

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 and \$1.05 billion of 5.25% Senior Notes due 2026 (collectively, the "Subsidiary Senior Unsecured Notes") and co-borrowers under the Credit Agreement (as defined herein); (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 Consolidated Financial Statements ("Financial Statement") and the section "Management's Discussion and Analysis of Financial Condition and Results of Operations" contained in our our annual report on Form 10-K for the year ended December 31, 2016 filed with the SEC (the "2016 10-K") on February 21, 2017, 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 2016 10-K, especially the information under the heading "Risk Factors".

Separation of Yum China

On October 31, 2016 (the "Distribution Date"), we completed the spin-off of our China business (the "Separation") into an independent, publicly-traded company under the name of YUM China Holdings, Inc. ("Yum China"). Concurrent with the Separation, a subsidiary of the Company entered into a master license agreement with a subsidiary of Yum China for the exclusive right to use and sublicense the use of intellectual property owned by YUM and its affiliates for the development and operation of KFC, Pizza Hut and Taco Bell restaurants in China. Prior to the Separation, our operations in mainland China were historically reported in our former China Division segment results. As a result of the Separation, the results of operations, assets and liabilities, and cash flows of the separated business are presented as Discontinued Operations in our Consolidated Statements of Income, Consolidated Balance Sheets and Consolidated Statements of Cash Flows for all periods presented.

The financial and operational data presented in our 2016 10-K gives pro forma effect to the 3% license fee paid by Yum China to the Restricted Group pursuant to the master license. As a result of the Separation, we have restated the results of our KFC and Pizza Hut Divisions for historical periods prior to the Separation to reflect the intercompany royalties that were previously eliminated as intercompany transactions and related taxes that were previously included in our former China Division results. We have also restated the results of our KFC and Pizza Hut Divisions to include the royalties paid by third-party franchisees previously included in China Division results that will be continued pursuant to the master license agreement following the Separation. As a result, no pro-forma treatment is required since the historical results of operations for our KFC and Pizza Hut Divisions present the impact of the Separation.

Securitization Transaction

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 in comparison to the corresponding data of YUM:

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 Securitization Transaction as if it had occurred on the first day of fiscal year 2014.

	% B/(W)						
				2016		2015	
	2016	2015	2014	Reported	Ex FX	Reported	Ex FX
Company sales	4,200	4,356	4,503	(4)	-	(3)	5
Franchise and license fees and income	1,709	1,658	1,690	3	7	(2)	5
Total revenues	<u>5,909</u>	<u>6,014</u>	<u>6,193</u>	(2)	2	(3)	5
G&A expenses	1,047	987	921	(6)	(8)	(7)	(13)
Operating Profit	1,198	1,003	1,150	19	25	(13)	(5)

For fiscal years 2016, 2015 and 2014 rent expense for the Restricted Group was \$242 million, \$255 million and \$280 million, respectively.

	2016	2015
System Sales Growth (decline), reported	1%	(2) %
System Sales Growth, excluding FX	5%	4 %
Same-Store Sales Growth %	1%	1 %

				% Increase (Decrease)	
	2016	2015	2014	2016	2015
<u>Unit Count</u>					
Franchise & License	35,359	34,036	32,989	4	3
Company-owned	<u>2,859</u>	<u>3,159</u>	<u>3,247</u>	(9)	(3)
	<u>38,218</u>	<u>37,195</u>	<u>36,236</u>	3	3

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 in comparison to the corresponding data of YUM:

Units

- A total of 5,399, 5,227 and 4,995 U.S. Taco Bell franchised and licensed units were excluded from the Restricted Group for the fiscal years 2016, 2015 and 2014, respectively, as the Restricted Group will no longer receive franchise fees from these restaurants;

Franchise and License Fees and Income

- Franchise and license fees and income decreased \$457 million, \$426 million and \$394 million for fiscal years 2016, 2015 and 2014, respectively, due to the exclusion of the franchise fees paid by all U.S. Taco Bell franchised and licensed restaurants as a result of the Securitization Transaction;

Company Restaurant Expenses

- Company restaurant expenses increased \$84 million, \$85 million and \$80 million for fiscal years 2016, 2015 and 2014, 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 \$114 million, \$112 million and \$107 million for fiscal years 2016, 2015 and 2014 due to the management fees paid by the Taco Bell Securitization Entities to Taco Bell Corp. as manager of the Taco Bell Securitization Entities, which 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 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 margins of the Restricted Group were negatively impacted due to the loss of substantial 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).

