (income) expense, net	**57**	**nm**	(196)	nm	(105)
Total operating costs and expenses	**12,173**	**12**	10,913	10	9,939
Operating income	**2,697**	**(19)**	3,330	–	3,320
Interest expense	**452**	**5**	430	8	396
McDonald's Japan IPO gain	**(137)**	**nm**	–	–	–
Nonoperating expense, net	**52**	**nm**	18	nm	40
Income before provision for income taxes	**2,330**	**(19)**	2,882	–	2,884
Provision for income taxes	**693**	**(23)**	905	(3)	936
Net income	**$ 1,637**	**(17)%**	$ 1,977	2%	$ 1,948
Net income per common share	**$ 1.27**	**(15)%**	$ 1.49	3%	$ 1.44
Net income per common share–diluted	**1.25**	**(14)**	1.46	5	1.39

nm Not meaningful.

The following table presents the 2001 growth rates for reported results, results adjusted for the special items noted below, and the adjusted results on a constant currency basis. In addition, the table includes the 2000 growth rates for reported and constant currency results. 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. Constant currency results are calculated by translating the current year results at prior year monthly average exchange rates.

Key highlights

	2001 Increase (decrease)			2000 Increase	
	As reported(1)	Adjusted(2)	Adjusted constant currency(2,3)	As reported	Constant currency(3)
Systemwide sales	**1%**	**1%**	**4%**	4%	7%
Revenues	**4**	**4**	**8**	7	12
Operating income	**(19)**	**(8)**	**(5)**	–	5
Net income	**(17)**	**(10)**	**(8)**	2	6
Net income per common share	**(15)**	**(7)**	**(5)**	3	8
Net income per common share–diluted	**(14)**	**(7)**	**(5)**	5	10

(1) The reported effective tax rate was 29.8%, primarily due to the one-time benefit of tax law changes in certain international markets ($147 million).

(2) Adjusted operating income of $3.1 billion and adjusted net income of $1.8 billion exclude the following special items:

Operating income:

- *$200 million of charges ($136 million after tax) related to the U.S. business reorganization and other global change initiatives discussed on page 33.*
- *$91 million of charges ($69 million after tax) related to the closing of 163 underperforming restaurants in international markets.*
- *$25 million of charges ($17 million after tax) primarily related to unrecoverable costs incurred in connection with the theft of promotional game pieces and the related termination of a supplier discussed on page 34.*
- *$24 million asset impairment charge (pre and after tax) in Turkey.*
- *$20 million charge ($14 million after tax) related to the anticipated disposition of Aroma Café in the U.K.*
- *$18 million of charges ($12 million after tax) primarily related to the write-off of certain technology costs.*

Nonoperating income:

- *$137 million gain (pre and after tax) on the initial public offering of McDonald's Japan.*
- *$12 million of charges ($8 million after tax) primarily related to the write-off of a corporate investment.*

(3) Excludes the effect of foreign currency translation on reported results.

The primary currencies negatively affecting reported results in 2001 and 2000 were the Euro, which is the currency in 12 of our European markets including France and Germany, the British Pound and the Australian Dollar. In addition, the Japanese Yen and Canadian Dollar negatively impacted reported results in 2001, while the Japanese Yen positively impacted reported results in 2000.

SYSTEMWIDE SALES

Systemwide sales include sales by all restaurants, whether operated by the Company, by franchisees or by affiliates operating under joint-venture agreements. We continue to focus on growing market share by increasing comparable sales with an emphasis on improving customer satisfaction through Quality, Service, Cleanliness and Value as well as strategic restaurant development. Restaurant expansion, partly offset by negative comparable sales, drove the constant currency sales increase in 2001, while restaurant expansion along with positive comparable sales drove the increase in 2000.

Systemwide sales

	2001			2000			1999
		Increase/(decrease)			Increase/(decrease)		
DOLLARS IN MILLIONS	Amount	As reported	Constant currency(1)	Amount	As reported	Constant currency(1)	Amount
U.S.	**$20,051**	**2%**	**na**	$19,573	3%	na	$19,006
Europe	**9,412**	**1**	**5%**	9,293	(3)	9%	9,557
APMEA	**7,010**	**(6)**	**3**	7,477	10	9	6,826
Latin America	**1,733**	**(3)**	**6**	1,790	7	9	1,665
Canada	**1,447**	**–**	**5**	1,443	7	7	1,346
Partner Brands	**977**	**61**	**62**	605	nm	nm	91
Total	**$40,630**	**1%**	**4%**	$40,181	4%	7%	$38,491

(1) Excludes the effect of foreign currency translation on reported results.
na Not applicable.
nm Not meaningful.

In all segments, the constant currency sales increases in 2001 and 2000 were primarily driven by expansion.

In the U.S., comparable sales were slightly positive in 2001 and positive in 2000. The introduction of the New Tastes Menu in early 2001 and successful promotions and new product introductions in 2000, combined with local market initiatives in both years, contributed to the increases.

In Europe, comparable sales were negative in 2001 and positive in 2000. The primary contributors to Europe's constant currency sales growth in both years were France and the U.K. In addition, the Netherlands and Russia delivered strong performances in 2001, while results in 2000 also benefited from increases in Germany, Italy and Spain. Despite the Company's outstanding quality and safety record, Europe's results in both years were negatively impacted by consumer confidence issues regarding the European beef supply. However, the impact lessened as we progressed through 2001, and we do not expect the negative impact from these issues to be significant going forward.

In APMEA, comparable sales were negative in 2001 and slightly negative in 2000. Sales in 2001 were impacted by weak economic conditions in Japan, Taiwan and Turkey and weak consumer spending in Australia, which also impacted the second half of 2000. Beginning in the fourth quarter of 2001, sales were also dampened by consumer confidence issues regarding the Japanese beef supply,

despite the fact that McDonald's Japan does not use Japanese beef. Although we are proactively communicating our strong beef safety and quality messages, we expect Japan's results in the near term to continue to be negatively affected by these consumer concerns. Positive comparable sales in China contributed to this segment's total constant currency sales increases in both years.

In Latin America, comparable sales were negative in 2001 and 2000 as weak economic conditions affected most markets in this segment. Positive comparable sales in Mexico and Venezuela helped drive this segment's total constant currency sales increases in both years.

We expect the weak economic conditions in many Asian, Middle Eastern and Latin American markets to continue in the near term.

In Canada, comparable sales were positive in 2001 and 2000. Canada's value program combined with drive-thru initiatives, extended hours and new product introductions drove the increases in both years.

The sales increases in the Partner Brands in 2001 and 2000 were primarily due to the acquisition of Boston Market in second quarter 2000. Expansion of Chipotle along with strong comparable sales at Chipotle and Boston Market also helped drive the increases in both years.

Average annual sales—McDonald's restaurants

	2001		2000		1999
		Increase/ (decrease)		Increase/ (decrease)	
DOLLARS IN THOUSANDS	Amount	Constant currency(2)	Amount	Constant currency(2)	Amount
Per restaurant(1)					
Traditional:					
U.S.	**$1,650**	**–**	$1,647	1%	$1,625
Europe	**1,722**	**(4)%**	1,851	(2)	2,130
APMEA	**1,190**	**(5)**	1,376	(2)	1,411
Latin America	**1,154**	**(5)**	1,333	(7)	1,464
Canada	**1,469**	**–**	1,530	6	1,451
Satellite:					
U.S.	**$ 546**	**2%**	$ 536	9%	$ 490
Outside the U.S.(3)	**533**	**(1)**	598	2	561
Per new restaurant(4)					
Traditional:					
U.S.	**$1,550**	**(1)%**	$1,570	7%	$1,473
Europe	**1,304**	**(6)**	1,430	(4)	1,673
APMEA	**984**	**(6)**	1,143	2	1,110
Latin America	**888**	**(5)**	1,030	(9)	1,152
Canada	**1,144**	**(7)**	1,278	5	1,218
Satellite:(5)					
Outside the U.S.(3)	**$ 591**	**2%**	$ 649	8%	$ 574

(1) McDonald's restaurants in operation at least 13 consecutive months.

(2) Excludes the effect of foreign currency translation on reported results.

(3) Represents satellite restaurants located in Canada and Japan, which comprise substantially all satellites outside the U.S.

(4) McDonald's restaurants in operation at least 13 consecutive months but not more than 25 months.

(5) Excludes U.S. because the Company did not open a significant number of satellite restaurants in the U.S.

Average sales per restaurant in constant currencies are affected by comparable sales as well as the size, location and number of new restaurants. The number of new restaurants affects average sales because new restaurants typically take a few years to reach long-term sales volumes. In addition, over the last several years more restaurants outside the U.S. have opened in lower-density areas and in countries with lower average sales volumes and correspondingly lower average development costs.

In 2001, average annual sales per traditional restaurant were relatively flat for the U.S. and Canada in constant currencies. In the other segments, average annual sales per traditional restaurant declined in constant currencies due to negative comparable sales and the significant number of new restaurants added, partly offset by the benefit of closing 163 underperforming restaurants. In 2000, positive comparable sales in the U.S. and Canada drove their increases in average annual sales per traditional restaurant. In the other segments, the declines were mainly due to new restaurant development.

Satellite restaurants generally have significantly lower development costs and sales volumes than traditional restaurants. The use of these small, limited-menu restaurants has allowed profitable expansion into areas that otherwise would not have been feasible. In 2001 and 2000, average annual sales for satellite restaurants increased in the U.S. partly due to the closing of certain low-volume satellites. Outside the U.S., average annual sales for satellite restaurants declined slightly in constant currencies in 2001 primarily due to negative comparable sales in Japan, after increasing in 2000 primarily due to higher sales volumes for openings in Japan.

In 2001, average sales for new traditional restaurants in the U.S. remained at about $1.6 million as we continued our selective expansion in higher volume locations with the development of larger facilities that support higher average sales. In segments outside the U.S., average sales for new traditional restaurants in constant currencies declined due to a higher proportion of openings in lower volume markets such as South Korea and Mexico and lower sales volumes for new traditional restaurants opened in Germany, Italy, the U.K., Japan, Argentina and Canada. The lower volumes in Germany, Italy and Japan were partly due to the consumer confidence issues regarding the beef supply.

In 2000, average sales for new traditional restaurants in the U.S. increased due to selective expansion and the development of larger facilities. In Europe and Latin America, average sales for new traditional restaurants in constant currencies decreased due to a higher proportion of openings in lower volume markets. In APMEA, average sales for new traditional restaurants increased due to higher sales volumes in China and a higher proportion of openings in higher volume markets such as Japan.

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

	2001			2000			1999
		Increase/(decrease)			Increase/(decrease)		
DOLLARS IN MILLIONS	Amount	As reported	Constant currency(1)	Amount	As reported	Constant currency(1)	Amount
U.S.	**$ 5,396**	**3%**	**na**	$ 5,259	3%	na	$ 5,093
Europe	**4,752**	**–**	**4%**	4,754	(3)	7%	4,925
APMEA	**2,203**	**5**	**12**	2,102	9	11	1,928
Latin America	**971**	**2**	**12**	949	40	41	680
Canada	**608**	**(1)**	**3**	615	7	7	576
Partner Brands	**940**	**67**	**67**	564	nm	nm	57
Total	**$14,870**	**4%**	**8%**	$14,243	7%	12%	$13,259

(1) Excludes the effect of foreign currency translation on reported results.
na Not applicable.
nm Not meaningful.

On a constant currency basis, total revenues increased at a higher rate than sales in 2001 primarily due to the second quarter 2000 acquisition of Boston Market restaurants, which are all Company-operated, and the restructuring of our ownership in the Philippines, effective July 1, 2001. As a result of the restructuring, most of our restaurants in the Philippines are now Company-operated rather than franchised. In addition, revenues benefited from an increase in the royalty percent received from our Japanese affiliate, effective January 1, 2001. In 2000, total revenues increased at a higher rate than sales due the acquisition of Boston Market and the acquisition of Donatos in third quarter 1999 as well as the consolidation of Argentina and Indonesia for financial reporting purposes in 2000.

OPERATING INCOME

Consolidated operating income decreased 19% in 2001 and was relatively flat in 2000 compared with 1999. Excluding the special items noted in the footnote to the table on page 29, adjusted operating income decreased 5% in constant currencies in 2001. Adjusted operating income decreased in 2001 primarily due to lower combined operating margin dollars and lower other operating income along with higher selling, general & administrative expenses. In constant currencies, operating income increased 5% in 2000, primarily due to higher combined operating margin dollars and higher other operating income, partly offset by higher selling, general & administrative expenses.

Operating income from the major markets accounted for more than 90% of consolidated operating income in 2001, 2000 and 1999.

