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YUM BRANDS INC

Form 10-Q

November 07, 2018

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D. C. 20549

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**FORM 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934** for the quarterly period ended September 30, 2018

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**

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**YUM! BRANDS, INC.**

(Exact name of registrant as specified in its charter)

|  |                                      |
|--|--------------------------------------|
| <u>North Carolina</u>  | <u>13-3951308</u>                    |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

|  |            |
|--|------------|
| 1441 Gardiner Lane, Louisville, Kentucky | 40213      |
| (Address of principal executive offices) | (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, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer" "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer:  Accelerated filer:

Non-accelerated filer:  (Do not check if a smaller reporting company) Smaller reporting company:

Emerging growth company:

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 October 31, 2018 was 312,301,824 shares.





**YUM! BRANDS, INC.**

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**PART I - FINANCIAL INFORMATION**

**Item 1. Financial Statements**

3

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**CONDENSED CONSOLIDATED STATEMENTS OF INCOME (Unaudited)**

## YUM! BRANDS, INC. AND SUBSIDIARIES

(in millions, except per share data)

|  | Quarter ended |           | Year to date |           |
|--|---------------|-----------|--------------|-----------|
|  | 9/30/2018     | 9/30/2017 | 9/30/2018    | 9/30/2017 |
| <b>Revenues</b>  |               |           |              |           |
| Company sales  | \$499         | \$ 871    | \$1,523      | \$ 2,682  |
| Franchise and property revenues                            | 605           | 565       | 1,773        | 1,619     |
| Franchise contributions for advertising and other services | 287           | —         | 834          | —         |
| Total revenues   | 1,391         | 1,436     | 4,130        | 4,301     |
| <b>Costs and Expenses, Net</b>                             |               |           |              |           |
| Company restaurant expenses                                | 399           | 717       | 1,258        | 2,223     |
| General and administrative expenses                        | 204           | 215       | 631          | 699       |
| Franchise and property expenses                            | 40            | 61        | 127          | 161       |
| Franchise advertising and other services expense           | 288           | —         | 834          | —         |
| Refranchising (gain) loss                                  | (100 )        | (201 )    | (285 )       | (331 )    |
| Other (income) expense                                     | 7             | 1         | 10           | 3         |
| Total costs and expenses, net                              | 838           | 793       | 2,575        | 2,755     |
| <b>Operating Profit</b>                                    | 553           | 643       | 1,555        | 1,546     |
| Investment (income) expense, net                           | (96 )         | (1 )      | (185 )       | (3 )      |
| Other pension (income) expense                             | 4             | 10        | 10           | 42        |
| Interest expense, net                                      | 111           | 110       | 330          | 325       |
| <b>Income before income taxes</b>                          | 534           | 524       | 1,400        | 1,182     |
| Income tax provision                                       | 80            | 106       | 192          | 278       |
| <b>Net Income</b>  | \$454         | \$ 418    | \$1,208      | \$ 904    |
| <br>   |               |           |              |           |
| <b>Basic Earnings Per Common Share</b>                     | \$1.43        | \$ 1.21   | \$3.72       | \$ 2.58   |
| <br>   |               |           |              |           |
| <b>Diluted Earnings Per Common Share</b>                   | \$1.40        | \$ 1.18   | \$3.64       | \$ 2.52   |
| <br>   |               |           |              |           |
| <b>Dividends Declared Per Common Share</b>                 | \$0.36        | \$ —      | \$1.08       | \$ 0.60   |

See accompanying Notes to Condensed Consolidated Financial Statements.

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)**

## YUM! BRANDS, INC. AND SUBSIDIARIES

(in millions)

|  | Quarter ended |               | Year to date   |                 |
|--|---------------|---------------|----------------|-----------------|
|  | 9/30/2018     | 9/30/2017     | 9/30/2018      | 9/30/2017       |
| Net Income   | \$454         | \$ 418        | \$1,208        | \$ 904          |
| Other comprehensive income (loss), net of tax  |               |               |                |                 |
| Translation adjustments and gains (losses) from intra-entity transactions of a long-term investment nature |               |               |                |                 |
| Adjustments and gains (losses) arising during the period   | (47 )         | 38            | (77 )          | 95              |
| Reclassification of adjustments and (gains) losses into Net Income   | (4 )          | 42            | (4 )           | 37              |
|  | (51 )         | 80            | (81 )          | 132             |
| Tax (expense) benefit  | 5             | (1 )          | 5              | (5 )            |
|  | (46 )         | 79            | (76 )          | 127             |
| Changes in pension and post-retirement benefits  |               |               |                |                 |
| Unrealized gains (losses) arising during the period  | 1             | 8             | 1              | (5 )            |
| Reclassification of (gains) losses into Net Income   | 5             | 10            | 16             | 46              |
|  | 6             | 18            | 17             | 41              |
| Tax (expense) benefit  | (1 )          | (7 )          | (4 )           | (15 )           |
|  | 5             | 11            | 13             | 26              |
| Changes in derivative instruments  |               |               |                |                 |
| Unrealized gains (losses) arising during the period  | 16            | (17 )         | 43             | (57 )           |
| Reclassification of (gains) losses into Net Income   | (8 )          | 15            | (23 )          | 52              |
|  | 8             | (2 )          | 20             | (5 )            |
| Tax (expense) benefit  | (2 )          | —             | (5 )           | 2               |
|  | 6             | (2 )          | 15             | (3 )            |
| Other comprehensive income (loss), net of tax  | (35 )         | 88            | (48 )          | 150             |
| <b>Comprehensive Income</b>  | <b>\$419</b>  | <b>\$ 506</b> | <b>\$1,160</b> | <b>\$ 1,054</b> |

See accompanying Notes to Condensed Consolidated Financial Statements.

