YUM BRANDS INC
Form 10-Q
April 26, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 10-Q

(Mark One)
[ü] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the quarterly period ended March 19, 2011

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ____________ to _________________

Commission file number 1-13163

YUM! BRANDS, INC.
(Exact name of registrant as specified in its charter)

North Carolina (State or other jurisdiction of incorporation or organization)	13-3951308 (I.R.S. Employer Identification No.)
1441 Gardiner Lane, Louisville, Kentucky (Address of principal executive offices)	40213 (Zip Code)

Registrant’s telephone number, including area code: (502) 874-8300

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [√] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [√] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one): Large accelerated filer: [√] Accelerated filer: [ ] Non-accelerated filer: [ ] Smaller reporting company: [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes [ ] No [√]

The number of shares outstanding of the Registrant's Common Stock as of April 21, 2011 was 465,566,072 shares.

YUM! BRANDS, INC.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (Unaudited)
YUM! BRANDS, INC. AND SUBSIDIARIES
(in millions, except per share data)

	Quarter ended	
Revenues	3/19/11	3/20/10
Company sales	$ 2,051	$ 1,996
Franchise and license fees and income	374	349
Total revenues	2,425	2,345
Costs and Expenses, Net		
Company restaurants		
Food and paper	662	625
Payroll and employee benefits	461	461
Occupancy and other operating expenses	568	570
Company restaurant expenses	1,691	1,656
General and administrative expenses	255	245
Franchise and license expenses	30	23
Closures and impairment (income) expenses	69	4
Refranchising (gain) loss	(2)	63
Other (income) expense	(19)	(10)
Total costs and expenses, net	2,024	1,981
Operating Profit	401	364
Interest expense, net	43	41
Income Before Income Taxes	358	323
Income tax provision	91	78
Net Income – including noncontrolling interest	267	245
Net Income – noncontrolling interest	3	4
Net Income – YUM! Brands, Inc.	$ 264	$ 241
Basic Earnings Per Common Share	$ 0.56	$ 0.51
Diluted Earnings Per Common Share	$ 0.54	$ 0.50
Dividends Declared Per Common Share	$ —	$ 0.21

See accompanying Notes to Condensed Consolidated Financial Statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
YUM! BRANDS, INC. AND SUBSIDIARIES
(in millions)

	Quarter ended	
	3/19/11	3/20/10
Cash Flows – Operating Activities		
Net Income – including noncontrolling interest	$ 267	$ 245
Depreciation and amortization	123	119
Closures and impairment (income) expenses	69	4
Refranchising (gain) loss	(2)	63
Contributions to defined benefit pension plans	(3)	(10)
Deferred income taxes	(60)	(74)
Equity income from investments in unconsolidated affiliates	(16)	(12)
Excess tax benefits from share-based compensation	(8)	(9)
Share-based compensation expense	13	13
Changes in accounts and notes receivable	11	(7)
Changes in inventories	34	5
Changes in prepaid expenses and other current assets	(25)	1
Changes in accounts payable and other current liabilities	(14)	(8)
Changes in income taxes payable	85	26
Other, net	34	36
Net Cash Provided by Operating Activities	508	392
Cash Flows – Investing Activities		
Capital spending	(173)	(163)
Proceeds from refranchising of restaurants	14	42
Acquisitions and investments	(1)	—
Sales of property, plant and equipment	—	9
Other, net	4	(4)
Net Cash Used in Investing Activities	(156)	(116)
Cash Flows – Financing Activities		
Repayments of long-term debt	(4)	(3)
Revolving credit facilities, three months or less, net	—	23
Short-term borrowings by original maturity		
More than three months - proceeds	—	—
More than three months - payments	—	—
Three months or less, net	—	(3)
Repurchase shares of Common Stock	(152)	(132)
Excess tax benefits from share-based compensation	8	9
Employee stock option proceeds	9	17
Dividends paid on Common Stock	(118)	(99)

Other, net	(4)	(2)
Net Cash Used in Financing Activities	(261)	(190)
Effect of Exchange Rates on Cash and Cash Equivalents	12	5
Net Increase in Cash and Cash Equivalents	103	91
Cash and Cash Equivalents - Beginning of Period	1,426	353
Cash and Cash Equivalents - End of Period	$ 1,529	$ 444

See accompanying Notes to Condensed Consolidated Financial Statements.