Operating income

	2001				2000			1999
		Increase/(decrease)				Increase/(decrease)		
DOLLARS IN MILLIONS	Amount	As reported	Constant currency(1)	Adjusted constant currency(1,2)	Amount	As reported	Constant currency(1)	Amount
U.S.	**$1,622**	**(10)%**	**na**	**–**	$1,795	7%	na	$1,679
Europe	**1,063**	**(10)**	**(7)%**	**(3)%**	1,180	(6)	6%	1,257
APMEA	**325**	**(28)**	**(20)**	**(10)**	451	4	5	433
Latin America	**11**	**(89)**	**(91)**	**(46)**	103	(23)	(23)	133
Canada	**124**	**(2)**	**2**	**10**	126	12	11	113
Partner Brands	**(66)**	**(61)**	**(62)**	**(1)**	(41)	nm	nm	(7)
Corporate	**(382)**	**(35)**	**na**	**(22)**	(284)	1	na	(288)
Total	**$2,697**	**(19)%**	**(17)%**	**(5)%**	$3,330	–%	5%	$3,320

(1) Excludes the effect of foreign currency translation on reported results.
(2) Excludes the special items noted in the footnote to the table on page 29 and quantified below.
na Not applicable.
nm Not meaningful.

U.S. operating income for 2001 included $181 million of special charges, primarily related to the U.S. business reorganization and costs incurred in connection with the theft of promotional game pieces and related termination of a supplier discussed on page 34. U.S. operating income accounted for over 50% of consolidated operating income in 2001, 2000 and 1999. Excluding the special charges, U.S. adjusted operating income was relatively flat in 2001 compared with an increase of $116 million or 7% in 2000. The increase in 2000 was due to higher combined operating margin dollars and higher other operating income.

Europe's operating income for 2001 included $46 million of special charges related to the closing of 50 underperforming restaurants across Europe and global change initiatives. Europe's operating income accounted for more than 35% of consolidated operating income in 2001, 2000 and 1999. Excluding the special charges, Europe's adjusted operating income decreased 3% in 2001 and increased 6% in 2000 in constant currencies. In both years, consumer confidence issues regarding the European beef supply negatively impacted results. This segment's results in 2001 benefited from strong performances in France and Russia. The increase in 2000 was primarily driven by strong operating results in France, Italy and Spain. France, Germany and the U.K. accounted for about 75% of Europe's operating income in 2001, 2000 and 1999.

APMEA's operating income for 2001 included $42 million of special charges, primarily related to the closing of 50 underperforming restaurants, mainly in Malaysia and the Philippines, and the asset impairment charge in

Turkey. Excluding the special charges, APMEA's adjusted operating income decreased 10% in 2001 and increased 5% in 2000 in constant currencies. In 2001, strong results in China, the increase in the royalty percent received from our affiliate in Japan and a gain on the sale of real estate in Singapore were more than offset by weak operating results in Australia, Japan, Taiwan and Turkey. The increase in 2000 was driven primarily by Japan, which benefited from the partial sale of its ownership in Toys 'R' Us Japan, as well as strong results in China and South Korea. Results in both years were negatively affected by the introduction of the goods and services tax in Australia in July 2000. Australia and Japan accounted for more than 60% of APMEA's operating income in 2001, 2000 and 1999.

Latin America's operating income for 2001 included $40 million of special charges related to the closing of 58 underperforming restaurants, primarily in Brazil and Puerto Rico, and global change initiatives. Excluding the special charges, Latin America's adjusted operating income decreased 46% in 2001 and 23% in 2000 in constant currencies. Results in both years were negatively impacted by the continuing difficult economic conditions experienced by most markets in the segment. Brazil accounted for more than 55% of Latin America's operating income in each of the past three years.

Canada's operating income for 2001 included $10 million of special charges related to the closing of five underperforming restaurants and to global change initiatives.

Operating income for the Partner Brands in 2001 included special charges of $20 million related to the anticipated disposal of Aroma Café and $5 million related to global change initiatives.

Results in the Corporate segment included $34 million of special charges related to global change initiatives and the write-off of certain technology costs. Excluding the special charges, the adjusted decrease in the Corporate segment of 22% in 2001 was primarily due to increased spending on future restaurant-related technology improvements.

As a result of continuing economic weakness in Latin America and Turkey, the Company expects to record a non-cash charge of approximately $45 million (pre and after tax) related to the impairment of assets in Latin America and closing of underperforming restaurants in Turkey in first quarter 2002.

OPERATING MARGINS

Operating margin information and discussions relate to McDonald's restaurants only and exclude Partner Brands.

Company-operated margins

Company-operated margin dollars are equal to sales by Company-operated restaurants less the operating costs of these restaurants. Company-operated margin dollars declined $145 million in 2001 and $4 million in 2000. In constant currencies, Company-operated margin dollars declined $96 million or 6% in 2001, compared with an increase of $73 million or 4% in 2000. The 2001 constant currency decrease was primarily due to negative comparable sales, partly offset by expansion, while the 2000 constant currency increase was due to expansion and positive comparable sales.

Company-operated margins were 15.1% of sales in 2001, 16.9% in 2000 and 17.7% in 1999. Operating cost trends as a percent of sales were as follows: food & paper costs as well as occupancy & other operating expenses increased in 2001 and 2000; payroll costs increased in 2001 and were flat in 2000.

Company-operated margins—McDonald's restaurants

IN MILLIONS	**2001**	2000	1999
U.S.	**$ 501**	$ 521	$ 516
Europe	**626**	683	743
APMEA	**240**	296	274
Latin America	**83**	95	70
Canada	**75**	75	71
Total	**$1,525**	$1,670	$1,674
PERCENT OF SALES			
U.S.	**16.0%**	17.0%	17.5%
Europe	**16.8**	18.3	19.2
APMEA	**12.4**	15.9	16.4
Latin America	**10.1**	12.4	14.1
Canada	**15.6**	15.4	15.7
Total	**15.1%**	16.9%	17.7%

In the U.S., food & paper costs were lower as a percent of sales in 2001 and 2000, while payroll costs and occupancy & other expenses were higher in both years.

Europe's Company-operated margins as a percent of sales declined in 2001, primarily due to higher payroll costs and negative comparable sales. In 2000, Europe's Company-operated margin percent declined as all costs increased as a percent of sales.

In APMEA, negative comparable sales in 2001 and slightly negative comparable sales in 2000 affected Company-operated margins as a percent of sales. In 2001, the change in restaurant classification in the Philippines also contributed to APMEA's margin decline because its Company-operated margins were lower than the average for the segment.

In Latin America, the margin declines were due to difficult economic conditions in most markets and negative comparable sales in both years.

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 those sites. Franchised margin dollars represented more than 60% of the combined operating margins in 2001, 2000 and 1999. Franchised margin dollars increased $26 million in 2001, compared with a $6 million decline in 2000. In constant currencies, the franchised margin dollars increased $91 million or 3% in 2001 and $119 million or 4% in 2000, primarily driven by the increase in the Japan royalty percent effective January 1, 2001, as well as expansion in both years and positive comparable sales in 2000.

Franchised margins—McDonald's restaurants

IN MILLIONS	**2001**	2000	1999
U.S.	**$1,799**	$1,765	$1,730
Europe	**792**	802	828
APMEA	**229**	199	211
Latin America	**103**	135	144
Canada	**105**	101	95
Total	**$3,028**	$3,002	$3,008
PERCENT OF REVENUES			
U.S.	**79.7%**	80.4%	81.0%
Europe	**77.2**	78.3	79.0
APMEA	**86.2**	81.5	82.3
Latin America	**68.4**	73.0	77.5
Canada	**80.4**	80.2	79.9
Total	**79.1%**	79.5%	80.3%

The declines in the consolidated franchised margin percent in 2001 and 2000 reflected higher occupancy costs due to an increased number of leased sites in all geographic segments. Our strategy of leasing a higher proportion of new sites over the past few years has reduced initial capital requirements and related interest expense. However, as anticipated, franchised margins as a percent of applicable revenues have been negatively impacted 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.

In 2001, franchised margins as a percent of applicable revenues decreased in Europe and Latin America partly due to rent assistance provided to franchisees in certain markets and negative comparable sales. We expect to continue providing rent assistance in certain Latin American markets in 2002. The franchised margin percent in APMEA increased for 2001 and decreased in 2000. The 2001 increase was primarily due to an increase in the royalty percent received from our Japanese affiliate and the restructuring of the Philippines' operations that resulted in the reclassification of franchised margins that were lower than the average for the segment. In 2000, our purchase of a majority interest in certain affiliate markets in both APMEA and Latin America shifted revenues from franchised and affiliated restaurants to Company-operated restaurants, which contributed to the reduction in the franchised restaurant margin percents.

SELLING, GENERAL & ADMINISTRATIVE EXPENSES

Consolidated selling, general & administrative expenses increased 5% in 2001 and 7% in 2000 (7% and 11% in constant currencies). Selling, general & administrative expenses as a percent of sales were 4.1% in 2001, 4.0% in 2000 and 3.8% in 1999. The increase in 2001 was partly due to increased spending on future restaurant-related technology improvements in the Corporate segment and higher selling, general & administrative expenses for the Partner Brands. The increase in 2000 was primarily due to spending to support the development of Partner Brands and the consolidation of Argentina and Indonesia for financial reporting purposes. Selling, general & administrative expenses in both years benefited from weaker foreign currencies and lower expense for performance-based incentive compensation.

As a result of the global change initiatives described below, the Company expects ongoing annual selling, general & administrative savings of about $100 million in 2002, compared with what otherwise would have been spent.

Selling, general & administrative expenses

	2001			2000			1999
		Increase/(decrease)			Increase/(decrease)		
DOLLARS IN MILLIONS	Amount	As reported	Constant currency(1)	Amount	As reported	Constant currency(1)	Amount
U.S.	**$ 563**	**1%**	**na**	$ 559	–	na	$ 559
Europe	**328**	**(2)**	**1%**	336	(3)%	8%	348
APMEA	**152**	**2**	**9**	149	10	16	135
Latin America	**126**	**5**	**14**	120	45	45	83
Canada	**51**	**(6)**	**(2)**	54	4	4	52
Partner Brands	**102**	**20**	**20**	85	nm	nm	12
Corporate	**340**	**20**	**na**	284	(1)	na	288
Total	**$1,662**	**5%**	**7%**	$1,587	7%	11%	$1,477

(1) Excludes the effect of foreign currency translation on reported results.
na Not applicable.
nm Not meaningful.

Corporate expenses consist of home office support costs in areas such as facilities, finance, human resources, information technology, legal, supply chain management and training.

SPECIAL CHARGE—GLOBAL CHANGE INITIATIVES

In fourth quarter 2001, the Company recorded a $200 million pretax special charge ($136 million after tax) related to strategic changes and ongoing restaurant initiatives in the U.S. and certain international markets. The changes and initiatives are designed to improve the customer experience and grow McDonald's global business. The changes in the U.S. included streamlining operations by reducing the number of regions and divisions, enabling the Company to combine staff functions and improve efficiency. In addition, the U.S. business introduced a variety of initiatives designed to improve the restaurant experience including accelerated operations training, restaurant simplification, incentives for outstanding restaurant operations and an enhanced national restaurant evaluation system.

In connection with these initiatives, the Company eliminated approximately 850 positions, consisting of 700 positions in the U.S., primarily in the divisions and regions, and 150 positions in international markets.

The special charge consisted of $114 million of severance and other employee-related costs; $69 million of lease cancellation and other costs related to the closing of region and division facilities; and $17 million of other cash costs, primarily consisting of payments made to facilitate a timely and smooth change of ownership from franchisees who have had a history of financial difficulty and consequently were unable to deliver the level of operational excellence needed to succeed in the future.

Of the original $200 million pretax special charge, the remaining accrual of approximately $126 million at year-end 2001 primarily related to employee severance and lease payments for facilities that have been closed and was included in other accrued liabilities in the Consolidated balance sheet. Employee severance is paid in installments over a period of up to one year after termination, and the remaining lease payments for facilities that have been closed will be paid through 2010. No significant adjustments have been made to the original plan approved by management. The Company expects to use cash provided by operations to fund the remaining employee severance and lease obligations.

OTHER OPERATING (INCOME) EXPENSE, NET

Other operating (income) expense includes gains on sales of restaurant businesses, equity in earnings of unconsolidated affiliates, restaurant closing and asset impairment charges, and other transactions related to franchising and the food service business.

Other operating (income) expense, net

IN MILLIONS	**2001**	2000	1999
Gains on sales of restaurant businesses	**$(112)**	$ (87)	$ (75)
Equity in earnings of unconsolidated affiliates	**(62)**	(121)	(138)
Charges for underperforming restaurant closings	**91**	–	–
Asset impairment charges	**44**	–	–
Other, net	**96**	12	108
Total	**$ 57**	$(196)	$(105)

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 franchisees 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. Resulting gains or losses are recorded in operating income because the transactions are an integral part of our business.

Equity in earnings of unconsolidated affiliates—businesses in which the Company actively participates but does not control—is reported after interest expense and income taxes, except for U.S. restaurant partnerships, which are reported before income taxes. The decrease in 2001 was due to weaker results in Japan, the increase in Japan's royalty expense and a weaker Japanese Yen. Although the increase in royalty expense reduced McDonald's equity in earnings for Japan, it was more than offset by the royalty benefit McDonald's received in franchised revenues. In 1999, equity in earnings of unconsolidated affiliates included a $21 million gain from the sale of real estate in a U.S. partnership.