Restricted Group - Taco Bell Division

	2016	2015	2014	% B/(W)				
				2016			2015	
				Reported	Ex FX	Ex FX and 53 rd Week	Reported	Ex FX
Company sales	1,540	1,544	1,454	-	-	(2)	6	6
Franchise and license fees and income	28	21	17	34	35	35	23	27
Total revenues	<u>1,568</u>	<u>1,565</u>	<u>1,471</u>	-	-	(1)	6	6
Restaurant profit	258	257	194	-	-	(2)	32	32
Restaurant margin %	16.8%	16.7%	13.4%	0.1 ppts.	- ppts.	(0.1) ppts.	3.3 ppts.	3.3 ppts.
G&A expenses	99	118	80	16	15	15	(47)	(47)
Operating Profit	166	137	111	21	21	21	23	23

	2016	2015
System Sales Growth (decline), reported	1%	3 %
System Sales Growth, excluding FX	1%	4 %
Same-Store Sales Growth %	1%	4 %

				% Increase (Decrease)	
	2016	2015	2014	2016	2015
<u>Unit Count</u>					
Franchise & License	320	280	278	14	1
Company-owned	885	900	933	(2)	(4)
	<u>1,205</u>	<u>1,180</u>	<u>1,211</u>	2	(3)

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 Taco Bell Division of the Restricted Group in comparison to the corresponding data of the Taco Bell Division of YUM:

Units

- A total of 5,399, 5,227 and 4,995 U.S. Taco Bell franchised and licensed units were excluded from our Restricted Group for fiscal years 2016, 2015 and 2014, respectively, as the Restricted Group no longer receives franchise fees from these restaurants;

Franchise and License Fees and Income

- Franchise and license fees and income decreased \$457 million, \$426 million and \$394 million for fiscal years 2016, 2015 and 2014, respectively, due to the exclusion of the franchise fees paid by all U.S. Taco Bell franchised restaurants as a result of the Securitization Transaction;

Company Occupancy and Other Expenses

- Company occupancy and other expenses increased \$84 million, \$85 million and \$80 million for each of the fiscal years of 2016, 2015 and 2014, 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 \$114 million, \$112 million, and \$107 million for each of the fiscal years of 2016, 2015 and 2014, respectively, due to the management fees paid by the Taco Bell Securitization Entities to the Taco Bell Corp. as manager of the Taco Bell Securitization Entities, which 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 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 impact to franchise and license fees from U.S. franchised Taco Bell restaurants and the payment of 5.5% 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 through receipt of the management fee).

Company Sales. In 2016, the decrease in Company sales, excluding the impacts of foreign currency translation and 53rd week, was driven primarily by refranchising, partially offset by net new unit growth and Company same-store sales growth of 1%.

In 2015, the increase in Company sales was driven primarily by company same-store sales growth of 4% and net new unit growth, partially offset by a 4% decrease in Company-owned units as a result of refranchising.

Restaurant Profit. In 2016, the decrease in Restaurant profit, excluding the impacts of foreign currency translation and 53rd week, was driven primarily by higher labor costs, refranchising, and higher store level investments, partially offset by Company same-store sales growth of 1%, favorable commodity costs and net new unit growth.

In 2015, the increase in Restaurant profit was driven primarily by company same-store sales growth of 4% and commodity deflation.

G&A Expenses. In 2016, the decrease in G&A expenses, excluding the impact of foreign currency translation, was driven by lower U.S. pension costs, lapping the Live Mas Scholarship contribution, and lower litigation costs.

In 2015, the increase in G&A expenses was driven by higher incentive compensation costs, investment spending on strategic growth and technology initiatives, higher U.S. pension costs, higher litigation costs and the creation of the Live Mas Scholarship.

Operating Profit. In 2016, the increase in Operating Profit, excluding the impacts of foreign currency translation and 53rd week, was driven by same-store sales growth, lower G&A expenses and net new unit growth, partially offset by refranchising.

In 2015, the increase in Operating Profit was driven by same-store sales growth and commodity deflation, partially offset by higher G&A expenses.