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

(in millions)

|  | Year to date    |                 |
|--|-----------------|-----------------|
|  | 9/30/2018       | 9/30/2017       |
| <b>Cash Flows – Operating Activities</b>   |                 |                 |
| Net Income   | \$ 1,208        | \$ 904          |
| Depreciation and amortization  | 103             | 195             |
| Refranchising (gain) loss  | (285 )          | (331 )          |
| Investment (income) expense, net   | (185 )          | (3 )            |
| Contributions to defined benefit pension plans   | (9 )            | (47 )           |
| Deferred income taxes  | 32              | 122             |
| Share-based compensation expense   | 36              | 53              |
| Changes in accounts and notes receivable   | (35 )           | 17              |
| Changes in prepaid expenses and other current assets   | 10              | (7 )            |
| Changes in accounts payable and other current liabilities  | (81 )           | (168 )          |
| Changes in income taxes payable  | (47 )           | (125 )          |
| Other, net   | 49              | 108             |
| <b>Net Cash Provided by Operating Activities</b>   | <b>796</b>      | <b>718</b>      |
| <b>Cash Flows – Investing Activities</b>   |                 |                 |
| Capital spending   | (147 )          | (228 )          |
| Investment in Grubhub Inc. common stock  | (200 )          | —               |
| Proceeds from refranchising of restaurants   | 445             | 716             |
| Other, net   | (9 )            | 1               |
| <b>Net Cash Provided by Investing Activities</b>   | <b>89</b>       | <b>489</b>      |
| <b>Cash Flows – Financing Activities</b>   |                 |                 |
| Proceeds from long-term debt   | 106             | 1,088           |
| Repayments of long-term debt   | (462 )          | (372 )          |
| Revolving credit facilities, three months or less, net   | 273             | 35              |
| Short-term borrowings by original maturity   |                 |                 |
| More than three months - proceeds  | 59              | —               |
| More than three months - payments  | (59 )           | —               |
| Three months or less, net  | —               | —               |
| Repurchase shares of Common Stock  | (1,684 )        | (1,348 )        |
| Dividends paid on Common Stock   | (349 )          | (315 )          |
| Debt issuance costs  | —               | (32 )           |
| Other, net   | (45 )           | (85 )           |
| <b>Net Cash Used in Financing Activities</b>   | <b>(2,161 )</b> | <b>(1,029 )</b> |
| <b>Effect of Exchange Rates on Cash and Cash Equivalents</b>   | <b>(55 )</b>    | <b>42</b>       |
| <b>Net Increase (Decrease) in Cash and Cash Equivalents, Restricted Cash and Restricted Cash Equivalents</b> | <b>(1,331 )</b> | <b>220</b>      |
| <b>Cash, Cash Equivalents, Restricted Cash and Restricted Cash Equivalents - Beginning of Period</b>         | <b>1,668</b>    | <b>831</b>      |
| <b>Cash, Cash Equivalents, Restricted Cash and Restricted Cash Equivalents - End of Period</b>               | <b>\$ 337</b>   | <b>\$ 1,051</b> |

See accompanying Notes to Condensed Consolidated Financial Statements.

**CONDENSED CONSOLIDATED BALANCE SHEETS**

## YUM! BRANDS, INC. AND SUBSIDIARIES

(in millions)