CONDENSED CONSOLIDATED BALANCE SHEETS
YUM! BRANDS, INC. AND SUBSIDIARIES
(in millions)

	(Unaudited) 3/19/11	12/25/10
ASSETS		
Current Assets		
Cash and cash equivalents	$ 1,529	$ 1,426
Accounts and notes receivable, net	311	256
Inventories	156	189
Prepaid expenses and other current assets	264	269
Deferred income taxes	59	61
Advertising cooperative assets, restricted	117	112
Total Current Assets	2,436	2,313
Property, plant and equipment, net	3,852	3,830
Goodwill	669	659
Intangible assets, net	408	475
Investments in unconsolidated affiliates	135	154
Other assets	507	519
Deferred income taxes	419	366
Total Assets	$ 8,426	$ 8,316
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Accounts payable and other current liabilities	$ 1,396	$ 1,602
Income taxes payable	105	61
Short-term borrowings	670	673
Advertising cooperative liabilities	117	112
Total Current Liabilities	2,288	2,448
Long-term debt	2,918	2,915
Other liabilities and deferred credits	1,361	1,284
Total Liabilities	6,567	6,647
Shareholders' Equity		
Common Stock, no par value, 750 shares authorized; 467 shares and 469 shares issued in 2011 and 2010, respectively	—	86
Retained earnings	1,960	1,717
Accumulated other comprehensive income (loss)	(177)	(227)
Total Shareholders' Equity – YUM! Brands, Inc.	1,783	1,576
Noncontrolling interest	76	93
Total Shareholders' Equity	1,859	1,669
Total Liabilities and Shareholders' Equity	$ 8,426	$ 8,316

See accompanying Notes to Condensed Consolidated Financial Statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
(Tabular amounts in millions, except per share data)

Note 1 - Financial Statement Presentation

We have prepared our accompanying unaudited Condensed Consolidated Financial Statements ("Financial Statements") in accordance with the rules and regulations of the Securities and Exchange Commission ("SEC") for interim financial information. Accordingly, they do not include all of the information and footnotes required by Generally Accepted Accounting Principles in the United States ("GAAP") for complete financial statements. Therefore, we suggest that the accompanying Financial Statements be read in conjunction with the Consolidated Financial Statements and Notes thereto included in our annual report on Form 10-K for the fiscal year ended December 25, 2010 ("2010 Form 10-K"). Except as disclosed herein, there has been no material change in the information disclosed in the Notes to our Consolidated Financial Statements included in the 2010 Form 10-K.

YUM! Brands, Inc. and Subsidiaries (collectively referred to as "YUM" or the "Company") comprise the worldwide operations of KFC, Pizza Hut, Taco Bell, Long John Silver's ("LJS") and A&W All-American Food Restaurants ("A&W") (collectively the "Concepts"). References to YUM throughout these Notes to our Financial Statements are made using the first person notations of "we," "us" or "our."

YUM's business consists of three reporting segments: YUM Restaurants China ("China" or "China Division"), YUM Restaurants International ("YRI" or "International Division") and United States. The China Division includes mainland China and YRI includes the remainder of our international operations.

Our fiscal year ends on the last Saturday in December and, as a result, a 53rd week is added every five or six years. The first three quarters of each fiscal year consist of 12 weeks and the fourth quarter consists of 16 weeks in fiscal years with 52 weeks and 17 weeks in fiscal years with 53 weeks. The current fiscal year of 2011 has a 53rd week. Our subsidiaries operate on similar fiscal calendars except that certain international subsidiaries operate on a monthly calendar, with two months in the first quarter, three months in the second and third quarters and four months in the fourth quarter. Our international subsidiaries that operate on a monthly calendar, including China, are not impacted by the addition of a 53rd week. All of our international businesses except China close one period or one month earlier to facilitate consolidated reporting.

Our preparation of the accompanying Financial Statements in conformity with GAAP requires us to make estimates and assumptions that affect reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the Financial Statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from the estimates.

In our opinion, the accompanying Financial Statements include all normal and recurring adjustments considered necessary to present fairly, when read in conjunction with our 2010 Form 10-K, our financial position as of March 19, 2011, and the results of our operations for the quarters ended March 19, 2011 and March 20, 2010 and cash flows for the quarters ended March 19, 2011 and March 20, 2010. Our results of operations and cash flows for these interim periods are not necessarily indicative of the results to be expected for the full year.

Our significant interim accounting policies include the recognition of certain advertising and marketing costs, generally in proportion to revenue, and the recognition of income taxes using an estimated annual effective tax rate.