The Company recorded $91 million of pretax charges ($69 million after tax) in 2001 related to the closing of 163 underperforming restaurants in international markets. The losses on these closed restaurants were recognized in the period the restaurant ceased operations, and the charges primarily consisted of asset write-offs and lease termination costs.

The asset impairment charges in 2001 consisted of a $24 million charge (pre and after tax) as a result of an assessment of the ongoing impact of significant currency devaluation on McDonald's cash flows in Turkey and a pretax charge of $20 million ($14 million after tax) related to the anticipated sale of Aroma Café, which we expect to be completed in the first half of 2002.

Other expense for 2001 included a pretax charge of $25 million ($17 million after tax) in the U.S., primarily related to unrecoverable costs incurred in connection with the theft of winning game pieces from the Company's Monopoly and certain other promotional games over an extended period of time, and the related termination of the supplier of the game pieces. Fifty-one people (none of whom were Company employees) were subsequently indicted on conspiracy and mail fraud charges. In 2001, the Company also recorded a pretax charge of $17 million ($12 million after tax), primarily related to the write-off of certain technology costs in the Corporate segment. Other expense for 1999 included the write-off of $24 million ($16 million after tax) of software not used in the business.

INTEREST EXPENSE

Interest expense increased in 2001 and 2000 due to higher average debt levels, partly offset by weaker foreign currencies in both years and lower average interest rates in 2001. Average debt levels were higher in both years because the Company used its available credit capacity to repurchase shares of its common stock. Based on current interest rates, we anticipate interest expense will decline in 2002.

McDONALD'S JAPAN INITIAL PUBLIC OFFERING (IPO) GAIN

In third quarter 2001, McDonald's Japan, the Company's largest market in the APMEA segment, completed an IPO of 12 million shares at an offering price of 4,300 Yen per share ($34.77 per share). The Company owns 50% of McDonald's Japan while the Company's partner Den Fujita and his family own approximately 26% and continue to be involved in the business. The Company recorded a $137 million gain (pre and after tax) in nonoperating income to reflect an increase in the carrying value of its investment as a result of the cash proceeds from the IPO received by McDonald's Japan.

NONOPERATING EXPENSE, NET

Nonoperating expense includes miscellaneous income and expense items such as interest income, minority interests, and gains and losses related to other investments, financings and translation. Results in 2001 included the write-off of a corporate investment, the write-off of a financing

receivable from a supplier in Latin America and minority interest expense related to the sale of real estate in Singapore, partly offset by translation gains. Results in 2000 reflected lower minority interest expense and lower translation losses than 1999 and a gain related to the sale of a partial ownership interest in a majority-owned international subsidiary.

PROVISION FOR INCOME TAXES
The effective income tax rate was 29.8% in 2001, 31.4% in 2000 and 32.5% in 1999. The lower effective income tax rate in 2001 was primarily due to the one-time benefit of tax law changes in certain international markets. Also contributing to the decrease in the income tax rate was the Japan IPO gain, partly offset by certain restaurant closing charges and the Turkey asset impairment charge, none of which were tax-affected for financial reporting purposes. The decrease in the income tax rate in 2000 was the result of a tax benefit resulting from an international transaction. The Company expects its 2002 effective income tax rate to be approximately 32.0% to 33.0%.

Consolidated net deferred tax liabilities included tax assets, net of valuation allowance, of $720 million in 2001 and $523 million in 2000. Substantially all of the net tax assets arose in the U.S. and other profitable markets.

NET INCOME AND NET INCOME PER COMMON SHARE
In 2001, net income decreased 17%, and diluted net income per common share decreased 14%. Excluding the special items noted in the footnote to the table on page 29, net income decreased 8%, and diluted net income per common share decreased 5% in constant currencies. In 2000, net income increased 2%, and diluted net income per common share increased 5%. On a constant currency basis, these increases were 6% and 10%. The spread between the percent change in net income and diluted net income per common share for both years was due to lower weighted average shares outstanding as a result of shares repurchased and a less dilutive effect from stock options.

Cash flows

The Company generates significant cash from operations and has substantial credit capacity to fund operating and discretionary spending. Cash from operations totaled $2.7 billion in 2001 and, although slightly lower than the amount in 2000, exceeded capital expenditures for the eleventh consecutive year. In 2000, cash from operations totaled $2.8 billion. This amount was less than in 1999, primarily due to higher income tax payments in 2000 as a result of both lower tax benefits related to stock option exercises and higher gains on the termination of foreign currency exchange agreements. Cash provided by operations, along with borrowings and other sources of cash, is used for capital expenditures, share repurchases, dividends and debt repayments.

Cash provided by operations

DOLLARS IN MILLIONS	**2001**	2000	1999
Cash provided by operations	**$2,688**	$2,751	$3,009
Free cash flow(1)	**782**	806	1,141
Cash provided by operations as a percent of capital expenditures	**141%**	141%	161%
Cash provided by operations as a percent of average total debt	**31**	35	42

(1) Cash provided by operations less capital expenditures.

In addition to its free cash flow, the Company can meet short-term funding needs through commercial paper borrowings and line of credit agreements. Accordingly, the Company strategically and purposefully maintains a relatively low current ratio, which was .81 at year-end 2001.

CAPITAL EXPENDITURES AND RESTAURANT DEVELOPMENT
Capital expenditures decreased $39 million or 2% in 2001 and increased $77 million or 4% in 2000. Capital expenditures for McDonald's restaurants in 2001, 2000 and 1999 reflected our strategy of leasing a higher proportion of new sites and the U.S. building program, which gives franchisees the option to own new restaurant buildings. About 80% of new and rebuilt U.S. traditional franchised and affiliated restaurant buildings in 2001 and 2000 are owned by franchisees and affiliates. The decrease in capital expenditures in 2001 was primarily due to lower spending in Europe and Latin America and weaker foreign currencies, partly offset by additional expenditures for Partner Brands and McDonald's restaurant business in the U.S. and China. Capital expenditures in 2000 increased due to higher spending for Partner Brands and the consolidation of Argentina and Indonesia, partly offset by weaker foreign currencies.

Approximately 60% of capital expenditures was invested in major markets excluding Japan in 2001, 2000 and 1999 (Japan is accounted for under the equity method, and accordingly, its capital expenditures are not included in consolidated amounts). Capital expenditures in markets outside the U.S. accounted for about 65% of total expenditures in 2001 and about 70% in 2000 and 1999.

The Company's expenditures for new restaurants in the U.S. are lower than they would have been as a result of the leasing strategy and the U.S. building program. For new franchised and affiliated restaurants, which represent about 85% of U.S. restaurants, the Company generally incurs no capital expenditures. However, the Company maintains long-term occupancy rights for the land and receives related rental income.

While the Company no longer makes significant expenditures on new sites in the U.S., 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 new traditional restaurants in the U.S. System were $1.7 million in 2001, $1.6 million in 2000 and $1.5 million in 1999. The

increases were primarily due to the construction of larger facilities designed to support higher average sales volumes.

Certain of the land the Company leases in the U.S. is leased from System Capital Corporation (SCC). The Company and six other unaffiliated companies that supply the McDonald's System are equal owners of SCC. No employees of SCC are employees of the seven shareholders. The Company's investment in SCC is accounted for on the cost basis. SCC's purpose is to provide funding to McDonald's franchisees, suppliers to the McDonald's System and McDonald's Corporation and to build equity within SCC that will benefit the McDonald's System. Its function is similar to that of a cooperative. SCC's primary operating activities include (1) providing loans to qualifying U.S. franchisees to purchase existing restaurant businesses as well as finance equipment, buildings and working capital, (2) contracting for construction of restaurant buildings and selling them to U.S. franchisees, (3) purchasing accounts receivable and financing inventory and other needs of eligible suppliers and distributors, and (4) acquiring and leasing land to McDonald's Corporation for new restaurants, primarily in the U.S. The Company's commitments under these leases are included in operating lease commitments on pages 39 and 50 and total approximately $14 million annually based on current interest rates.

SCC funds itself in the capital markets on an independent basis. Moody's, Standard & Poor's and Fitch periodically review SCC, including reviews of key performance indicators and asset quality. These rating agencies currently rate SCC's funding subsidiary's commercial paper A-1, P-1 and F1; and its long-term debt Aa2, AA and AA, respectively. SCC competes with other lenders who provide similar financing to franchisees and suppliers.

SCC is not permitted to hold McDonald's stock, and McDonald's has no commitments or guarantees that provide for the potential issuance of its stock to SCC. SCC does not engage in speculative derivative activities, and SCC does not hedge McDonald's positions. In addition, no McDonald's employee is permitted to invest in SCC.

Capital expenditures

IN MILLIONS	**2001**	2000	1999
New restaurants	**$ 1,198**	$ 1,308	$ 1,231
Existing restaurants(1)	**571**	507	515
Other properties(2)	**137**	130	122
Total	**$ 1,906**	$ 1,945	$ 1,868
Total assets	**$22,535**	$21,684	$20,983

(1) Includes technology to improve service and food quality and enhancements to older facilities in order to achieve higher levels of customer satisfaction.

(2) Primarily for computer equipment and furnishings for office buildings.

Average development costs outside the U.S. vary widely by market depending on the types of restaurants built and the real estate and construction costs within each market. These costs, which include land, buildings and equipment owned by the Company, are managed through the use of optimally sized restaurants, construction and design efficiencies, standardization and global sourcing. In addition, foreign currency fluctuations affect average development costs.

Average development costs for new traditional restaurants in major markets outside the U.S. excluding Japan were approximately $1.5 million in 2001, $1.6 million in 2000 and $1.8 million in 1999. Average annual sales for new traditional restaurants in the same markets were about $1.4 million in 2001, $1.5 million in 2000 and $1.7 million in 1999. Average development costs for new satellite restaurants located in Canada and Japan, which comprise more than 90% of the satellites outside the U.S., were about $200,000 (excluding lease costs) in 2001, 2000 and 1999. The use of these small, limited-menu restaurants, for which the land and building generally are leased, has allowed expansion into areas that otherwise would not have been feasible.

The Company and its affiliates owned 38% of the land for its restaurant sites at year-end 2001 and 40% at year-end 2000.

Capital expenditures by affiliates, which were not included in consolidated amounts, were about $181 million in 2001, $204 million in 2000 and $259 million in 1999. The decrease in 2000 was primarily due to the consolidation of Argentina in 2000.

Systemwide restaurants at year end(1)

	2001	2000	1999
U.S.	**13,099**	12,804	12,629
Europe	**5,794**	5,460	4,943
APMEA	**7,321**	6,771	6,097
Latin America	**1,581**	1,510	1,299
Canada	**1,223**	1,154	1,125
Partner Brands	**1,075**	1,008	216
Total	**30,093**	28,707	26,309

(1) Includes satellite units at December 31, 2001, 2000 and 1999 as follows: U.S.—1,004, 999, 1,048; Europe—63, 46, 44; APMEA (primarily Japan)—1,879, 1,681, 1,354; Latin America—46, 45, 41; and Canada—307, 280, 259.

McDonald's continues to focus on managing capital outlays effectively through selective expansion. In 2001, the Company added 1,319 McDonald's restaurants Systemwide, compared with 1,606 in 2000 and 1,598 in 1999. In addition, the Company added 67 restaurants in 2001 operated by Partner Brands, compared with 792 restaurants in 2000, 707 of which were the result of the Boston Market acquisition. In 2002, the Company expects to add 1,300 to 1,400 McDonald's restaurants and open 100 to 150 new Partner Brands' restaurants.

In 2001, more than 60% of McDonald's restaurant additions was in the major markets, and we anticipate a similar percent for 2002. Almost 50% of Company-operated restaurants and nearly 85% of franchised restaurants were located in the major markets at the end of 2001. Franchisees and affiliates operated 74% of McDonald's restaurants at year-end 2001. Partner Brands' restaurants are primarily Company-operated.

SHARE REPURCHASES AND DIVIDENDS

The Company uses free cash flow and credit capacity to repurchase shares, as we believe this enhances shareholder value. During 2001, the Company purchased 36.1 million shares for approximately $1.1 billion. Cumulative share purchases over the past five years totaled $6.0 billion or 187.4 million shares. In 2002, the Company began purchasing shares under a new $5.0 billion share repurchase program announced in October 2001. We expect to purchase shares under this program over the next four years, depending on free cash flow.

To reduce the overall cost of treasury stock purchases, the Company sells common equity put options in connection with its share repurchase program and receives premiums for these options. The Company sold 12.2 million common equity put options in 2001 and 16.8 million in 2000 and received premiums of $32 million in 2001 and $56 million in 2000. These premiums were reflected in shareholders' equity as a reduction of the cost of treasury stock purchased. At December 31, 2001, 12.2 million common equity put options were outstanding, of which 3.0 million were exercised in February 2002 at a cost of $87 million. The remaining options expire at various dates through November 2002, with exercise prices between $26.37 and $30.23.

