

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

*Unless otherwise noted, the section references to (i) "us", "our", "we", "the Company" and "YUM" refer to YUM Brands, Inc. and its consolidated subsidiaries, (ii) "the Parent" refers to YUM Brands, Inc., on a stand-alone basis, (iii) "the Issuers" refers to KFC Holding Co., Pizza Hut Holdings, LLC and Taco Bell of America, LLC, which are direct wholly-owned subsidiaries of the Parent and co-issuers of \$1.05 billion of 5.00% Senior Notes due 2024, \$1.05 billion of 5.25% Senior Notes due 2026, and \$750 million of 4.75% Senior Notes due 2027 (collectively, the "Subsidiary Senior Unsecured Notes") and co-borrowers under the Credit Agreement, as defined in our annual report on Form 10-K for the year ended December 31, 2017 filed with the SEC (the "2017 10-K") on February 22, 2018; (iii) "the Specified Guarantors" refers to collectively Yum Restaurant Services Group, LLC, Restaurant Concepts LLC and Taco Bell Corp. (including their subsidiaries except for Taco Bell Funding, LLC and its special-purpose, wholly owned subsidiaries), which are directly wholly-owned subsidiaries of the Parent and guarantors of the Notes and under the Credit Agreement; (iv) "the Companies" refers to collectively the Issuers and the Specified Guarantors, (v) "the Taco Bell Securitization Entities" refers to collectively Taco Bell Funding, LLC, a Delaware special purpose limited liability company and wholly owned subsidiary of Taco Bell Corp, and its special-purpose, wholly owned subsidiaries, and (vi) the "Restricted Group" refers collectively to the Companies and their subsidiaries, other than the Taco Bell Securitization Entities which will not be subject to the covenants under the Indenture governing the Subsidiary Senior Unsecured Notes and the Credit Agreement, and also excludes the Parent and ABR Insurance Company which will not be subject to such covenants as well.*

*This discussion should be read in conjunction with the Condensed Consolidated Financial Statements ("Financial Statements") and the section "Management's Discussion and Analysis of Financial Condition and Results of Operations" contained in our quarterly report on Form 10-Q for the quarter ended June 30, 2018 as filed with the SEC on August 7, 2018 (the "Second Quarter 10-Q") and contains additional information related to the pro forma results of operations and financial condition of the Restricted Group. None of the financial information in this discussion has been audited or reviewed by our auditors. This discussion has been prepared and posted to our website in accordance with our reporting obligations under the Indenture governing the Subsidiary Senior Unsecured Notes and the Credit Agreement. You should read the following Restricted Group's pro forma results of operation and financial condition together with the information included in our 2017 10-K, especially the information under the heading "Risk Factors".*

### *Pro Forma Results of Operations for the Restricted Group*

The following table sets forth certain unaudited financial and operating data of the Restricted Group as of the dates and for the periods indicated after giving pro forma effect to the exclusion of the Taco Bell Securitization Entities from the Restricted Group as if the Securitization Transaction had occurred on the first day of fiscal year 2017.

	Quarter ended			Year to date		
	2018	2017	% B/(W)	2018	2017	% B/(W)
Company sales	\$ 512	\$ 909	(44)	\$ 1,024	\$ 1,811	(43)
Franchise and property revenues	461	425	8	929	832	12
Franchise contributions for advertising and other services	272	—	N/A	547	—	N/A
Total revenues	<u>\$ 1,245</u>	<u>\$ 1,334</u>	(7)	<u>\$ 2,500</u>	<u>\$ 2,643</u>	(5)
Restaurant profit	\$ 77	\$ 143	(46)	\$ 138	\$ 269	(49)
Restaurant margin %	15.1 %	15.6 %	(0.5) ppts.	13.4 %	14.8 %	(1.4) ppts.
G&A expenses	\$ 178	\$ 220	18	\$ 366	\$ 431	15
Operating Profit	\$ 342	\$ 314	9	\$ 797	\$ 698	14

### Performance Metrics

Unit Count	6/30/2018	6/30/2017	% Increase (Decrease)
Franchise	38,378	35,945	7
Company-owned	1,302	2,512	(48)
	<u>39,680</u>	<u>38,457</u>	3

	Quarter ended		Year to date	
	2018	2017	2018	2017
System Sales Growth (decline), reported	6	3	7	2
System Sales Growth, excluding FX	3	5	3	4
Same-store Sales Growth %	1	2	1	1

The Securitization Transaction and the exclusion of the Taco Bell Securitization Entities from the Restricted Group had the following pro forma impact on the financial and operating data of the Restricted Group and the Taco Bell Division of the Restricted Group in comparison to the corresponding data of YUM and the Taco Bell Division:

#### Units

- A total of 5,886 and 5,535 U.S. Taco Bell franchise units were excluded from the Restricted Group as of June 30, 2018 and 2017, respectively, as the Restricted Group no longer receives franchise fees from these restaurants.

#### Franchise and Property Revenues

- Franchise and property revenues decreased \$123 million and \$114 million during the quarters ended June 30, 2018 and 2017, respectively, due to the exclusion of the franchise fees paid by all U.S. Taco Bell franchise restaurants as a result of the Securitization Transaction.
- Franchise and property revenues decreased \$239 million and \$222 million for the years to date ended June 30, 2018 and 2017, respectively, due to the exclusion of the franchise fees paid by all U.S. Taco Bell franchise restaurants as a result of the Securitization Transaction.