Note 2 - Earnings Per Common Share ("EPS")

	Quarter ended	
	3/19/11	3/20/10
Net Income – YUM! Brands, Inc.	$ 264	$ 241
Weighted-average common shares outstanding (for basic calculation)	473	474
Effect of dilutive share-based employee compensation	13	11
Weighted-average common and dilutive potential common shares outstanding (for diluted calculation)	486	485
Basic EPS	$ 0.56	$ 0.51
Diluted EPS	$ 0.54	$ 0.50
Unexercised employee stock options and stock appreciation rights (in millions) excluded from the diluted EPS computation(a)	2.3	8.5

(a) These unexercised employee stock options and stock appreciation rights were not included in the computation of diluted EPS because to do so would have been antidilutive for the periods presented.

Note 3 - Shareholders' Equity

Under the authority of our Board of Directors, we repurchased shares of our Common Stock during the quarters ended March 19, 2011 and March 20, 2010, as indicated below. All amounts exclude applicable transaction fees.

		Shares Repurchased (thousands)		Dollar Value of Shares Repurchased		Remaining Dollar Value of Shares that may be Repurchased	
Authorization Date	Authorization Expiration Date	2011	2010	2011	2010	2011	2010
September 2009	September 2010	—	4,009	$ —	$ 137	$ —	$ 163
March 2010	March 2011	2,873	—	142	—	51	300
January 2011	June 2012	—	—	—	—	750	—
Total		2,873(a)	4,009(b)	$ 142(a)	$ 137(b)	$ 801	$ 463

(a) Amount excludes the effect of $19 million in share repurchases (0.4 million shares) with trade dates prior to the 2010 fiscal year end but cash settlement dates subsequent to the 2010 fiscal year end and includes the effect of $9 million in share repurchases (0.2 million shares) with trade dates prior to March 19, 2011 but with settlement dates subsequent to March 19, 2011.

(b)

Amount includes the effect of $5 million in share repurchases (0.1 million shares) with trade dates prior to March 20, 2010 but with settlement dates subsequent to March 20, 2010.

Comprehensive income was as follows:

	Quarter ended	
	3/19/11	3/20/10
Net Income – YUM! Brands, Inc.	$ 264	$ 241
Foreign currency translation adjustment	48	(31)
Changes in fair value of derivatives, net of tax	(6)	12
Reclassification of derivative (gains) losses to Net Income, net of tax	6	(10)
Reclassification of pension actuarial losses to Net Income, net of tax	5	4
Total comprehensive income – YUM! Brands, Inc.	$ 317	$ 216

A reconciliation of the beginning and ending carrying amount of the equity attributable to noncontrolling interests is as follows:

Noncontrolling interest as of December 25, 2010	$ 93
Net Income – noncontrolling interest	3
Foreign currency translation adjustment	1
Dividends declared	(21)
Noncontrolling interest as of March 19, 2011	$ 76

Note 4 - Items Affecting Comparability of Net Income and Cash Flows

Planned Sale of LJS and A&W

During the quarter ended March 19, 2011 we decided to sell our LJS and A&W brands. While the LJS and A&W asset groups comprising these brands did not meet the criteria for held for sale classification as of March 19, 2011, our decision to sell was considered an impairment indicator. As such, we reviewed the LJS and A&W asset groups for potential impairment and determined that their carrying values were not recoverable based on our estimates of holding period cash flows while we continue to own the brands and expected proceeds upon sale. Accordingly, we wrote the carrying values of the LJS and A&W asset groups down to our estimate of their fair values, which reflected the sales prices we would expect to receive from potential buyers. These fair value determinations considered current market conditions, trends in the businesses and prices for similar transactions in the restaurant industry, and resulted in a non-cash write down of the LJS and A&W asset groups' carrying values totaling $66 million. The write down was allocated to definite-lived trademarks and franchise contract rights which we will continue to amortize until the LJS and A&W asset groups are considered held for sale. Additionally, we will continue to review the brands' asset groups for any further necessary impairment through the date the brands are sold. The goodwill that was included in the LJS and A&W reporting unit was written off in a previous year.

Facility Actions

Refranchising (gain) loss, Store closure (income) costs and Store impairment charges by reportable segment are as follows:

	Quarter ended March 19, 2011			
	China Division	YRI	U.S.	Worldwide
Refranchising (gain) loss (a)	$ (1)	$ —	$ (1)	$ (2)
Store closure (income) costs(b)	$ (1)	$ 1	$ 1	$ 1
Store impairment charges	1	1	—	2
Closure and impairment (income) expenses(c)	$ —	$ 2	$ 1	$ 3

	Quarter ended March 20, 2010			
	China Division	YRI	U.S.	Worldwide
Refranchising (gain) loss (a) (d) (e)	$ —	$ 7	$ 56	$ 63
Store closure (income) costs(b)	$ —	$ —	$ 1	$ 1
Store impairment charges	—	2	1	3
Closure and impairment (income) expenses	$ —	$ 2	$ 2	$ 4

(a) Refranchising (gain) loss is not allocated to segments for performance reporting purposes.