|   | (Unaudited)<br>9/30/2018 | 12/31/2017      |
|---|--------------------------|-----------------|
| <b>ASSETS</b>   |                          |                 |
| <b>Current Assets</b>   |                          |                 |
| Cash and cash equivalents   | \$ 198                   | \$ 1,522        |
| Accounts and notes receivable, net  | 528                      | 400             |
| Prepaid expenses and other current assets   | 443                      | 384             |
| Advertising cooperative assets, restricted  | —                        | 201             |
| <b>Total Current Assets</b>   | <b>1,169</b>             | <b>2,507</b>    |
| Property, plant and equipment, net  | 1,378                    | 1,697           |
| Goodwill  | 489                      | 512             |
| Intangible assets, net  | 84                       | 110             |
| Other assets  | 886                      | 346             |
| Deferred income taxes   | 149                      | 139             |
| <b>Total Assets</b>   | <b>\$ 4,155</b>          | <b>\$ 5,311</b> |
| <b>LIABILITIES AND SHAREHOLDERS' DEFICIT</b>  |                          |                 |
| <b>Current Liabilities</b>  |                          |                 |
| Accounts payable and other current liabilities  | \$ 885                   | \$ 813          |
| Income taxes payable  | 14                       | 123             |
| Short-term borrowings   | 295                      | 375             |
| Advertising cooperative liabilities   | —                        | 201             |
| <b>Total Current Liabilities</b>  | <b>1,194</b>             | <b>1,512</b>    |
| Long-term debt  | 9,405                    | 9,429           |
| Other liabilities and deferred credits  | 1,014                    | 704             |
| <b>Total Liabilities</b>  | <b>11,613</b>            | <b>11,645</b>   |
| <b>Shareholders' Deficit</b>  |                          |                 |
| Common Stock, no par value, 750 shares authorized; 313 and 332 shares issued in 2018 and 2017, respectively | —                        | —               |
| Accumulated deficit   | (7,141)                  | (6,063)         |
| Accumulated other comprehensive loss  | (317)                    | (271)           |
| <b>Total Shareholders' Deficit</b>  | <b>(7,458)</b>           | <b>(6,334)</b>  |
| <b>Total Liabilities and Shareholders' Deficit</b>  | <b>\$ 4,155</b>          | <b>\$ 5,311</b> |

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 included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017 (“2017 Form 10-K”).

YUM! Brands, Inc. and its Subsidiaries (collectively referred to herein as “YUM” or the “Company”) comprise the worldwide operations of KFC, Pizza Hut and Taco Bell (collectively the “Concepts”). YUM has over 45,000 units in more than 140 countries and territories, of which 61% are located outside the U.S. YUM was created as an independent, publicly-owned company on October 6, 1997 via a tax-free distribution by our former parent, PepsiCo, Inc., of our Common Stock to its shareholders. References to YUM throughout these Financial Statements are made using the first person notations of “we,” “us” or “our.”

As of September 30, 2018, YUM consisted of three operating segments:

- The KFC Division which includes our worldwide operations of the KFC concept
- The Pizza Hut Division which includes our worldwide operations of the Pizza Hut concept
- The Taco Bell Division which includes our worldwide operations of the Taco Bell concept

YUM's fiscal year begins on January 1 and ends December 31 of each year, with each quarter comprised of three months. Our U.S. subsidiaries and certain international subsidiaries operate on a weekly periodic calendar where the first three quarters of each fiscal year consists 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. Our remaining international subsidiaries operate on a monthly calendar similar to that on which YUM operates.

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 these estimates.

The accompanying Financial Statements include all normal and recurring adjustments considered necessary to present fairly, when read in conjunction with our 2017 Form 10-K, our financial position as of September 30, 2018, our cash flows for the years to date ended September 30, 2018 and 2017 and the results of our operations and comprehensive income for the quarters and years to date ended September 30, 2018 and 2017. Our results of operations, comprehensive income 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 advertising and marketing costs, generally in proportion to revenue, and the recognition of income taxes using an estimated annual effective tax rate.

In January 2016, the Financial Accounting Standards Board (“FASB”) issued a standard that updates certain aspects of recognition, measurement, presentation and disclosure of financial instruments. We adopted this standard beginning with the quarter ended March 31, 2018. While the adoption of this standard did not have a material impact on our



Financial Statements the standard requires our investment in Grubhub Inc. ("Grubhub") common stock, which was consummated in April 2018 (see Note 5), to be remeasured to fair value in each future reporting period with corresponding changes recorded in our Condensed Consolidated Statement of Income.

In October 2016, the FASB issued a standard that requires the recognition of the income tax consequences of an intra-entity transfer of an asset, other than inventory, when the transfer occurs. As required, we adopted this standard in the quarter ended March 31, 2018 and have recorded a cumulative adjustment to beginning retained earnings to write-off the unamortized tax consequences of certain historical intra-entity transfers of assets. As a result, we recognized a reduction in Other assets of \$30 million with an offsetting increase to our Accumulated deficit.

In August 2017, the FASB issued a standard that refines and expands existing hedge accounting guidance. We adopted this standard beginning with the quarter ended March 31, 2018. The adoption of this standard did not have a material impact on the Financial Statements.

In February 2018, the FASB issued a standard that allows a reclassification to retained earnings for tax effects that were stranded within accumulated other comprehensive (income) loss ("AOCI") subsequent to the accounting in the fourth quarter of 2017 necessary as a result of the enactment of the Tax Cuts and Jobs Act of 2017. We adopted this standard during the quarter ended March 31, 2018 and reclassified stranded tax effects of \$19 million from AOCI with a corresponding decrease to Accumulated deficit at the beginning of our first quarter 2018. These stranded tax effects primarily related to the remeasurement of deferred tax assets associated with pension losses within AOCI. The Company's policy is to follow the specific identification approach for releasing stranded tax effects from AOCI.

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. See Notes 2 and 5.

We have reclassified certain other items in the Financial Statements for the prior periods to be comparable with the classification for the quarter and year to date ended September 30, 2018. These reclassifications had no effect on previously reported Net Income.