During 2001, the Company also entered into equity forward contracts in connection with its share repurchase program. The equity forward contracts, totaling $151 million for 5.5 million shares, settled in March 2002 at an average price of $27.41 per share.

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 repurchases. Accordingly, the common stock dividend yield is modest. However, the Company has paid dividends on common stock for 26 consecutive years and has increased the dividend amount every year. Additional dividend increases will be considered after reviewing returns to shareholders, profitability expectations and financing needs. Cash dividends are declared and paid on an annual basis. As in the past, future dividends will be declared at the discretion of the Board of Directors.

Financial position and capital resources

TOTAL ASSETS AND RETURNS

Total assets grew by $851 million or 4% in 2001 and $700 million or 3% in 2000. At year-end 2001 and 2000, more than 60% of consolidated assets was located in the major markets excluding Japan. Net property and equipment rose $242 million in 2001 and represented 77% of total assets at year end.

Operating income is used to compute return on average assets, while net income is used to calculate return on average common equity. Month-end balances are used to compute both average assets and average common equity.

Returns on assets and equity

	2001[(1)]	2000	1999
Return on average assets	**14.1%**	15.9%	16.6%
Return on average common equity	**19.1**	21.6	20.8

(1) Excludes the special items noted in footnote 2 to the table on page 29. Including the special items, return on average assets was 12.3% and return on average common equity was 17.5%.

Both return on average assets and return on average common equity declined in 2001, primarily due to lower operating income as a result of consumer confidence issues regarding the European beef supply and weak operating results in APMEA and Latin America previously discussed. In general, returns benefited from the Company's continued focus on more efficient capital deployment. This included a more prudent site selection process, leasing a higher proportion of new sites, the U.S. building program and the use of free cash flow for share repurchases. In 2000, return on average common equity benefited from an increase in the average amount of common equity put options outstanding compared with 1999, which reduced average common equity.

FINANCINGS AND MARKET RISK

The Company generally borrows on a long-term basis and is exposed to the impact of interest-rate changes and foreign currency fluctuations. In managing the impact of these changes, the Company uses interest-rate exchange agreements and finances in the currencies in which assets are denominated. All derivatives used to minimize these risks were recorded at fair value in the Company's Consolidated balance sheet at December 31, 2001, and totaled $213 million in miscellaneous other assets and $134 million in other long-term liabilities. See summary of significant accounting policies related to financial instruments on pages 46–47 for additional information regarding their use and the impact of SFAS No. 133 regarding derivatives.

The Company uses major capital markets, bank financings and derivatives to meet its financing requirements and reduce interest expense. For example, foreign 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 certain foreign currency royalties, 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 currency denominated debt, including the effects of foreign currency exchange agreements, was $5.0 billion and $5.1 billion at year-end 2001 and 2000, respectively.

The Company does not have significant exposure to any individual counterparty and has master agreements that contain netting arrangements. Certain of these agreements also require each party to post collateral if credit ratings fall below, or aggregate exposures exceed, certain contractual limits. At December 31, 2001, neither the Company nor its counterparties was required to post collateral for any obligation.

Debt highlights *(1)*

	2001	2000	1999
Fixed-rate debt as a percent of total debt	**45%**	58%	70%
Weighted-average annual interest rate of total debt	**5.4**	5.8	5.9
Foreign currency-denominated debt as a percent of total debt	**57**	60	76
Total debt as a percent of total capitalization (total debt and total shareholders' equity)	**48**	48	43

(1) All percentages are as of December 31, except for the weighted-average annual interest rate, which is for the year.

Moody's, Standard & Poor's and Fitch currently rate McDonald's debt Aa3, A+ and AA, respectively. A strong rating is important to the Company because of its global development plans. The Company has not experienced, and does not expect to experience, difficulty in obtaining financing or in refinancing existing debt. Certain of the Company's debt obligations contain cross-default provisions and restrictions on Company and subsidiary mortgages and the long-term debt of certain subsidiaries. There are no provisions in the Company's debt obligations that would accelerate repayment of debt as a result of a change in credit ratings.

At year-end 2001, the Company had $1.3 billion available under committed line of credit agreements (see debt financing note on page 50) as well as $1.2 billion under a U.S. shelf registration and $1.1 billion under a Euro Medium-Term Notes program for future debt issuance. In early 2002, the Company issued $450 million of Medium-Term Notes ($150 million at a rate of 4.15% due 2005 and $300 million at a rate of 5.75% due 2012) under the U.S. shelf registration to pay down commercial paper. At the time of these issuances, the Company entered into interest-rate exchange agreements to convert fixed-rate interest payments on the debt to a floating-rate based on LIBOR. Also in early 2002, the Company redeemed $50 million of 6.0% Medium-Term Notes originally due 2008. The notes were redeemed at 100% of principal plus accrued interest.

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. 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 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 2001 and 2000, 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) at year end were as follows:

Foreign currency exposures

IN MILLIONS OF U.S. DOLLARS	**2001**	2000
Euro	**$1,251**	$1,185
British Pounds Sterling	**786**	638
Canadian Dollars	**738**	763
Australian Dollars	**516**	329
Brazilian Reais	**490**	491

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 2001 levels nor a 10% adverse change in foreign currency rates from 2001 levels would materially affect the Company's results of operations, cash flows or the fair value of its financial instruments.

CONTRACTUAL OBLIGATIONS AND COMMITMENTS

The Company has long-term contractual obligations primarily in the form of lease and debt obligations. In addition, the Company has long-term contractual revenue and cash flow streams that relate to its franchise arrangements. Cash provided by operations (including cash provided by these franchise arrangements) along with our borrowing capacity and other sources of cash will be used to satisfy the obligations. The following table summarizes the Company's contractual obligations and their aggregate maturities as well as future minimum contractual rent payments due to the Company under existing franchise arrangements as of December 31, 2001 (see discussions of cash flows, financial position and capital resources in

Management's discussion and analysis as well as the Notes to the consolidated financial statements for further details):

Contractual cash flows

	Outflows		Inflows
IN MILLIONS	Operating leases	Debt obligations(1)	Minimum rent under franchise arrangements
2002	$ 841	$ 363	$ 1,669
2003	815	796	1,651
2004	779	1,621	1,624
2005	722	1,072	1,576
2006	690	844	1,532
Thereafter	6,069	4,128	13,368
Total	$9,916	$8,824	$21,420

(1) The maturities reflect reclassifications of short-term obligations to long-term obligations of $750 million in 2004 and $500 million in 2007 as they are supported by long-term line of credit agreements. Debt obligations do not include $94 million of fair value adjustments recorded as a result of SFAS No.133, Accounting for Derivative Instruments and Hedging Activities.

In addition to long-term obligations, the Company had certain other commitments at December 31, 2001. In connection with its share repurchase program, the Company had 12.2 million common equity put options outstanding at December 31, 2001, with a total exercise price of $350 million, of which 3.0 million were exercised in February 2002 at a cost of $87 million. The remaining options expire at various dates through November 2002 with exercise prices between $26.37 and $30.23. In addition, the Company entered into equity forward contracts, in connection with its share repurchase program, totaling $151 million for 5.5 million shares that settled in March 2002. The Company also guaranteed certain affiliate and other loans totaling $148 million.

Other matters

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Management's discussion and analysis of financial condition and results of operations are based upon the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the U.S. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosures. On an ongoing basis, the Company evaluates its estimates and judgments based on historical experience and various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions.

The Company annually reviews its financial reporting and disclosure practices and accounting policies to ensure that its financial reporting and disclosures provide accurate and transparent information relative to the current economic and business environment. The Company believes that of its significant accounting policies (see summary of significant accounting policies more fully described on pages 45–47), the following policies involve a higher degree of judgment and/or complexity.

Property and equipment

Property and equipment are depreciated or amortized over their useful lives based on management's estimates of the period over which the assets will generate revenue. The Company periodically reviews these lives relative to physical factors, economic factors and industry trends.

Asset impairment

In assessing the recoverability of the Company's fixed assets, goodwill and other non-current assets, the Company considers changes in economic conditions and makes assumptions regarding estimated future cash flows and other factors. If these estimates or their related assumptions change in the future, the Company may be required to record impairment charges.

Restructuring and litigation accruals

In 2001, the Company recorded a $200 million pretax special charge related to strategic changes and ongoing restaurant initiatives in the U.S. and certain international markets. The accrual recorded included estimates pertaining to employee termination costs and remaining lease obligations for closed facilities. Although we do not anticipate significant changes, the actual costs may differ from these estimates.

From time to time, the Company is subject to proceedings, lawsuits and other claims primarily related to franchisees, suppliers, employees, customers and competitors. We are required to assess the likelihood of any adverse judgments or outcomes to these matters as well as potential ranges of probable losses. A determination of the amount of accrual required, if any, for these contingencies is made after careful analysis of each matter. The required accrual may change in the future due to new developments in each matter or changes in approach such as a change in settlement strategy in dealing with these matters. The Company does not believe that any such matter will have a material adverse effect on its financial condition or results of operations.

Financial instruments

The Company's derivatives are recorded in the Consolidated balance sheet at fair value. Fair value is estimated using various pricing models or discounted cash flow analyses that incorporate quoted market prices. The use of different pricing models or assumptions could produce different results.

Income taxes

The Company records a valuation allowance to reduce its deferred tax assets if it is more likely than not that some portion or all of the deferred assets will not be realized. While the Company has considered future taxable income and ongoing feasible tax strategies in assessing the need for the valuation allowance, if these estimates and assumptions change in the future, the Company may be required to adjust its valuation allowance. This could result in a charge to, or an increase in, income in the period such determination is made.

Deferred U.S. income taxes have not been recorded for basis differences totaling $2.7 billion related to investments in certain foreign subsidiaries or affiliates. The basis differences consist primarily of undistributed earnings considered permanently invested in the businesses. If management's intentions change in the future, deferred taxes may need to be provided.

In addition, the Company operates within multiple taxing jurisdictions and is subject to audit in these jurisdictions. The Company records accruals for the estimated outcomes of these audits, and the accruals may change in the future due to new developments in each matter.

NEW ACCOUNTING STANDARDS

Goodwill

In June 2001, the Financial Accounting Standards Board issued SFAS No. 141, *Business Combinations,* effective for acquisitions initiated on or after July 1, 2001, and No. 142, *Goodwill and Other Intangible Assets,* effective for fiscal years beginning after December 15, 2001. SFAS No. 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001, and includes guidance on the initial recognition and measurement of goodwill and other intangible assets arising from business combinations. SFAS No. 142 indicates that goodwill (and intangible assets deemed to have indefinite lives) will no longer be amortized but will be subject to annual impairment tests. Other intangible assets will continue to be amortized over their useful lives.

The Company began applying the new rules on accounting for goodwill and other intangible assets January 1, 2002. Application of the nonamortization provisions of SFAS No. 142 would have increased 2001 net income by approximately $30 million ($0.02 per share) and is expected to result in a similar increase in 2002. The Company is performing the first of required goodwill impairment tests as of January 1, 2002, and expects to record a non-cash charge of about $100 million after tax ($0.08 per share), primarily in certain Latin American markets. The impairment charge required to be recognized upon adoption of SFAS No. 142 will be reflected as the cumulative effect of a change in accounting principle in the first quarter of 2002.

Long-lived assets

In August 2001, the Financial Accounting Standards Board issued SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* which provides additional guidance on the financial accounting and reporting for the impairment or disposal of long-lived assets. The Company adopted the new rules as of January 1, 2002, and the adoption will not have a material effect on the Company's results of operations or financial position.

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 menu prices, cost controls and substantial property holdings—many of which are at fixed costs and partly financed by debt made less expensive by inflation. In hyperinflationary markets, menu board prices typically are adjusted to keep pace with inflation, mitigating the effect on reported results.

EURO CONVERSION

Twelve member countries of the European Union have established fixed conversion rates between their existing currencies ("legacy currencies") and one common currency, the Euro. Since January 1, 2002, the new Euro-denominated notes and coins are in circulation, and legacy currencies have been withdrawn from circulation. The Company has restaurants located in all member countries, and the conversion to the Euro has eliminated currency exchange rate risk for transactions among the member countries, which for the Company primarily consists of payments to suppliers. In addition, because the Company uses foreign-denominated debt and derivatives to meet its financing requirements and to reduce its foreign currency risks, certain of these financial instruments are denominated in Euro. The Company successfully addressed all issues involved with converting to the new currency, and the conversion did not have a significant impact on its 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 regarding future events and operating performance and speak only as of March 25, 2002, unless otherwise noted. These forward-looking statements involve a number of risks and uncertainties. The following are some of the factors that could cause actual results to differ materially from those expressed in or underlying our forward-looking statements: the effectiveness of operating initiatives and advertising and promotional 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; legislation and governmental regulation; and accounting policies and practices. The foregoing list of important factors is not exclusive.