(b) Store closure (income) costs include the net gain or loss on sales of real estate on which we formerly operated a Company restaurant that was closed, lease reserves established when we cease using a property under an operating lease and subsequent adjustments to those reserves and other facility-related expenses from previously closed stores.

(c) The impairment charge of $66 million resulting from the planned sale of the LJS and A&W businesses was not allocated to segments for performance reporting purposes and is not included in this table.

(d) During the quarter ended March 20, 2010 we refranchised all of our remaining company restaurants in Taiwan, which consisted of 124 KFCs. We included in our March 20, 2010 financial statements a non-cash write-off of $7 million of goodwill in determining the loss on refranchising of Taiwan. This loss did not result in a related income tax benefit, and was not allocated to any segment for performance reporting purposes. The amount of goodwill write-off was based on the relative fair values of the Taiwan business disposed of and the portion of the business that was retained. The fair value of the business disposed of was determined by reference to the discounted value of the future cash flows expected to be generated by the restaurants and retained by the franchisee, which included a deduction for the anticipated royalties the franchisee will pay the Company associated with the franchise agreement entered into in connection with this refranchising transaction. The fair value of the Taiwan business retained consisted of expected net cash flows to be derived from royalties from franchisees, including the royalties associated with the franchise agreement entered into in connection with this refranchising transaction. We believed the terms of the franchise agreement entered into in connection with the Taiwan refranchising were substantially consistent with market. The remaining carrying value of goodwill related to our Taiwan business of $30 million, after the aforementioned write-off, was determined not to be impaired subsequent to the refranchising as the fair value of the Taiwan reporting unit exceeded its carrying amount.

(e) U.S. refranchising loss for the quarter ended March 20, 2010 included $73 million in non-cash impairment charges related to our offer to refranchise a substantial portion of our Company operated KFCs in the U.S. We recorded an additional $12 million in non-cash impairment charges related to these restaurants in the quarter ended December 25, 2010. The majority of the restaurants offered for sale in 2010 continue to be Company operated at March 19, 2011. We believed in 2010 and continue to believe at March 19, 2011 that the restaurant groups for which we have not yet entered into agreements to sell do not meet the criteria to be classified as held for sale. Consistent with our historical policy, we are reviewing these restaurant groups for impairment on a held for use basis each quarter as a result of our intent to refranchise. To the extent the carrying value of these restaurant groups are not recoverable based upon our estimate of expected refranchising proceeds and holding period cash flows while we continue to operate the restaurants, they are written down to current estimates of their fair value. These fair value estimates, which are based on the sales price we would expect to receive for each restaurant group, consider current market conditions, real-estate values, trends in the KFC-U.S. business, prices for similar transactions in the restaurant industry and preliminary offers for any restaurant groups to date. No further impairment charges were recorded for these restaurant groups in the quarter ended March 19, 2011 as we currently estimate that the carrying values of all restaurant groups are recoverable. We continue to depreciate the carrying values of the restaurant assets, net of the aforementioned impairment charges, and will continue to do so through the date we believe the held for sale criteria for any restaurant groups are met. The $85 million in impairment charges recorded in 2010 does not include any allocation of the KFC reporting unit goodwill in the restaurant groups' carrying values. This additional non-cash write down is being recorded, consistent with our historical policy, when a restaurant group ultimately meets the criteria to be classified as held for sale. We will also be required to record a charge for the fair value of our guarantee of future lease payments for leases we assign to the franchisee upon any sale.

Assets held for sale at March 19, 2011 and December 25, 2010 total $43 million and $23 million, respectively, of U.S. property, plant and equipment and are included in Prepaid expenses and other current assets on our Condensed Consolidated Balance Sheets.

Note 5 - Recently Adopted Accounting Pronouncements

In July 2010, the Financial Accounting Standards Board ("FASB") issued accounting guidance that requires new disclosures about an entity's allowance for credit losses and the credit quality of its financing receivables. Existing disclosures were amended to require an entity to provide certain disclosures on a disaggregated basis by portfolio segment or by class of financing receivables. The new disclosures as of the end of a reporting period were effective for interim and annual reporting periods ending on or after December 15, 2010. The disclosures about activity that occurs during a reporting period were effective for interim and annual reporting periods beginning on or after December 15, 2010. All necessary disclosures have been complied with in this Form 10-Q.