## **Note 2 - Revenue Recognition Accounting Policy**

We adopted Topic 606 at the beginning of the quarter ended March 31, 2018. Below is a discussion of how our revenues are earned, our accounting policies pertaining to revenue recognition prior to the adoption of Topic 606 ("Legacy GAAP"), our accounting policies pertaining to revenue recognition subsequent to the adoption of Topic 606 and other required disclosures. Refer to Note 5 for information regarding the cumulative effect adjustment recorded to Accumulated deficit as of the beginning of the quarter ended March 31, 2018 to reflect the adoption of Topic 606. Also included in Note 5 is disclosure of the amount by which each balance sheet and income statement line item was impacted in the current reporting periods as compared to Legacy GAAP.

### Company Sales

Revenues from the sale of food items by Company-owned restaurants are recognized as Company sales when a customer purchases the food, which is when our obligation to perform is satisfied. The timing and amount of revenue recognized related to Company sales was not impacted by the adoption of Topic 606.

### Franchise and Property Revenues

#### *Franchise Revenues*

Our most significant source of revenues arises from the operation of our Concept stores by our franchisees. Franchise rights may be granted through a store-level franchise agreement or through a master franchise agreement. Our franchise agreements require that the franchisee remit continuing fees to us as a percentage of the applicable restaurant's sales in exchange for the license of the intellectual property associated with our Concepts' brands (the "franchise right"). Our franchise agreements also typically require certain, less significant, upfront franchise fees such as initial fees paid upon opening of a store, fees paid to renew the term of the franchise right and fees paid in the event the franchise agreement is transferred to another franchisee.

Continuing fees represent the substantial majority of the consideration we receive under our franchise agreements. Continuing fees are typically billed and paid monthly and are usually 4%-6% for store-level franchise agreements. Master franchise agreements transfer exclusive master franchise rights and administrative obligations, including control of advertising contributions, to master franchisees in certain regions who in turn grant sub-franchising rights to sub-franchisees. As a result of transferring administrative obligations to a master franchisee the percentage of a master franchisee's restaurants' sales that we receive as a continuing fee (typically 3%) is less than the percentage we receive for restaurants operating under a store-level franchise agreement. Upfront franchise fees are typically billed and paid when a new franchise or sub-franchise agreement becomes effective or when an existing agreement is transferred to another franchisee or sub-franchisee.

Under Legacy GAAP, continuing fees were recognized as the related sales occurred. The timing and amount of revenue recognized related to continuing fees was not impacted by the adoption of Topic 606 based on the application of the sales-based royalty exception within Topic 606. Under Legacy GAAP, revenue related to initial fees was recognized upon store opening and renewal

and transfer fees were recognized when the related agreement became effective. Upon the adoption of Topic 606, we have determined that the services we provide in exchange for these upfront franchise fees are highly interrelated with the franchise right and are not individually distinct from the ongoing services we provide to our franchisees. As a result, upon the adoption of Topic 606, upfront franchise fees are recognized as revenue over the term of each respective franchise or sub-franchise agreement. Revenues for these upfront franchise fees are recognized on a straight-line basis, which is consistent with the franchisee's or sub-franchisee's right to use and benefit from the intellectual property. Revenues from continuing fees and upfront franchise fees is presented within Franchise and property revenues in our Condensed Consolidated Statements of Income.

Additionally, from time-to-time we provide non-refundable consideration to franchisees in the form of cash or other incentives (e.g. cash payments to incent new unit openings, free or subsidized equipment, etc.). The Company's intent in providing such consideration is to drive new unit development or same-store sales growth that will result in higher future revenues for the Company. Under Legacy GAAP, these payments were recognized when we were obligated to make the payment and were presented as either a reduction to Franchise and property revenues, if cash was provided directly to the franchisee, or as Franchise and property expenses, if cash was not provided directly to the franchisee. Due to the adoption of Topic 606, such payments are capitalized and presented within Prepaid expense and other current assets or Other assets. These capitalized balances are being amortized as a reduction in Franchise and property revenues over the period of expected cash flows from the franchise agreements to which the payment relates.

#### *Property Revenues*

From time to time, we enter into rental agreements with franchisees for the lease or sublease of restaurant locations. These rental agreements typically originate from refranchising transactions and revenues related to the agreements are recognized as they are earned. Amounts owed under the rental agreements are typically billed and paid on a monthly basis. Revenues from rental agreements with franchisees are presented within Franchise and property revenues within our Condensed Consolidated Statements of Income. Related expenses are presented as Franchise and property expenses within our Condensed Consolidated Statements of Income and primarily include depreciation or, in the case of a sublease, rental expense. The timing and amount of revenue and expenses recognized related to the rental of restaurants we lease or sublease was not impacted by the adoption of Topic 606.