The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Consolidated statement of income

IN MILLIONS, EXCEPT PER SHARE DATA	Years ended December 31, **2001**	2000	1999
Revenues			
Sales by Company-operated restaurants	**$11,040.7**	$10,467.0	$ 9,512.5
Revenues from franchised and affiliated restaurants	**3,829.3**	3,776.0	3,746.8
Total revenues	**14,870.0**	14,243.0	13,259.3
Operating costs and expenses			
Food and packaging	**3,802.1**	3,557.1	3,204.6
Payroll and employee benefits	**2,901.2**	2,690.2	2,418.3
Occupancy and other operating expenses	**2,750.4**	2,502.8	2,206.7
Total Company-operated restaurant expenses	**9,453.7**	8,750.1	7,829.6
Franchised restaurants–occupancy expenses	**800.2**	772.3	737.7
Selling, general & administrative expenses	**1,661.7**	1,587.3	1,477.6
Special charge–global change initiatives	**200.0**		
Other operating (income) expense, net	**57.4**	(196.4)	(105.2)
Total operating costs and expenses	**12,173.0**	10,913.3	9,939.7
Operating income	**2,697.0**	3,329.7	3,319.6
Interest expense–net of capitalized interest of $15.2, $16.3 and $14.3	**452.4**	429.9	396.3
McDonald's Japan IPO gain	**(137.1)**		
Nonoperating expense, net	**52.0**	17.5	39.2
Income before provision for income taxes	**2,329.7**	2,882.3	2,884.1
Provision for income taxes	**693.1**	905.0	936.2
Net income	**$ 1,636.6**	$ 1,977.3	$ 1,947.9
Net income per common share	**$ 1.27**	$ 1.49	$ 1.44
Net income per common share–diluted	**$ 1.25**	$ 1.46	$ 1.39
Dividends per common share	**$ .23**	$ .22	$ .20
Weighted-average shares	**1,289.7**	1,323.2	1,355.3
Weighted-average shares–diluted	**1,309.3**	1,356.5	1,404.2

See notes to consolidated financial statements.

Consolidated balance sheet

IN MILLIONS, EXCEPT PER SHARE DATA	December 31, **2001**	2000
Assets		
Current assets		
Cash and equivalents	**$ 418.1**	$ 421.7
Accounts and notes receivable	**881.9**	796.5
Inventories, at cost, not in excess of market	**105.5**	99.3
Prepaid expenses and other current assets	**413.8**	344.9
Total current assets	**1,819.3**	1,662.4
Other assets		
Investments in and advances to affiliates	**990.2**	824.2
Goodwill, net	**1,419.8**	1,278.2
Miscellaneous	**1,015.7**	871.1
Total other assets	**3,425.7**	2,973.5
Property and equipment		
Property and equipment, at cost	**24,106.0**	23,569.0
Accumulated depreciation and amortization	**(6,816.5)**	(6,521.4)
Net property and equipment	**17,289.5**	17,047.6
Total assets	**$22,534.5**	$21,683.5
Liabilities and shareholders' equity		
Current liabilities		
Notes payable	**$ 184.9**	$ 275.5
Accounts payable	**689.5**	684.9
Income taxes	**20.4**	92.2
Other taxes	**180.4**	195.5
Accrued interest	**170.6**	149.9
Other accrued liabilities	**824.9**	608.4
Current maturities of long-term debt	**177.6**	354.5
Total current liabilities	**2,248.3**	2,360.9
Long-term debt	**8,555.5**	7,843.9
Other long-term liabilities and minority interests	**629.3**	489.5
Deferred income taxes	**1,112.2**	1,084.9
Common equity put options and forward contracts	**500.8**	699.9
Shareholders' equity		
Preferred stock, no par value; authorized–165.0 million shares; issued–none		
Common stock, $.01 par value; authorized–3.5 billion shares; issued–1,660.6 million shares	**16.6**	16.6
Additional paid-in capital	**1,591.2**	1,441.8
Unearned ESOP compensation	**(106.7)**	(115.0)
Retained earnings	**18,608.3**	17,259.4
Accumulated other comprehensive income	**(1,708.8)**	(1,287.3)
Common stock in treasury, at cost; 379.9 and 355.7 million shares	**(8,912.2)**	(8,111.1)
Total shareholders' equity	**9,488.4**	9,204.4
Total liabilities and shareholders' equity	**$22,534.5**	$21,683.5

See notes to consolidated financial statements.

Consolidated statement of cash flows

IN MILLIONS	Years ended December 31, **2001**	2000	1999
Operating activities			
Net income	**$ 1,636.6**	$ 1,977.3	$ 1,947.9
Adjustments to reconcile to cash provided by operations			
Depreciation and amortization	**1,086.3**	1,010.7	956.3
Deferred income taxes	**(87.6)**	60.5	52.9
Changes in operating working capital items			
Accounts receivable	**(104.7)**	(67.2)	(81.9)
Inventories, prepaid expenses and other current assets	**(62.9)**	(29.6)	(47.7)
Accounts payable	**10.2**	89.7	(23.9)
Taxes and other liabilities	**160.0**	(45.8)	270.4
Other	**50.4**	(244.1)	(65.1)
Cash provided by operations	**2,688.3**	2,751.5	3,008.9
Investing activities			
Property and equipment expenditures	**(1,906.2)**	(1,945.1)	(1,867.8)
Purchases of restaurant businesses	**(331.6)**	(425.5)	(340.7)
Sales of restaurant businesses and property	**375.9**	302.8	262.4
Other	**(206.3)**	(144.8)	(315.7)
Cash used for investing activities	**(2,068.2)**	(2,212.6)	(2,261.8)
Financing activities			
Net short-term borrowings (repayments)	**(248.0)**	59.1	116.7
Long-term financing issuances	**1,694.7**	2,381.3	902.5
Long-term financing repayments	**(919.4)**	(761.9)	(682.8)
Treasury stock purchases	**(1,068.1)**	(2,023.4)	(891.5)
Common stock dividends	**(287.7)**	(280.7)	(264.7)
Other	**204.8**	88.9	193.0
Cash used for financing activities	**(623.7)**	(536.7)	(626.8)
Cash and equivalents increase (decrease)	**(3.6)**	2.2	120.3
Cash and equivalents at beginning of year	**421.7**	419.5	299.2
Cash and equivalents at end of year	**$ 418.1**	$ 421.7	$ 419.5
Supplemental cash flow disclosures			
Interest paid	**$ 446.9**	$ 469.7	$ 411.5
Income taxes paid	**773.8**	854.2	642.2

See notes to consolidated financial statements.

Consolidated statement of shareholders' equity

IN MILLIONS, EXCEPT PER SHARE DATA	Common stock issued		Additional paid-in capital	Unearned ESOP compen-sation	Retained earnings	Accumulated other comprehensive income		Common stock in treasury		Total shareholders' equity
	Shares	Amount				Deferred hedging adjustment	Foreign currency translation	Shares	Amount	
Balance at December 31, 1998	1,660.6	$16.6	$ 989.2	$(148.7)	$13,879.6	$ —	$ (522.5)	(304.4)	$(4,749.5)	$9,464.7
Net income					1,947.9					1,947.9
Translation adjustments (including taxes of $53.5)							(364.3)			(364.3)
Comprehensive income										1,583.6
Common stock cash dividends ($.20 per share)					(264.7)					(264.7)
ESOP loan payment				15.8						15.8
Treasury stock purchases								(24.2)	(932.7)	(932.7)
Common equity put option issuances and expirations, net									(665.9)	(665.9)
Stock option exercises and other (including tax benefits of $185.3)			299.1	(0.4)				18.8	139.6	438.3
Balance at December 31, 1999	1,660.6	16.6	1,288.3	(133.3)	15,562.8	—	(886.8)	(309.8)	(6,208.5)	9,639.1
Net income					1,977.3					1,977.3
Translation adjustments (including taxes of $65.1)							(400.5)			(400.5)
Comprehensive income										1,576.8
Common stock cash dividends ($.22 per share)					(280.7)					(280.7)
ESOP loan payment				20.1						20.1
Treasury stock purchases								(56.7)	(2,002.2)	(2,002.2)
Common equity put option issuances and expirations, net									25.5	25.5
Stock option exercises and other (including tax benefits of $80.3)			153.5	(1.8)				10.8	74.1	225.8
Balance at December 31, 2000	1,660.6	16.6	1,441.8	(115.0)	17,259.4	—	(1,287.3)	(355.7)	(8,111.1)	9,204.4
Net income					**1,636.6**					**1,636.6**
Translation adjustments (including taxes of $65.7)							**(412.2)**			**(412.2)**
SFAS No.133 transition adjustment (including tax benefits of $9.2)						**(17.0)**				**(17.0)**
Fair value adjustments–cash flow hedges (including taxes of $1.4)						**7.7**				**7.7**
Comprehensive income										**1,215.1**
Common stock cash dividends ($.23 per share)					**(287.7)**					**(287.7)**
ESOP loan payment				**8.0**						**8.0**
Treasury stock purchases								**(36.1)**	**(1,090.2)**	**(1,090.2)**
Common equity put option issuances and expirations, net and forward contracts									**199.2**	**199.2**
Stock option exercises and other (including tax benefits of $70.0)			**149.4**	**0.3**				**11.9**	**89.9**	**239.6**
Balance at December 31, 2001	**1,660.6**	**$16.6**	**$1,591.2**	**$(106.7)**	**$18,608.3**	**$ (9.3)**	**$(1,699.5)**	**(379.9)**	**$(8,912.2)**	**$9,488.4**

See notes to consolidated financial statements.

Summary of significant accounting policies

NATURE OF BUSINESS
The Company operates in the food service industry and primarily operates quick-service restaurant businesses under the McDonald's brand. To capture additional meal occasions, the Company operates other restaurant concepts under its Partner Brands: Aroma Café, Boston Market, Chipotle and Donatos Pizzeria. In addition, the Company has a minority ownership in Pret A Manger. In fourth quarter 2001, the Company approved a plan to dispose of its Aroma Café business in the U.K. and expects to complete the sale in the first half of 2002.

All restaurants are operated by the Company or, under the terms of franchise arrangements, by franchisees who are independent entrepreneurs, or by affiliates operating under joint-venture agreements between the Company and local business people.

CONSOLIDATION
The consolidated financial statements include the accounts of the Company and its subsidiaries. Substantially all 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 accounting principles generally accepted in the U.S. 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.

REVENUE RECOGNITION
Sales by Company-operated restaurants are recognized on a cash basis. Revenues from franchised and affiliated restaurants include continuing rent and service fees as well as initial fees. Continuing fees are recognized in the period earned. Initial fees are recognized upon opening of a restaurant, which is when the Company has performed substantially all initial services required by the franchise arrangement.

FOREIGN CURRENCY TRANSLATION
The functional currency of substantially all operations outside the U.S. is the respective local currency, except for a small number of countries with hyperinflationary economies, where the functional currency is the U.S. Dollar.

ADVERTISING COSTS
Production costs for radio and television advertising, which are primarily in the U.S., are expensed when the commercials are initially aired. Advertising expenses included in costs of Company-operated restaurants and in selling, general & administrative expenses were (in millions): 2001–$600.9; 2000–$595.3; 1999–$522.9.

STOCK-BASED COMPENSATION
The Company accounts for stock options as prescribed by Accounting Principles Board Opinion No. 25 and includes pro forma information in the stock options note, 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–the lesser of useful lives of assets or lease terms including option periods; and equipment–three to 12 years.

GOODWILL
Goodwill represents the excess of cost over the value of net tangible assets of acquired restaurant businesses and, for acquisitions prior to July 1, 2001, is amortized using the straight-line method over an average life of about 30 years.

In June 2001, the Financial Accounting Standards Board issued SFAS No. 141, *Business Combinations,* effective for acquisitions initiated on or after July 1, 2001, and No. 142, *Goodwill and Other Intangible Assets,* effective for fiscal years beginning after December 15, 2001. SFAS No. 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001, and includes guidance on the initial recognition and measurement of goodwill and other intangible assets arising from business combinations. SFAS No. 142 indicates that goodwill (and intangible assets deemed to have indefinite lives) will no longer be amortized but will be subject to annual impairment tests. Other intangible assets will continue to be amortized over their useful lives.

The Company began applying the new rules on accounting for goodwill and other intangible assets January 1, 2002. Application of the nonamortization provisions of SFAS No.142 would have increased 2001 net income by approximately $30 million ($0.02 per share) and is expected to result in a similar increase in 2002.

In the first quarter of 2002, the Company is performing the first of required goodwill impairment tests as of January 1, 2002. The impairment test compares the fair value of a reporting unit, generally based on discounted cash flows, with its carrying amount including goodwill (we have defined reporting units as each individual country for McDonald's restaurant business and each individual Partner Brand). If the carrying amount of a reporting unit exceeds its fair value, an impairment loss is measured as the difference between the fair value of reporting unit goodwill and the carrying amount of the goodwill.