#### Company Restaurant Expenses

- Company restaurant expenses increased \$14 million and \$18 million during the quarters ended June 30, 2018 and 2017, respectively, due to the payment of royalty fees of 5.5% of annual sales to the Taco Bell Securitization Entities by all U.S. Company-owned Taco Bell restaurants (which are part of the Restricted Group).
- Company restaurant expenses increased \$27 million and \$36 million for the years to date ended June 30, 2018 and 2017, respectively, due to the payment of royalty fees of 5.5% of annual sales to the Taco Bell Securitization Entities by all U.S. Company-owned Taco Bell restaurants (which are part of the Restricted Group).

#### G&A Expenses

- G&A expenses decreased \$28 million and \$27 million during the quarters ended June 30, 2018 and 2017, respectively, due to the management fees paid by the Taco Bell Securitization Entities to Taco Bell Corp. as manager of the Taco Bell Securitization Entities. These fees are recorded as a reduction of G&A expenses and, on an annual basis, are equal to the sum of a base fee of \$35 million (subject to 2% per annum escalation, compounded annually) plus 15.1% of total securitization cash revenue paid to the Taco Bell Securitization Entities by company stores and franchisees for the year.
- G&A expenses decreased \$56 million and \$53 million for the years to date ended June 30, 2018 and 2017, respectively, due to the management fees paid by the Taco Bell Securitization Entities to Taco Bell Corp. as manager of the Taco Bell Securitization Entities. These fees are recorded as a reduction of G&A expenses and, on an annual basis, are equal to the sum of a base fee of \$35 million (subject to 2% per annum escalation, compounded annually) plus 15.1% of total securitization cash revenue paid to the Taco Bell Securitization Entities by company stores and franchisees for the year.

Consequently, the overall operating margins of the Restricted Group were negatively impacted due to the loss of franchise and license fees from U.S. franchised restaurants and our obligation to pay franchise fees on U.S. Company-owned restaurants to the Taco Bell Securitization Entities, while maintaining the same level of expenses (other than the reimbursement of a portion of G&A expenses).

Beginning in 2018, amounts transferred to or on behalf of Yum! Brands, Inc. as Parent Entity Expenses (as defined in the Indentures) or operating costs and expenses incurred in the ordinary course of business (as permitted by the Credit Agreement) were excluded from G&A expenses of the Restricted Group. G&A expenses of the Restricted Group were reduced for such costs by \$2 million for the quarter ended June 30, 2018 and \$5 million for year to date ended June 30, 2018.

System sales growth was negatively impacted by the refranchising of U.S. Company-owned Taco Bell restaurants. These refranchised units were no longer included in the Restricted Group upon completion of the refranchising transaction.

**Restricted Group - Taco Bell Division**

	Quarter ended				Year to date			
	2018	2017	% B/(W)		2018	2017	% B/(W)	
			Reported	Ex FX			Reported	Ex FX
System Sales Growth			(16)	(16)			(17)	(17)
Same-Store Sales Growth %			3	N/A			2	N/A
Company sales	\$ 253	\$ 336	(25)	(25)	\$ 496	\$ 673	(26)	(26)
Franchise and property revenues	11	6	85	84	23	12	88	86
Franchise contributions for advertising and other services	97	—	N/A	N/A	\$ 188	\$ —	N/A	N/A
Total revenues	<u>\$ 361</u>	<u>\$ 342</u>	6	6	<u>\$ 707</u>	<u>\$ 685</u>	3	3
Restaurant profit	\$ 46	\$ 58	(19)	(19)	\$ 82	\$ 114	(28)	(28)
Restaurant margin %	18.6%	17.3%	1.3 ppts.	1.3 ppts.	16.4%	16.8%	(0.4) ppts.	(0.4) ppts.
G&A expenses	\$ 13	\$ 12	(7)	(7)	\$ 25	\$ 28	13	14
Franchise and property expenses	6	5	(25)	(25)	12	10	(22)	(21)
Franchise advertising and other services expense	96	—	N/A	N/A	186	—	N/A	N/A
Operating Profit	\$ 40	\$ 47	(14)	(14)	\$ 71	\$ 88	(19)	(19)

Unit Count	6/30/2018	6/30/2017	% Increase (Decrease)
Franchise	413	354	17
Company-owned	606	797	(24)
	<u>1,019</u>	<u>1,151</u>	(11)

*Company Sales.* The decrease in Company sales for the quarter was driven primarily by refranchising, partially offset by company same-store sales growth of 3% and net unit growth.

The year to date decrease in Company sales was driven primarily by refranchising, partially offset by company same-store sales growth of 2% and net unit growth.

*Restaurant Profit.* The decrease in Restaurant profit for the quarter was driven primarily by refranchising and higher labor costs, partially offset by company same-store sales growth of 3%.

The year to date decrease in Restaurant profit was driven primarily by refranchising, higher labor costs and increased commodity cost inflation, partially offset by company same-store sales growth of 2%.

*G&A Expenses.* The quarterly increase in G&A expenses was driven primarily by lapping lower litigation costs. The year to date decrease in G&A expenses was driven primarily by higher management fees paid by the Taco Bell Securitization Entities and the favorable impact of forfeitures related to share based compensation awards, partially offset by lapping lower litigation costs.

*Operating Profit.* The quarterly and year to date decreases in Operating Profit were driven by refranchising and higher restaurant operating costs, partially offset by same-store sales growth.

#### **Additional Information Related to Restricted Group:**

##### **Adoption of Topic 606**

From 2014 through 2017 the FASB issued standards to provide principles within a single framework for revenue recognition of transactions involving contracts with customers across all industries ("Topic 606"). We adopted these standards beginning with the quarter ended March 31, 2018, using the modified retrospective method. The impact on the Restricted Group Operating Profit was not significant.

Refer to Notes 2 and 5 of the Form 10-Q for the quarter ended June 30, 2018 for further discussion.