#### Franchise Contributions for Advertising and Other Services

##### *Advertising Cooperatives*

We participate in various advertising cooperatives with our franchisees, typically within a country where we have both Company-owned restaurants and franchise restaurants. These advertising cooperatives are established to collect and administer funds contributed for use in advertising and promotional programs designed to increase sales and enhance the reputation of the Company and its franchise owners. Contributions to the advertising cooperatives are required for both Company-owned and franchise restaurants and are generally based on a percentage of restaurant sales. Revenues for these services are typically billed and paid on a monthly basis. We are required to spend all funds collected by advertising cooperatives we consolidate on advertising and promotional programs. Under Legacy GAAP, receipts and expenditures related to advertising cooperatives we were required to consolidate were presented on a net basis in our Condensed Consolidated Statements of Income. In accordance with the provisions of Topic 606, we have determined we act as a principal in the transactions entered into by the advertising cooperatives we are required to consolidate based on our responsibility to define the nature of the goods or services provided and/or our responsibility to define which franchisees receive the benefit of the goods or services. Additionally, we have determined the advertising services provided to franchisees are highly interrelated with the franchise right and therefore not distinct. Franchisees remit to us a percentage of restaurant sales as consideration for providing the advertising services. As a result, revenues for advertising services are recognized when the related sales occur based on the application of the

sales-based royalty exception within Topic 606. These revenues are presented as Franchise contributions for advertising and other services. Expenses incurred to provide these services are presented as Franchise advertising and other services expense.

*Other Services*

On a much more limited basis, we provide goods or services to certain franchisees that are individually distinct from the franchise right because they do not require integration with other goods or services we provide. Such arrangements typically relate to supply chain, quality assurance and information technology services. In instances where we rely on third parties to provide goods or services to franchisees at our direction, we have determined we act as a principal in these transactions. The extent to which we provide such goods or services varies by brand, geographic region and, in some instances, franchisee. Similar to advertising services, receipts and expenditures related to these other services were presented on a net basis under Legacy GAAP. Upon adoption of Topic 606, revenues from the goods or services described above are presented as Franchise contributions for advertising and other services within our Condensed Consolidated Statements of Income. Expenses related to the provisioning of these goods

and services are recorded in Franchise advertising and other services expense. These revenues are recognized as the goods or services are transferred to the franchisee and related expenses are recognized as incurred.

Taxes assessed by a governmental authority that are both imposed on and concurrent with a specific revenue transaction and collected from a customer are excluded from revenue under both Legacy GAAP and Topic 606.

### Disaggregation of Total Revenues

The following table disaggregates revenue by Concept, for our two most significant markets based on Operating Profit and for all other markets. We believe this disaggregation best reflects the extent to which the nature, amount, timing and uncertainty of our revenues and cash flows are impacted by economic factors.

|  | Quarter ended 9/30/2018      |                          |                          |         |
|--|------------------------------|--------------------------|--------------------------|---------|
|  | KFC<br>Division              | Pizza<br>Hut<br>Division | Taco<br>Bell<br>Division | Total   |
| <b>U.S.</b>  |                              |                          |                          |         |
| Company sales  | \$ 17                        | \$ 6                     | \$ 265                   | \$288   |
| Franchise and property revenues                            | 46                           | 66                       | 136                      | 248     |
| Franchise contributions for advertising and other services | 3                            | 62                       | 105                      | 170     |
| <b>China</b>   |                              |                          |                          |         |
| Franchise and property revenues                            | 52                           | 16                       | —                        | 68      |
| <b>Other</b>   |                              |                          |                          |         |
| Company sales  | 204                          | 7                        | —                        | 211     |
| Franchise and property revenues                            | 222                          | 61                       | 6                        | 289     |
| Franchise contributions for advertising and other services | 105                          | 11                       | 1                        | 117     |
|  | \$ 649                       | \$ 229                   | \$ 513                   | \$1,391 |
|  | Year to date ended 9/30/2018 |                          |                          |         |
|  | KFC<br>Division              | Pizza<br>Hut<br>Division | Taco<br>Bell<br>Division | Total   |
| <b>U.S.</b>  |                              |                          |                          |         |
| Company sales  | \$ 50                        | \$ 31                    | \$ 759                   | \$840   |
| Franchise and property revenues                            | 135                          | 200                      | 387                      | 722     |
| Franchise contributions for advertising and other services | 7                            | 187                      | 293                      | 487     |
| <b>China</b>   |                              |                          |                          |         |
| Franchise and property revenues                            | 155                          | 47                       | —                        | 202     |
| <b>Other</b>   |                              |                          |                          |         |
| Company sales  | 657                          | 24                       | 2                        | 683     |
| Franchise and property revenues                            | 647                          | 185                      | 17                       | 849     |
| Franchise contributions for advertising and other services | 307                          | 39                       | 1                        | 347     |
|  | \$ 1,958                     | \$ 713                   | 1,459                    | \$4,130 |

Contract Liabilities

Our contract liabilities are comprised of unamortized upfront fees received from franchisees. A summary of significant changes to the contract liability balance during 2018 is presented below.