Note 6 - Other (Income) Expense

	Quarter ended	
	3/19/11	3/20/10
Equity income from investments in unconsolidated affiliates	$ (16)	$ (12)
Foreign exchange net (gain) loss and other	(3)	2
Other (income) expense	$ (19)	$ (10)

Note 7 – Supplemental Balance Sheet Information

Receivables

	3/19/11	12/25/10
Accounts and notes receivable	$ 349	$ 289
Allowance for doubtful accounts	(38)	(33)
Accounts and notes receivable, net	$ 311	$ 256

	3/19/11	12/25/10
Noncurrent notes receivable and direct financing leases	$ 79	$ 87
Allowance for doubtful accounts	(29)	(30)
Noncurrent notes receivable and direct financing leases, net	$ 50	$ 57

The Company's receivables are primarily generated as a result of ongoing business relationships with our franchisees and licensees as a result of royalty and lease agreements. Trade receivables consisting of royalties from franchisees and licensees are generally due within 30 days of the period in which the corresponding sales occur and are classified as Accounts and notes receivable on our Condensed Consolidated Balance Sheets. Our financing receivables primarily consist of notes receivable and direct financing leases with franchisees which we enter into from time to time. Balances of notes receivable and direct financing leases due within one year are included in Accounts and notes receivable while amounts due beyond one year are included in Other assets. The activity in the Allowance for doubtful accounts was not significant in the quarter ended March 19, 2011.

Property, Plant and Equipment

	3/19/11	12/25/10
Property, plant and equipment, gross	$ 7,223	$ 7,103
Accumulated depreciation and amortization	(3,371)	(3,273)
Property, plant and equipment, net	$ 3,852	$ 3,830

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Note 8 – Income Taxes

		Quarter ended		
		3/19/11		3/20/10
Income taxes	$	91	$	78
Effective tax rate		25.2%		24.1%

Our effective tax rates were lower than the expected U.S. federal statutory rate of 35% primarily due to the majority of our income being earned outside of the U.S. where tax rates are generally lower than the U.S. rate.

Our first quarter 2011 rate was higher than the prior year primarily due to lapping more favorable foreign and U.S. tax effects in 2010 attributable to foreign operations, including a foreign law change. This was partially offset by lapping 2010 unfavorable prior year adjustments.

On June 23, 2010, the Company received a Revenue Agent Report ("RAR") from the Internal Revenue Service (the "IRS") relating to its examination of our U.S. federal income tax returns for fiscal years 2004 through 2006. The IRS has proposed an adjustment to increase the taxable value of rights to intangibles used outside the U.S. that YUM transferred to certain of its foreign subsidiaries. The proposed adjustment would result in approximately $700 million of additional taxes plus net interest to date of approximately $155 million. Furthermore, if the IRS prevails it is likely to make similar claims for years subsequent to fiscal 2006. The potential additional taxes for these later years, through 2010, computed on a similar basis to the 2004-2006 additional taxes, would be approximately $320 million plus net interest of approximately $20 million.

We believe that the Company has properly reported taxable income and paid taxes in accordance with applicable laws and that the proposed adjustment is inconsistent with applicable income tax laws, Treasury Regulations and relevant case law. We intend to defend our position vigorously and have filed a protest with the IRS. As the final resolution of the proposed adjustment remains uncertain, the Company will continue to provide for its position in accordance with GAAP. There can be no assurance that payments due upon final resolution of this issue will not exceed our currently recorded reserve and such payments could have a material adverse effect on our financial position. Additionally, if increases to our reserves are deemed necessary due to future developments related to this issue, such increases could have a material, adverse effect on our results of operations as they are recorded. The Company does not expect resolution of this matter within twelve months and cannot predict with certainty the timing of such resolution.

Note 9 - Reportable Operating Segments

We identify our operating segments based on management responsibility. The China Division includes mainland China and YRI includes the remainder of our international operations. In the U.S., we consider LJS and A&W to be a single operating segment. We consider our KFC-U.S., Pizza Hut-U.S., Taco Bell-U.S. and LJS/A&W-U.S. operating segments to be similar and therefore have aggregated them into a single reportable operating segment.

The following tables summarize revenue and operating profit for each of our reportable operating segments:

	Quarter ended	
Revenues	3/19/11	3/20/10
China Division	$ 906	$ 708
YRI	666	704
U.S.		