Based on the Company's preliminary analysis, the Company expects to record a non-cash goodwill impairment charge of about $100 million after tax ($0.08 per share), primarily in certain Latin American markets. Any impairment

that is required to be recognized when adopting SFAS No.142 will be reflected as the cumulative effect of a change in accounting principle in the first quarter of 2002.

LONG-LIVED ASSETS

In accordance with SFAS No.121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of,* long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. For purposes of reviewing McDonald's restaurant assets for potential impairment, assets are grouped together at a television market level in the U.S. and at a country level for each of the international markets. For Partner Brands, assets are grouped by each individual brand. If an indicator of impairment (e.g., negative operating cash flows for the most recent calendar year) exists for any grouping of assets, an estimate of undiscounted future cash flows produced by each restaurant within the asset grouping is compared to its carrying value. If a restaurant is determined to be impaired, the loss is measured by the excess of the carrying amount of the restaurant over its fair value as determined by an estimate of discounted future cash flows.

Losses on assets held for disposal are recognized when management has approved and committed to a plan to dispose of the assets, and the assets are available for disposal. Generally, such losses relate to either restaurants that have closed and ceased operations or businesses that are available for sale.

In August 2001, the Financial Accounting Standards Board issued SFAS No.144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* which provides additional guidance on the financial accounting and reporting for the impairment or disposal of long-lived assets. The Company will adopt the new rules as of January 1, 2002, and the adoption will not have a material effect on the Company's results of operations or financial position.

FINANCIAL INSTRUMENTS

The Company generally borrows on a long-term basis and is exposed to the impact of interest-rate changes and foreign currency fluctuations. In managing the impact of these changes, the Company uses interest-rate exchange agreements and finances in the currencies in which assets are denominated. The Company uses foreign currency denominated debt and derivatives to hedge foreign currency royalties, 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. 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.

The counterparties to these agreements consist of a diverse group of financial institutions. The Company continually monitors its positions and the credit ratings of its counterparties, and adjusts positions as appropriate. The Company did not have significant exposure to any individual counterparty at December 31, 2001 and has master agreements that contain netting arrangements. Certain of these agreements also require each party to post collateral if credit ratings fall below, or aggregate exposures exceed, certain contractual limits. At December 31, 2001, neither the Company nor its counterparties was required to post collateral for any obligation.

Effective January 1, 2001, the Company adopted SFAS No.133, *Accounting for Derivative Instruments and Hedging Activities,* as amended. SFAS No.133 requires companies to recognize all derivatives as either assets or liabilities in the balance sheet at fair value. SFAS No.133 also requires companies to designate all derivatives that qualify as hedging instruments as either fair value hedges, cash flow hedges or hedges of net investments in foreign operations. This designation is based upon the exposure being hedged.

The Company recorded a transition adjustment at January 1, 2001 related to cash flow hedges, which reduced accumulated other comprehensive income in shareholders' equity by $17.0 million, after tax. This adjustment was primarily related to interest-rate exchange agreements used to lock in long-term borrowing rates. The cumulative effect of adopting SFAS No.133 at January 1, 2001 was not material to the Company's statement of income.

All derivatives, primarily interest-rate exchange agreements and foreign currency exchange agreements, were classified in the Company's Consolidated balance sheet at December 31, 2001 as either miscellaneous other assets or other long-term liabilities (excluding accrued interest) and totaled $212.6 million and $134.2 million, respectively.

Fair value hedges

The Company enters into fair value hedges to reduce the exposure to changes in the fair value of an asset or a liability, or an identified portion thereof, which is attributable to a particular risk. The types of fair value hedges the Company enters into include: (1) interest-rate exchange agreements to convert a portion of its fixed-rate debt to floating-rate debt and (2) foreign currency exchange agreements for the exchange of various currencies and interest rates. The foreign currency exchange agreements are entered into to hedge the currency risk associated with debt and intercompany loans denominated in foreign currencies, and essentially result in floating-rate assets or liabilities denominated in U.S. Dollars or appropriate functional currencies.

For fair value hedges, the gains or losses on derivatives as well as the offsetting gains or losses on the related hedged items are recognized in current earnings. During the year ended December 31, 2001, there was no significant impact to the Company's earnings related to the ineffective portion of fair value hedging instruments.

Cash flow hedges

The Company enters into cash flow hedges to mitigate the exposure to variability in expected future cash flows attributable to a particular risk. The types of cash flow hedges

the Company enters into include: (1) interest-rate exchange agreements that effectively convert a portion of floating-rate debt to fixed-rate debt and are designed to reduce the impact of interest-rate changes on future interest expense, (2) forward foreign exchange contracts and foreign currency options that are designed to protect against the reduction in value of forecasted foreign currency cash flows such as royalties and other payments denominated in foreign currencies, and (3) foreign currency exchange agreements for the exchange of various currencies and interest rates. The foreign currency exchange agreements are entered into to hedge the currency risk associated with debt and intercompany loans denominated in foreign currencies, and essentially result in fixed-rate assets or liabilities denominated in U.S. Dollars or appropriate functional currencies.

For cash flow hedges, the effective portion of the gains or losses on derivatives is reported in the deferred hedging adjustment component of accumulated other comprehensive income in shareholders' equity and reclassified into earnings in the same period or periods in which the hedged transaction affects earnings. The remaining gain or loss in excess of the cumulative change in the present value of future cash flows of the hedged item, if any, is recognized in current earnings during the period of change. During the year ended December 31, 2001, there was no significant impact to the Company's earnings related to the ineffective portion of cash flow hedging instruments.

Subsequent to the transition adjustment recorded at January 1, 2001, the Company recorded increases to the deferred hedging adjustment component of accumulated other comprehensive income in shareholders' equity of $7.7 million, after tax, related to cash flow hedges during the year ended December 31, 2001. Based on interest rates and foreign currency exchange rates at December 31, 2001, no significant amount of deferred hedging adjustments, after tax, included in accumulated other comprehensive income in shareholders' equity at December 31, 2001, will be recognized in earnings in 2002 as the underlying hedged transactions are realized. The maximum maturity date of any cash flow hedge of forecasted transactions at December 31, 2001 was 15 months, excluding instruments hedging forecasted payments of variable interest on existing financial instruments that have various maturity dates through 2011.

Hedges of net investments in foreign operations

The Company uses forward foreign exchange contracts and foreign currency denominated debt to hedge its investments in certain foreign subsidiaries and affiliates. Realized and unrealized translation adjustments from these hedges are included in shareholders' equity in the foreign currency translation component of accumulated other comprehensive income and offset translation adjustments on the underlying net assets of foreign subsidiaries and affiliates, which also are recorded in accumulated other comprehensive income.

During the year ended December 31, 2001, the Company recorded increases in translation adjustments in accumulated other comprehensive income of $168.5 million, after tax, related primarily to foreign currency denominated debt designated as hedges of net investments.

COMMON EQUITY PUT OPTIONS AND FORWARD CONTRACTS

During 2001, 2000 and 1999, the Company sold 12.2 million, 16.8 million and 27.0 million common equity put options, respectively, in connection with its share repurchase program. Premiums received are recorded in shareholders' equity as a reduction of the cost of treasury stock purchased and were $31.8 million in 2001, $56.0 million in 2000 and $97.5 million in 1999. At December 31, 2001, 12.2 million common equity put options were outstanding. The options expire at various dates through November 2002 at exercise prices between $26.37 and $30.23. At December 31, 2001, the $350.0 million total exercise price of these outstanding options was classified in common equity put options and forward contracts in the Consolidated balance sheet, and the related offset was recorded in common stock in treasury, net of the premiums received.

During 2001, the Company also entered into equity forward contracts in connection with its share repurchase program. The forward contracts, for 5.5 million shares, settle in March 2002 and have an average purchase price of $27.41. At December 31, 2001, the $150.8 million total purchase price of these outstanding forward contracts was classified in common equity put options and forward contracts, and the related offset was recorded in common stock in treasury.

SALES OF STOCK BY SUBSIDIARIES AND AFFILIATES

As permitted by Staff Accounting Bulletin No. 51 issued by the Securities and Exchange Commission, when a subsidiary or affiliate sells unissued shares in a public offering, the Company records an adjustment to reflect an increase or decrease in the carrying value of its investment and a resulting gain or loss in nonoperating (income) expense.

PER COMMON SHARE INFORMATION

Diluted net income per common share is calculated using net income divided by diluted weighted-average shares. Diluted weighted-average shares include weighted-average shares outstanding plus the dilutive effect of stock options, calculated using the treasury stock method. The dilutive effect of stock options was (in millions of shares): 2001–19.6; 2000–33.3; 1999–48.9. Stock options that were not included in dilutive weighted-average shares because they would have been antidilutive were (in millions of shares): 2001–83.1; 2000–49.2; 1999–9.9. The dilutive effect of common equity put options and forward contracts was not significant.

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, net

IN MILLIONS	2001	2000	1999
Gains on sales of restaurant businesses	**$(112.4)**	$ (86.9)	$ (75.0)
Equity in earnings of unconsolidated affiliates	**(61.5)**	(120.9)	(138.3)
Charges for underperforming restaurant closings	**91.2**		
Asset impairment charges	**44.0**		
Other, net	**96.1**	11.4	108.1
Other operating (income) expense, net	**$ 57.4**	$(196.4)	$(105.2)

CHARGES FOR UNDERPERFORMING RESTAURANT CLOSINGS
In third and fourth quarters 2001, the Company recorded $91.2 million of pretax charges ($68.8 million after tax) related to the closing of 163 underperforming restaurants in international markets. The charges primarily consist of asset write-offs and lease termination payments.

ASSET IMPAIRMENT CHARGES
In second quarter 2001, the Company recorded a $24.0 million asset impairment charge (pre and after tax) due to an assessment of the ongoing impact of significant currency devaluation on McDonald's cash flows in Turkey.

In fourth quarter 2001, the Company recorded a pretax charge of $20.0 million ($13.6 million after tax) related to the anticipated disposal of Aroma Café in the U.K.

OTHER, NET
Other, net includes miscellaneous operating income and expense items including net gains or losses from property dispositions, provisions for bad debts and other transactions related to franchising and the food service business.

In third quarter 2001, the Company recorded a pretax charge of $17.4 million ($12.0 million after tax) primarily related to the write-off of certain technology costs in the Corporate segment.

In fourth quarter 2001, the Company recorded a pretax charge of $25.0 million ($17.0 million after tax) in the U.S. primarily related to unrecoverable costs incurred in connection with the theft of winning game pieces from the Company's Monopoly and certain other promotional games over an extended period of time, and the related termination of the supplier of the game pieces. Fifty-one people (none of whom were Company employees) were subsequently indicted on conspiracy and mail fraud charges.

In 1999, the Company wrote off $24.0 million ($16.3 million after tax) of software not used in the business.

Special charge–global change initiatives

In fourth quarter 2001, the Company recorded a $200.0 million pretax special charge ($136.1 million after tax) related to strategic changes and ongoing restaurant initiatives in the U.S. and certain international markets. The changes and initiatives are designed to improve the customer experience and grow McDonald's global business. The changes in the U.S. included streamlining operations by reducing the number of regions and divisions, enabling the Company to combine staff functions and improve efficiency. In addition, the U.S. business introduced a variety of initiatives designed to improve the restaurant experience including accelerated operations training, restaurant simplification, incentives for outstanding restaurant operations and an enhanced national restaurant evaluation system.

In connection with these initiatives, the Company eliminated approximately 850 positions, consisting of 700 positions in the U.S., primarily in the divisions and regions, and 150 positions in international markets.

The special charge consisted of $114.4 million of severance and other employee-related costs; $68.8 million of lease cancellation and other costs related to the closing of region and division facilities; and $16.8 million of other cash costs, primarily consisting of payments made to facilitate a timely and smooth change of ownership from franchisees who have had a history of financial difficulty and consequently were unable to deliver the level of operational excellence needed to succeed in the future.

Of the original $200.0 million pretax special charge, the remaining accrual of approximately $126.0 million at year-end 2001 primarily related to employee severance and lease payments for facilities that have been closed and was included in other accrued liabilities in the Consolidated balance sheet. Employee severance is paid in installments over a period of up to one year after termination, and the remaining lease payments for facilities that have been closed will be paid through 2010. No significant adjustments have been made to the original plan approved by management.

McDonald's Japan initial public offering (IPO) gain

In third quarter 2001, McDonald's Japan, the Company's largest market in the Asia/Pacific, Middle East and Africa segment, completed an IPO of 12 million shares at an offering price of 4,300 Yen per share ($34.77 per share). The Company owns 50% of McDonald's Japan while the Company's partner Den Fujita and his family now own approximately 26% and continue to be involved in the business. The Company recorded a $137.1 million gain (pre and after tax) in nonoperating income to reflect an increase in the carrying value of its investment as a result of the cash proceeds from the IPO received by McDonald's Japan.