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|   | Deferred<br>Franchise<br>Fees |
|---|-------------------------------|
| Balance at January 1, 2018  | \$ 392                        |
| Revenue recognized that was included in unamortized upfront fees received from franchisees at the beginning of the period                           | (47 )                         |
| Increase for upfront fees associated with contracts that became effective during the period, net of amounts recognized as revenue during the period | 61                            |
| Other <sup>(a)</sup>  | (11 )                         |
| Balance at September 30, 2018   | \$ 395                        |

Includes impact of foreign currency translation as well as the recognition of deferred franchise fees into (a) Refranchising (gain) loss upon the modification of existing franchise agreements when entering into master franchise agreements.

We expect to recognize contract liabilities as revenue over the remaining term of the associated franchise agreement as follows:

|                  |       |
|------------------|-------|
| Less than 1 year | \$58  |
| 1 - 2 years      | 53    |
| 2 - 3 years      | 49    |
| 3 - 4 years      | 45    |
| 4 - 5 years      | 40    |
| Thereafter       | 150   |
| Total            | \$395 |

We have applied the optional exemption, as provided for under Topic 606, which allows us to not disclose the transaction price allocated to unsatisfied performance obligations when the transaction price is a sales-based royalty.

### Note 3 - Earnings Per Common Share (“EPS”)

|   | Quarter<br>ended |        | Year to date |        |
|---|------------------|--------|--------------|--------|
|   | 2018             | 2017   | 2018         | 2017   |
| Net Income  | \$454            | \$418  | \$1,208      | \$904  |
| Weighted-average common shares outstanding (for basic calculation)  | 318              | 345    | 325          | 351    |
| Effect of dilutive share-based employee compensation  | 7                | 8      | 7            | 7      |
| Weighted-average common and dilutive potential common shares outstanding (for diluted calculation)                                      | 325              | 353    | 332          | 358    |
| Basic EPS   | \$1.43           | \$1.21 | \$3.72       | \$2.58 |
| Diluted EPS   | \$1.40           | \$1.18 | \$3.64       | \$2.52 |
| Unexercised employee stock options and stock appreciation rights (in millions) excluded from the diluted EPS computation <sup>(a)</sup> | 2.2              | 1.9    | 1.9          | 2.3    |

(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 4 - Shareholders' Deficit**

Under the authority of our Board of Directors, we repurchased shares of our Common Stock during the years to date ended September 30, 2018 and 2017 as indicated below. All amounts exclude applicable transaction fees.

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|                             | Shares Repurchased<br>(thousands) |                       | Dollar Value of<br>Shares Repurchased |                        | Remaining<br>Dollar Value<br>of Shares that<br>may be<br>Repurchased |
|-----------------------------|-----------------------------------|-----------------------|---------------------------------------|------------------------|--|
|                             | 2018                              | 2017                  | 2018                                  | 2017                   | 2018   |
| November 2016 Authorization | —                                 | 19,110                | \$—                                   | \$1,327                | \$ —   |
| November 2017 Authorization | 18,240                            | —                     | 1,500                                 | —                      | —  |
| August 2018 Authorization   | 2,244                             | —                     | 198                                   | —                      | 1,802  |
| Total                       | 20,484 <sup>(a)</sup>             | 19,110 <sup>(b)</sup> | \$1,698 <sup>(a)</sup>                | \$1,327 <sup>(b)</sup> | \$ 1,802   |

<sup>(a)</sup> Includes the effect of \$14 million in share repurchases (0.2 million shares) with trade dates prior to September 30, 2018, but cash settlement dates subsequent to September 30, 2018.

<sup>(b)</sup> Includes the effect of \$24 million in share repurchases (0.3 million shares) with trade dates on, or prior to, September 30, 2017, but cash settlement dates subsequent to September 30, 2017 and excludes the effect of \$45 million in share purchases (0.7 million shares) with trades dates prior to December 31, 2016, but cash settlement dates subsequent to December 31, 2016.

On August 10, 2018 our Board of Directors authorized share repurchases through December 2019 of up to \$2 billion (excluding applicable transaction fees) of our outstanding Common Stock.

Changes in AOCI are presented below.

|  | Translation<br>Adjustments<br>and Gains<br>(Losses)<br>From<br>Intra-Entity<br>Transactions<br>of a<br>Long-Term<br>Nature | Pension and<br>Post-Retirement<br>Benefits | Derivative<br>Instruments | Total   |
|--|--|--|---------------------------|---------|
| Balance at December 31, 2017, net of tax                                     | \$ (174 )  | \$ (106 )                                  | \$ 9                      | \$(271) |
| Adoption of accounting standards   | 21 <sup>(a)</sup>  | (17 ) <sup>(b)</sup>                       | (2 ) <sup>(b)</sup>       | 2       |
| OCI, net of tax  |  |  |                           |         |
| Gains (losses) arising during the period classified into AOCI,<br>net of tax | (72 )  | 1  | 35                        | (36 )   |
| (Gains) losses reclassified from AOCI, net of tax                            | (4 )   | 12   | (20 )                     | (12 )   |
|  | (76 )  | 13   | 15                        | (48 )   |
| Balance at September 30, 2018, net of tax                                    | \$ (229 )  | \$ (110 )                                  | \$ 22                     | \$(317) |

- (a) Represents the impact of foreign currency translation from the adoption of Topic 606. See Notes 2 and 5.
- (b) During the quarter ended March 31, 2018, we adopted a standard that allows for the reclassification from AOCI to Accumulated deficit for stranded tax effects resulting from the Tax Act. See Note 1.

