

## 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, 2018 filed with the SEC (the "2018 10-K") on February 20, 2019; (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 September 30, 2019 as filed with the SEC on November 5, 2019 (the "Third 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 2018 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 2018.

(in millions)	Quarter ended			Year to date		
	2019	2018	% B/(W)	2019	2018	% B/(W)
Company sales	\$ 364	\$ 499	(27)	\$ 1,056	\$ 1,523	(31)
Franchise and property revenues	505	475	6	1,482	1,404	6
Franchise contributions for advertising and other services	330	287	15	957	834	15
Total revenues	<u>\$ 1,199</u>	<u>\$ 1,261</u>	(5)	<u>\$ 3,495</u>	<u>\$ 3,761</u>	(7)
Restaurant profit	\$ 60	\$ 85	(28)	\$ 172	\$ 223	(23)
Restaurant margin %	16.9%	17.2%	(0.3) ppts.	16.3%	14.7%	1.7 ppts.
G&A expenses	\$ 177	\$ 175	(1)	\$ 523	\$ 541	3
Operating Profit	\$ 359	\$ 437	(18)	\$ 1,036	\$ 1,234	(16)

### Performance Metrics

Unit Count	9/30/2019	9/30/2018	% Increase (Decrease)
Franchise	42,079	38,852	8
Company-owned	883	1,173	(25)
	<u>42,962</u>	<u>40,025</u>	7

	Quarter ended		Year to date	
	2019	2018	2019	2018
System Sales Growth (decline), reported	6%	2%	5%	5%
System Sales Growth, excluding FX	7%	4%	8%	4%
Same-store Sales Growth %	2%	2%	3%	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 6,196 and 5,951 U.S. Taco Bell franchise units were excluded from the Restricted Group as of September 30, 2019 and 2018, respectively, as the Restricted Group no longer receives franchise fees from these restaurants.

### Franchise and Property Revenues

- Franchise and property revenues of \$140 million and \$130 million were excluded from the Restricted Group for the quarters ended September 30, 2019 and 2018, 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 of \$408 million and \$369 million were excluded from the Restricted Group for the years to date ended September 30, 2019 and 2018, 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

- The Restricted Group includes \$12 million and \$15 million of additional company restaurant expenses for the quarters ended September 30, 2019 and 2018, 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).
- The Restricted Group includes \$34 million and \$42 million of additional company restaurant expenses for the years to date ended September 30, 2019 and 2018, 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

- Management fees of \$29 million for each of the quarters ended September 30, 2019 and 2018 were paid by the Taco Bell Securitization Entities to Taco Bell Corp. as manager of the Taco Bell Securitization Entities, and were recorded as a reduction of G&A expenses for the Restricted Group. On an annual basis, these management fees 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 U.S. company stores and U.S. franchisees for the year.
- Management fees of \$88 million and \$85 million for the years to date ended September 30, 2019 and 2018, respectively, were paid by the Taco Bell Securitization Entities to Taco Bell Corp. as manager of the Taco Bell Securitization Entities, and were recorded as a reduction of G&A expenses for the Restricted Group. On an annual basis, these management fees 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 U.S. company stores and U.S. franchisees for the year.

Consequently, the overall operating margins of the Restricted Group are negatively impacted due to the exclusion of franchise and license fees from U.S. Taco Bell franchised restaurants and our obligation to pay franchise fees on U.S. Taco Bell Company-owned restaurants to the Taco Bell Securitization Entities, with no corresponding reduction of Restricted Group expenses (other than a partial offset by the management fee paid to the Restricted Group by the Taco Bell Securitization Entities as reimbursement for a portion of G&A expenses).

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) are excluded from G&A expenses of the Restricted Group. G&A expenses of the Restricted Group were reduced for such costs by \$2 million and less than \$1 million for the quarters ended September 30, 2019 and 2018, respectively, and \$6 million and \$5 million for the years to date ended September 30, 2019 and 2018, respectively.

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**

(in millions)	Quarter ended				Year to date			
	2019	2018	% B/(W)		2019	2018	% B/(W)	
			Reported	Ex FX			Reported	Ex FX
System Sales Growth			(8)	(7)			(8)	(7)
Same-Store Sales Growth %			4	N/A			4	N/A
Company sales	\$ 216	\$ 265	(18)	(18)	\$ 626	\$ 761	(18)	(18)
Franchise and property revenues	18	12	45	45	52	35	46	47
Franchise contributions for advertising and other services	115	106	8	8	\$ 328	\$ 294	11	11
Total revenues	<u>\$ 349</u>	<u>\$ 383</u>	(9)	(9)	<u>\$ 1,006</u>	<u>\$ 1,090</u>	(8)	(8)
Restaurant profit	\$ 38	\$ 50	(23)	(23)	\$ 110	\$ 132	(17)	(17)
Restaurant margin %	18.2%	19.3%	(1.1) ppts.	(1.1) ppts.	17.6%	17.4%	0.2 ppts.	0.2 ppts.
G&A expenses	\$ 11	\$ 11	5	5	\$ 36	\$ 36	(1)	(2)
Franchise and property expenses	9	5	(59)	(59)	26	17	(47)	(47)
Franchise advertising and other services expense	113	107	(7)	(7)	325	293	(11)	(11)
Operating Profit	\$ 38	\$ 45	(17)	(17)	\$ 104	\$ 116	(11)	(11)

Unit Count	9/30/2019	9/30/2018	% Increase (Decrease)
Franchise	521	430	21
Company-owned	474	561	(16)
	<u>995</u>	<u>991</u>	-

*Company Sales.* The quarterly decrease in Company sales was driven by refranchising, partially offset by net new unit growth and company same-store sales growth of 2%.

The year to date decrease in Company sales was driven by refranchising, partially offset by company same-store sales growth of 4% and net new unit growth.

*Restaurant Margin Percentage.* The quarterly decrease in restaurant margin percentage was driven by higher labor and commodity costs inflation, partially offset by same-store sales growth.

The year to date increase in restaurant margin percentage was driven by same-store sales growth, partially offset by higher labor, commodity and other operating costs.

*G&A Expenses.* The quarterly decrease in G&A expenses driven by the positive impacts of YUM's Strategic Transformation Initiatives was partially offset by the impact of higher incentive compensation.

The year to date increase in G&A expenses driven by the unfavorable impact of lapping prior year forfeitures related to share based compensation awards was offset by higher management fees received from the Taco Bell Securitization Entities.

*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 842**

Starting in February 2016 and continuing into 2019, the Financial Accounting Standards Board ("FASB") issued standards on the recognition and measurement of leases ("Topic 842"). We adopted these standards beginning with the quarter ended March 31, 2019, using a modified retrospective transition approach for leases existing at, or entered into after, the beginning of 2019. 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 September 30, 2019 for further discussion.