Franchise arrangements

Individual franchise arrangements generally include a lease and a license and provide for payment of initial fees as well as continuing rent and service fees to the Company based upon a percent of sales, with minimum rent payments. McDonald's franchisees are granted the right to operate a restaurant using the McDonald's system and, in certain cases, the use of a restaurant facility, generally for a period of 20 years. Franchisees pay related occupancy costs including property taxes, insurance and maintenance. Franchisees in the U.S. generally have the option to own

new restaurant buildings, while leasing the land from McDonald's. In addition, franchisees outside the U.S. generally pay a refundable, noninterest-bearing security deposit. Foreign affiliates pay a royalty to the Company based upon a percent of sales.

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

Revenues from franchised and affiliated restaurants consisted of:

IN MILLIONS	2001	2000	1999
Minimum rents	**$1,477.9**	$1,465.3	$1,473.8
Percent rent and service fees	**2,290.2**	2,247.0	2,208.8
Initial fees	**61.2**	63.7	64.2
Revenues from franchised and affiliated restaurants	**$3,829.3**	$3,776.0	$3,746.8

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

IN MILLIONS	Owned sites	Leased sites	Total
2002	$ 948.7	$ 707.5	$ 1,656.2
2003	935.9	701.4	1,637.3
2004	920.3	689.3	1,609.6
2005	895.7	666.7	1,562.4
2006	870.8	647.2	1,518.0
Thereafter	7,384.0	5,771.9	13,155.9
Total minimum payments	$11,955.4	$9,184.0	$21,139.4

At December 31, 2001, net property and equipment under franchise arrangements totaled $9.0 billion (including land of $2.7 billion) after deducting accumulated depreciation and amortization of $3.4 billion.

Income taxes

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

IN MILLIONS	2001	2000	1999
U.S.	**$ 958.2**	$1,280.6	$1,222.2
Outside the U.S.	**1,371.5**	1,601.7	1,661.9
Income before provision for income taxes	**$2,329.7**	$2,882.3	$2,884.1

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

IN MILLIONS	2001	2000	1999
U.S. federal	**$ 357.3**	$361.1	$347.4
U.S. state	**59.7**	77.0	68.9
Outside the U.S.	**363.7**	406.4	467.0
Current tax provision	**780.7**	844.5	883.3
U.S. federal	**57.7**	75.2	31.3
U.S. state	**4.3**	9.5	12.3
Outside the U.S.	**(149.6)**	(24.2)	9.3
Deferred tax provision(1)	**(87.6)**	60.5	52.9
Provision for income taxes	**$ 693.1**	$905.0	$936.2

(1) Includes the one-time benefit of tax law changes in certain international markets: 2001–$(147.3) million; amounts in 2000 and 1999 were not significant.

Net deferred tax liabilities consisted of:

IN MILLIONS	December 31, 2001	2000
Property and equipment basis differences	**$1,304.4**	$1,202.6
Other	**429.9**	353.3
Total deferred tax liabilities	**1,734.3**	1,555.9
Deferred tax assets before valuation allowance(1)	**(899.9)**	(646.9)
Valuation allowance	**180.1**	124.0
Net deferred tax liabilities(2)	**$1,014.5**	$1,033.0

(1) Includes tax effects of loss carryforwards (in millions): 2001–$166.0; 2000–$129.4, and foreign tax credit carryforwards: 2001–$21.6; 2000–$41.2.

(2) Net of current tax assets included in prepaid expenses and other current assets in the Consolidated balance sheet (in millions): 2001–$97.7; 2000–$51.9.

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

	2001	2000	1999
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**	1.9	1.8
Benefits and taxes related to foreign operations(1)	**(7.8)**	(4.8)	(4.4)
Other, net	**.8**	(.7)	.1
Effective income tax rates	**29.8%**	31.4%	32.5%

(1) Includes the one-time benefit of tax law changes.

Deferred U.S. income taxes have not been recorded for basis differences related to investments in certain foreign subsidiaries and affiliates. These basis differences were approximately $2.7 billion at December 31, 2001, and consisted primarily of undistributed earnings considered permanently invested in the businesses. Determination of the deferred income tax liability on these unremitted earnings is not practicable because such liability, if any, is dependent on circumstances existing if and when remittance occurs.

Segment and geographic information

The Company operates in the food service industry. Substantially all revenues result from the sale of menu products at restaurants operated by the Company, franchisees or affiliates. 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 and income taxes, except for U.S. affiliates, which are reported before income taxes. Royalties and other payments received from subsidiaries outside the U.S. were (in millions): 2001–$607.7; 2000–$603.6; 1999–$568.3.

Segment information reflects the Company's current management structure. The new APMEA segment includes results for McDonald's restaurant operations in Asia/Pacific, the Middle East and Africa. The Partner Brands segment includes results for Aroma Café, Boston Market, Chipotle, Donatos and Pret A Manger. In addition, U.S. and Corporate selling, general & administrative expenses have been

restated to reflect a realignment of certain home office departments' responsibilities.

Corporate general & administrative expenses are included in the corporate segment of operating income and consist of home office support costs in areas such as facilities, finance, human resources, information technology, legal, supply chain management and training. Corporate assets include corporate cash and equivalents, asset portions of financing instruments, home office facilities and deferred tax assets.

IN MILLIONS	**2001**	2000	1999
U.S.	**$ 5,395.6**	$ 5,259.1	$ 5,093.0
Europe	**4,751.8**	4,753.9	4,924.9
APMEA	**2,203.3**	2,101.8	1,928.8
Latin America	**971.3**	949.3	680.3
Canada	**608.1**	615.1	575.6
Partner Brands	**939.9**	563.8	56.7
Total revenues	**$14,870.0**	$14,243.0	$13,259.3
U.S.	**$ 1,622.5**	$ 1,795.7	$ 1,678.6
Europe	**1,063.2**	1,180.1	1,256.5
APMEA	**325.0**	451.2	433.5
Latin America	**10.9**	102.3	133.0
Canada	**123.7**	126.3	113.3
Partner Brands	**(66.5)**	(41.5)	(7.5)
Corporate	**(381.8)**	(284.4)	(287.8)
Total operating income	**$ 2,697.0** (1)	$ 3,329.7	$ 3,319.6
U.S.	**$ 8,213.7**	$ 7,798.1	$ 7,607.4
Europe	**7,139.1**	7,083.7	6,966.8
APMEA	**3,144.5**	2,983.4	3,030.5
Latin America	**1,898.3**	1,855.6	1,477.5
Canada	**574.2**	552.0	573.6
Partner Brands	**637.1**	450.7	203.2
Corporate	**927.6**	960.0	1,124.2
Total assets	**$22,534.5**	$21,683.5	$20,983.2
U.S.	**$ 545.9**	$ 468.6	$ 426.4
Europe	**635.8**	797.6	881.8
APMEA	**275.7**	253.5	221.3
Latin America	**197.5**	245.7	213.2
Canada	**80.4**	52.5	63.0
Partner Brands	**153.3**	79.6	16.4
Corporate	**17.6**	47.6	45.7
Total capital expenditures	**$ 1,906.2**	$ 1,945.1	$ 1,867.8
U.S.	**$ 449.9**	$ 417.6	$ 399.7
Europe	**313.7**	296.5	305.2
APMEA	**133.2**	129.8	123.5
Latin America	**79.3**	69.4	45.5
Canada	**32.9**	34.9	35.3
Partner Brands	**36.8**	16.6	2.3
Corporate	**40.5**	45.9	44.8
Total depreciation and amortization	**$ 1,086.3**	$ 1,010.7	$ 956.3

(1) Includes $377.6 million of pretax special charges (U.S.–$181.0; Europe–$45.8; APMEA–$41.5; Latin America–$40.4; Canada–$9.8; Partner Brands–$24.9 and Corporate–$34.2) primarily related to the U.S. business reorganization and other global change initiatives, the closing of 163 underperforming restaurants in international markets and asset impairment charges. See other operating (income) expense, net and special charge–global change initiatives notes for further discussion.

Total long-lived assets, primarily property and equipment and goodwill, were (in millions)—Consolidated: 2001–$20,355.3; 2000–$19,798.3; 1999–$19,082.8. U.S. based: 2001–$8,670.4; 2000–$8,373.2; 1999–$7,984.9.

Leasing arrangements

At December 31, 2001, the Company was lessee at 6,866 restaurant locations through ground leases (the Company leases the land and the Company or franchisee owns the building) and at 7,089 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 existing operating leases with initial terms of one year or more are:

IN MILLIONS	Restaurant	Other	Total
2002	$ 772.3	$ 69.1	$ 841.4
2003	756.8	57.7	814.5
2004	731.1	48.2	779.3
2005	681.1	41.1	722.2
2006	653.5	36.4	689.9
Thereafter	5,901.6	166.8	6,068.4
Total minimum payments	$9,496.4	$419.3	$9,915.7

Rent expense was (in millions): 2001–$958.6; 2000–$886.4; 1999–$796.3. These amounts included percent rents in excess of minimum rents (in millions): 2001–$119.6; 2000–$133.0; 1999–$117.1.

Debt financing

LINE OF CREDIT AGREEMENTS

At December 31, 2001, the Company had several line of credit agreements with various banks totaling $1.3 billion, all of which remained unused at year-end 2001. Subsequent to year end, the Company renegotiated these line of credit agreements as follows: a $750.0 million line expiring in 2003 with a term of 364 days and fees of .045% per annum on the total commitment, with a feature that allows the Company to convert the borrowings to a one-year term loan at any time prior to expiration; a $500.0 million line expiring in February 2007 with fees of .065% per annum on the total commitment; and a $25.0 million line expiring in 2003 with a term of 364 days and fees of .07% per annum on the total commitment. 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 $785.3 million at December 31, 2001; 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, consisting of U.S. Dollar and Euro commercial paper and foreign currency bank line borrowings, was 3.4% at December 31, 2001 and 6.9% at December 31, 2000.

FAIR VALUES

At December 31, 2001, the fair value of the Company's debt and notes payable obligations was estimated at $9.1 billion, compared to a carrying amount of $8.9 billion. This fair value was 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.

The carrying amounts for both cash and equivalents and notes receivable approximate fair value. Foreign currency and interest-rate exchange agreements, foreign currency options and forward foreign exchange contracts were recorded in the Consolidated balance sheet at fair value estimated using various pricing models or discounted cash flow analyses that incorporated quoted market prices. No fair value was estimated for noninterest-bearing security deposits by franchisees, because these deposits are an integral part of the overall franchise arrangements. Given the market value of its common stock and its significant real estate holdings, the Company believes that the fair value of its total assets was substantially higher than the carrying value at December 31, 2001.

ESOP LOANS AND OTHER GUARANTEES

The Company has guaranteed and included in total debt at December 31, 2001 $26.8 million of Notes issued by the Leveraged Employee Stock Ownership Plan (ESOP) with payments through 2006. Borrowings related to the ESOP at December 31, 2001, which include $89.1 million of loans from the Company to the ESOP and the $26.8 million of Notes guaranteed by the Company, are reflected as long-term debt with a corresponding reduction of shareholders' equity (unearned ESOP compensation). The ESOP is repaying the loans and interest through 2018 using Company contributions and dividends from its McDonald's common stock holdings. As the principal amount of the borrowings is repaid, the debt and the unearned ESOP compensation are being reduced.

The Company also has guaranteed certain affiliate and other loans totaling $148.0 million at December 31, 2001.

DEBT OBLIGATIONS

The Company has incurred debt obligations principally through public and private offerings and bank loans. There are no provisions in the Company's debt obligations that would accelerate repayment of debt as a result of a change in credit ratings. Certain of the Company's debt obligations contain cross-default provisions and restrictions on Company and subsidiary mortgages and the 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 the Company's debt obligations (the interest rates reflected in the table include the effects of interest-rate and foreign currency exchange agreements):

IN MILLIONS OF U.S. DOLLARS	Maturity dates	Interest rates(1) December 31 2001	2000	Amounts outstanding December 31 2001	2000
Fixed–original issue(2)		**6.2%**	6.8%	**$ 3,293.8**	$2,793.2
Fixed–converted via exchange agreements(3)		**5.3**	6.1	**(1,829.9)**	(351.5)
Floating		**2.3**	6.6	**2,364.8**	914.1
Total U.S. Dollars	2002–2033			**3,828.7**	3,355.8
Fixed		**5.7**	5.7	**629.7**	679.1
Floating		**3.5**	4.8	**1,724.9**	1,609.6
Total Euro	2002–2015			**2,354.6**	2,288.7
Fixed		**6.1**	6.2	**698.8**	524.6
Floating		**5.6**	7.2	**150.3**	233.3
Total British Pounds Sterling	2002–2021			**849.1**	757.9
Fixed		**4.5**	5.5	**276.9**	346.5
Floating		**6.2**	6.7	**58.9**	25.7
Total other European currencies(4)	2002–2006			**335.8**	372.2
Fixed		**2.3**	2.7	**584.0**	589.0
Floating		**0.1**	0.5	**227.9**	262.4
Total Japanese Yen	2005–2030			**811.9**	851.4
Fixed		**7.1**	8.6	**317.6**	322.0
Floating		**6.2**	7.6	**300.0**	453.5
Total other Asia/Pacific currencies(5)	2002–2006			**617.6**	775.5
Fixed		**5.8**	5.6	**3.2**	4.1
Floating		**15.5**	12.8	**23.2**	68.3
Total other currencies	2002–2021			**26.4**	72.4
Debt obligations before fair value adjustments(6)				**8,824.1**	8,473.9
Fair value adjustments(7)				**93.9**	
Total debt obligations				**$ 8,918.0**	$8,473.9

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

(2) Includes $150 million of debentures that mature in 2027 ($500 million of debentures in 2000), which are subordinated to senior debt and 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 interest-rate exchange agreements.