**Note 5 - Items Affecting Comparability of Net Income, Financial Position and Cash Flows**Refranchising (Gain) Loss

The Refranchising (gain) loss by reportable segment is presented below. Given the size and volatility of refranchising initiatives, our chief operating decision maker ("CODM") does not consider the impact of Refranchising (gain) loss when assessing segment performance. As such, we do not allocate such gains and losses to our segments for performance reporting purposes.

During the quarter and year to date ended September 30, 2018, we refranchised 134 restaurants and 329 restaurants, respectively, and received \$193 million and \$445 million, respectively, in pre-tax proceeds. During the quarter and year to date ended September 30, 2017, we refranchised 209 restaurants and 574 restaurants, respectively, and received \$395 million and \$716 million, respectively, in pre-tax proceeds.

A summary of Refranchising (gain) loss is as follows:

|                    | Quarter ended |         | Year to date |         |
|--------------------|---------------|---------|--------------|---------|
|                    | 2018          | 2017    | 2018         | 2017    |
| KFC Division       | \$(29 )       | \$(50 ) | \$(128 )     | \$(8 )  |
| Pizza Hut Division | 3             | 27      | 14           | 40      |
| Taco Bell Division | (74 )         | (178 )  | (171 )       | (363 )  |
| Worldwide          | \$(100)       | \$(201) | \$(285)      | \$(331) |

KFC U.S. Acceleration Agreement

During 2015, we reached an agreement with our KFC U.S. franchisees that gave us brand marketing control as well as an accelerated path to expanded menu offerings, improved assets and enhanced customer experience. In connection with this agreement we are investing approximately \$130 million from 2015 through 2019 primarily to fund new back-of-house equipment for franchisees and to provide incentives to accelerate franchisee store remodels. Under Legacy GAAP these amounts were expensed as incurred including \$4 million and \$12 million during the quarter and year to date ended September 30, 2017, respectively. We recorded total pre-tax charges for such amounts of \$115 million, primarily as Franchise and property expenses, during the three year period ended December 31, 2017. Due to their size and unique and long-term brand building nature, as well as their non-recurring impact on KFC Division's results when expensed upfront, our CODM did not consider the impact of these investments when assessing segment performance from 2015 through 2017. As such, prior to 2018 the investments were not allocated to the KFC Division segment operating results for performance reporting purposes.

Upon adoption of Topic 606 in 2018, approximately \$100 million of these incentives paid to franchisees from 2015 through 2017 were capitalized, which was net of amortization of \$19 million. These capitalized amounts are now being amortized as a reduction to Franchise and property revenues over the period of expected cash flows from the franchise agreements to which the payment relates. Amortization related to both franchise incentive payments that were capitalized upon the adoption of Topic 606 and franchise incentive payments that will be capitalized going forward will be allocated to KFC segment operating results as the expense is recurring and is not expected to significantly impact the comparability of results in any given period. During the quarter and year to date ended September 30, 2018, we recorded a reduction to KFC Division Franchise and property revenues related to the amortization of these franchise incentive payments of \$2 million and \$7 million, respectively.

In addition to the investments above, we agreed to fund \$60 million of incremental system advertising from 2015 through 2018. During the quarters ended September 30, 2018 and 2017, we incurred \$2 million and \$5 million, respectively, in incremental system advertising expense. During the years to date ended September 30, 2018 and 2017, we incurred \$7 million and \$14 million, respectively, in incremental system advertising expense. We funded approximately \$50 million of such advertising during the three year period ended December 31, 2017, which included \$20 million during 2017. We currently expect to fund approximately \$10 million in 2018. These advertising amounts were recorded primarily in Franchise and property expenses and have been and continue to be included in the KFC Division segment operating results.

### YUM's Strategic Transformation Initiatives

In October 2016, we announced our strategic transformation plans to drive global expansion of the KFC, Pizza Hut and Taco Bell brands ("YUM's Strategic Transformation Initiatives") following the then anticipated separation of our China business on October 31, 2016. Major features of the Company's strategic transformation plans involve being more focused on the development of our three brands, increasing our franchise ownership and creating a leaner, more efficient cost structure. During the quarters ended September 30, 2018 and 2017, we recognized pre-tax charges of \$1 million and \$4 million, respectively, primarily within G&A, related to these initiatives. During the years to date ended September 30, 2018 and 2017, we recognized pre-tax charges of \$2 million and \$15 million, respectively, primarily within G&A, related to these initiatives. These costs primarily related to severance and relocation costs. Due to the scope of the initiatives as well as the significance of YUM's Strategic Transformation Initiatives program, our CODM does not consider the impact of these initiatives when assessing segment performance. As such, costs associated with the initiatives are not being allocated to any segment for performance reporting purposes.