(4) Primarily consists of Swiss Francs, Swedish Kronor and Danish Kroner in 2001 (Swiss Francs in 2000).

(5) Primarily consists of Korean Won, Chinese Renminbi and New Taiwanese Dollars in 2001 (Australian Dollars and New Taiwanese Dollars in 2000).

(6) Aggregate maturities for debt balances at December 31, 2001, before fair value adjustments, were as follows: 2002–$362.5; 2003–$796.4; 2004–$1,621.6; 2005–$1,072.0; 2006–$843.9; and thereafter–$4,127.7. These amounts include reclassifications of short-term obligations to long-term obligations of $750.0 in 2004 and $500.0 in 2007 as they are supported by long-term line of credit agreements discussed on page 50.

(7) Effective January 1, 2001, the Company adopted SFAS 133. As a result, debt obligations are adjusted to fair value to the extent of related hedging instruments. The related hedging instruments are also recorded at fair value in either miscellaneous other assets or long-term liabilities.

Property and equipment

Net property and equipment consisted of:

IN MILLIONS	December 31, **2001**	2000
Land	**$ 3,975.6**	$ 3,932.7
Buildings and improvements on owned land	**8,127.0**	8,250.0
Buildings and improvements on leased land	**8,020.2**	7,513.3
Equipment, signs and seating	**3,371.7**	3,172.2
Other	**611.5**	700.8
	24,106.0	23,569.0
Accumulated depreciation and amortization	**(6,816.5)**	(6,521.4)
Net property and equipment	**$17,289.5**	$17,047.6

Depreciation and amortization expense was (in millions): 2001–$945.6; 2000–$900.9; 1999–$858.1.

Employee benefit plans

The Company's Profit Sharing and Savings Plan for U.S.-based employees includes profit sharing, 401(k) and leveraged employee stock ownership (ESOP) features. The 401(k) feature allows participants to make pretax contributions that are partly matched from shares released under the ESOP. McDonald's executives, staff and restaurant managers participate in additional ESOP allocations and profit sharing contributions, based on their compensation. The profit sharing contribution is discretionary, and the Company determines the amount each year.

Participant 401(k) contributions, profit sharing contributions and any related earnings can be invested in McDonald's common stock or among several other investment alternatives. The Company's matching contributions and ESOP allocations are generally invested in McDonald's common stock. Beginning in first quarter 2002, the Company's matching contributions can be invested in McDonald's common stock or among the other investment alternatives.

In addition, the Company maintains a nonqualified, unfunded Supplemental Plan that allows participants to make tax-deferred contributions and receive Company-provided allocations that cannot be made under the Profit Sharing and Savings Plan because of Internal Revenue Service limitations. The investment alternatives in the Supplemental Plan include certain of the same investments as the Profit Sharing and Savings Plan. Total liabilities under the Supplemental Plan were $301.1 million at December 31, 2001 and $288.8 million at December 31, 2000, and were included in other long-term liabilities in the Consolidated balance sheet.

The Company has entered into derivative contracts to hedge the changes in these liabilities. At December 31, 2001, derivatives with a fair value of $68.2 million indexed to the Company's stock and $18.5 million indexed to certain market indices were included in miscellaneous other assets in the Consolidated balance sheet. All changes in Plan liabilities and in the fair value of the derivatives are recorded in selling, general & administrative expenses. Changes in fair value of the derivatives indexed to the Company's stock are recorded in the income statement because the contracts provide the counterparty with a choice of cash settlement or settlement in shares.

Total U.S. costs for the Profit Sharing and Savings Plan, including nonqualified benefits and related hedging activities, were (in millions): 2001–$54.6; 2000–$49.6; 1999–$49.4.

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): 2001–$39.7; 2000–$38.1; 1999–$37.2.

Other postretirement benefits and postemployment benefits, excluding severance benefits related to the global change initiatives, were immaterial.

Stock options

At December 31, 2001, the Company had five stock-based compensation plans for employees and nonemployee 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. In 2001, the Board of Directors approved a three-year extension to the term of 44.2 million options granted between May 1, 1999 and December 31, 2000 with an exercise price greater than $28.90. Because the market value of the stock was less than the exercise price of the options at the time of extension, no compensation expense was required to be recorded.

Also in 2001, the Board of Directors approved a special grant of 11.9 million options at a price of $28.90 as an incentive to meet an operating income performance goal for calendar year 2003. The options vest on January 31, 2004, and if the performance goal is met, the options will retain their original 10-year term; otherwise, they will expire on June 30, 2004.

At December 31, 2001, the number of shares of common stock reserved for issuance under the plans was 263.5 million including 70.6 million available for future grants. A summary of the status of the Company's plans as of December 31, 2001, 2000 and 1999, and changes during the years then ended, is presented in the following table.

Options	2001 Shares *IN MILLIONS*	2001 Weighted-average exercise price	2000 Shares *IN MILLIONS*	2000 Weighted-average exercise price	1999 Shares *IN MILLIONS*	1999 Weighted-average exercise price
Outstanding at beginning of year	**175.8**	**$25.34**	164.7	$23.06	164.0	$19.32
Granted(1)	**38.6**	**29.37**	26.5	35.16	25.4	40.35
Exercised	**(11.9)**	**13.70**	(10.8)	13.68	(18.8)	13.89
Forfeited	**(9.6)**	**29.03**	(4.6)	27.81	(5.9)	18.01
Outstanding at end of year	**192.9**	**$26.65**	175.8	$25.34	164.7	$23.06
Exercisable at end of year	**98.2**		79.3		69.4	

(1) Includes the special grant in 2001 of 11.9 million options discussed on page 52.

Options granted each year were 3.0%, 2.0% and 1.9% of weighted average common shares outstanding for 2001, 2000 and 1999, representing grants to approximately 15,100, 14,100 and 12,700 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 over the last three years was $7.29, while the average option exercise price over this period was $13.79. In addition, stock option exercises resulted in $335.6 million of tax benefits for the Company during the three years ended December 31, 2001.

The following table presents information related to options outstanding and options exercisable at December 31, 2001, based on ranges of exercise prices.

	December 31, 2001				
	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
$10 to 15	26.9	1.7	$13.58	26.9	$13.56
16 to 23	36.1	4.4	20.64	22.3	20.05
24 to 34	83.6	7.2	27.25	29.9	25.64
35 to 46	46.3	10.6	37.85	19.1	38.60
$10 to 46	192.9	6.7	$26.65	98.2	$23.60

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. 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. As a result, the pro forma disclosures for 2000 and 1999 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 estimated at the date of grant using an option pricing model. The model was designed to estimate the fair value of exchange-traded options that, 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 tables present the pro forma disclosures and the weighted-average assumptions used to estimate the fair value of these options:

Pro forma disclosures	**2001**	2000	1999
Net income–pro forma *IN MILLIONS*	**$1,481.8**	$1,842.4	$1,844.0
Net income per common share–pro forma			
Basic	**1.15**	1.39	1.36
Diluted	**1.13**	1.36	1.31
Weighted-average fair value per option granted	**10.66**	14.11	14.06

Assumptions	**2001**	2000	1999
Expected dividend yield	**.65%**	.65%	.65%
Expected stock price volatility	**29.9%**	38.8%	22.9%
Risk-free interest rate	**5.03%**	6.39%	5.72%
Expected life of options *IN YEARS*	**7**	7	7

Quarterly results (unaudited)

IN MILLIONS, EXCEPT PER SHARE DATA	Quarters ended December 31		Quarters ended September 30		Quarters ended June 30		Quarters ended March 31	
	2001	2000	**2001**	2000	**2001**	2000	**2001**	2000
Systemwide sales	**$10,112.7**	$9,924.5	**$10,629.2**	$10,512.4	**$10,238.8**	$10,237.6	**$9,649.7**	$9,506.7
Revenues								
Sales by Company-operated restaurants	**$ 2,811.4**	$2,676.6	**$ 2,876.9**	$ 2,768.5	**$ 2,738.2**	$ 2,582.0	**$2,614.2**	$2,439.9
Revenues from franchised and affiliated restaurants	**960.1**	913.0	**1,002.4**	980.5	**969.3**	978.6	**897.5**	903.9
Total revenues	**3,771.5**	3,589.6	**3,879.3**	3,749.0	**3,707.5**	3,560.6	**3,511.7**	3,343.8
Company-operated margin	**383.5**	404.2	**436.1**	470.9	**396.6**	435.0	**370.8**	406.8
Franchised margin	**758.1**	721.1	**799.0**	788.5	**771.4**	784.0	**700.6**	710.1
Operating income	**482.7**[1]	774.0	**746.6**[2]	910.8	**772.5**[4]	876.3	**695.2**	768.6
Net income	**$ 271.9**[1]	$ 452.0	**$ 545.5**[3]	$ 548.5	**$ 440.9**[4]	$ 525.9	**$ 378.3**	$ 450.9
Net income per common share	**$ .21**[1]	$ .35	**$ .42**[3]	$ .42	**$ .34**[4]	$ .40	**$ .29**	$ .34
Net income per common share–diluted	**.21**[1]	.34	**.42**[3]	.41	**.34**[4]	.39	**.29**	.33
Dividends per common share	**$ .225**	$ —	**$ —**	$ .215	**$ —**	$ —	**$ —**	$ —
Weighted-average shares	**1,282.7**	1,307.0	**1,286.1**	1,315.6	**1,289.7**	1,327.1	**1,300.7**	1,343.4
Weighted-average shares–diluted	**1,299.3**	1,335.8	**1,305.8**	1,346.0	**1,311.1**	1,365.5	**1,325.3**	1,383.8
Market price per common share								
High	**$ 30.10**	$ 34.50	**$ 31.00**	$ 34.25	**$ 30.96**	$ 39.94	**$ 35.06**	$ 43.63
Low	**25.00**	27.56	**26.00**	26.38	**25.39**	31.00	**24.75**	29.81
Close	**26.47**	34.00	**27.14**	30.19	**27.06**	32.94	**26.55**	37.38

(1) Includes the following pretax special charges totaling $0.13 of expense per share:

- *$200.0 million ($136.1 million after tax) related to the U.S. business reorganization and global change initiatives.*
- *$25.0 million ($17.0 million after tax) related to unrecoverable costs incurred in connection with the theft of promotional game pieces and the related termination of a supplier.*
- *$20.0 million ($13.6 million after tax) related to the anticipated disposition of Aroma Café in the U.K.*
- *$7.1 million ($4.8 million after tax) related to the closing of an additional nine underperforming restaurants in international markets.*

(2) Includes $101.5 million of pretax special charges ($76.0 million after tax) related primarily to the closing of 154 underperforming restaurants in international markets and the write-off of certain technology costs.

(3) In addition to the $101.5 million of pretax special charges noted in (2) above, includes $137.1 million gain (pre and after tax) on the initial public offering of McDonald's Japan and $12.4 million of pretax special charges ($8.1 million after tax) primarily related to the write-off of a corporate investment (totaling $0.04 of income per share).

(4) Includes $24.0 million asset impairment charge (pre and after tax or $0.02 per share) in Turkey.

Management's report

Management is responsible for the preparation, integrity and fair presentation of the consolidated financial statements and financial comments. The financial statements were prepared in accordance with accounting principles generally accepted in the U.S. and include certain amounts based on management's judgment and best estimates. Other financial information presented 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 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 to the effectiveness of any system of internal control, including the possibility of human error and the circumvention or overriding of controls. Accordingly, even an effective internal control system can provide only reasonable assurance with respect to financial statement preparation and safeguarding of assets. Furthermore, the effectiveness of an internal control system can change with circumstances. The Company believes that 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.

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

McDONALD'S CORPORATION
January 24, 2002

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, 2001 and 2000, and the related Consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2001. 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 auditing standards generally accepted in the U.S. 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, 2001 and 2000, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2001, in conformity with accounting principles generally accepted in the U.S.

As discussed in the Notes to the consolidated financial statements, effective January 1, 2001, the Company changed its method for accounting for derivative financial instruments to conform with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities.*

ERNST & YOUNG LLP
Chicago, Illinois
January 24, 2002