### Pizza Hut U.S. Transformation Agreement

In May 2017, we reached an agreement with Pizza Hut U.S. franchisees that will improve brand marketing alignment, accelerate enhancements in operations and technology and that includes a permanent commitment to incremental advertising as well as digital and technology contributions by franchisees (the "Transformation Agreement"). In connection with the Transformation Agreement we anticipate investing approximately \$90 million to upgrade restaurant equipment to improve operations, fund improvements in restaurant technology and enhance digital and e-commerce capabilities. We currently expect the majority of this investment, which will be a mix of both capital and operating investments, to be split between 2017 and 2018.

We invested \$39 million related to the Transformation Agreement in 2017, which included \$8 million of investments that we capitalized and \$31 million that was expensed primarily as Franchise and property expenses or G&A. The \$31 million expense amount included \$5 million of franchisee incentive payments that under Legacy GAAP were expensed as incurred, but that upon adoption of Topic 606 in 2018 were capitalized. In 2018, both amounts capitalized upon adoption of Topic 606 and franchisee incentive payments capitalized thereafter are being amortized as a reduction to Franchise and property revenues over the period of expected cash flows from the franchise agreements to which the payments relate.

We have invested \$5 million and \$16 million in the quarter and year to date, respectively, related to the Transformation Agreement, primarily consisting of capital investments and franchisee incentive payments that were capitalized.

Due to their unique and long-term brand-building nature as well as their non-recurring impact on Pizza Hut's Division results, the financial impact of operating investments that are part of the Transformation Agreement are not being considered by our CODM when assessing segment performance in 2017 or 2018. As such, these operating investments were not allocated to the Pizza Hut Division operating segment results for performance reporting purposes. Depreciation on capital investments made as part of the Transformation Agreement is being allocated to Pizza Hut segment results as the expense is recurring and is not expected to significantly impact the comparability of results in any given period. For the same reasons, the amortization related to franchisee incentive payments that were capitalized upon the adoption of Topic 606 and amortization related to franchisee incentive payments that are being capitalized going forward are being allocated to Pizza Hut Division operating segment results starting in 2018.

In addition to the investments above, we agreed to fund \$37.5 million of incremental system advertising dollars from the second half of 2017 through 2018. During the quarter and year to date ended September 30, 2018, we incurred \$4 million and \$9 million, respectively, in related incremental system advertising expense. We funded approximately \$25

million of such advertising during 2017, which was expensed in the third and fourth quarters of 2017. We currently expect to fund approximately \$12.5 million in 2018. These advertising amounts have been and will continue to be recorded primarily in Franchise and property expenses and are included in Pizza Hut's segment operating results.

Modifications of Share-based Compensation Awards

In connection with the separation of our business in China, we modified certain share-based compensation awards held as part of our Executive Income Deferral ("EID") Plan in phantom shares of YUM Common Stock to provide one phantom Yum China share-based award for each outstanding phantom YUM share-based award. Through October 31, 2018, these Yum China awards could be settled in cash, as opposed to stock, which required recognition of the fair value of these awards within G&A in our Condensed Consolidated Income Statement. During the quarter and year to date ended September 30, 2018 we recorded pre-tax credits related to these awards of \$2 million and \$3 million, respectively, due to depreciation in the market price of Yum China's common stock. During the quarter and year to date ended September 30, 2017, we recorded pre-tax charges related to these awards of less than \$1 million and \$18 million, respectively, due to appreciation in the market price of Yum China common stock. Given

these adjustments were a direct result of the separation, our CODM did not consider their impact when assessing segment performance. As such, these amounts were not allocated to any of our segment operating results.

Subsequent to the quarter end, on October 31, 2018, deferrals in phantom shares of Yum China common stock are no longer an investment option within our EID Plan and any balances relating to these shares were moved to another available EID Plan investment option as selected by the participants. Amounts directed into cash or phantom shares of a Stock Index Fund or a Bond Index Fund will remain classified as a liability and any appreciation or depreciation in these investments from the transfer date forward will be recognized as compensation expense and included in our segment operating results consistent with existing investments in these funds. Any balances directed into phantom shares of YUM Common Stock will be reclassified to Common Stock on our Consolidated Balance Sheet. We do not recognize compensation expense for the appreciation or depreciation, if any, of investments in phantom shares of our Common Stock.

#### Impact of Adopting New Revenue Recognition Standards

As discussed in Note 1, we adopted Topic 606 beginning with the quarter ended March 31, 2018, using the modified retrospective method. Topic 606 was applied to all contracts with customers as of January 1, 2018 and the cumulative effective of this transition was recorded as an adjustment to Accumulated deficit as of this date. As a result, the following adjustments were made to the Condensed Consolidated Balance Sheet as of January 1, 2018:



## CONDENSED CONSOLIDATED BALANCE SHEET

|  | As<br>Reported<br>12/31/2017 | Adjustments | Balances<br>with<br>Adoption<br>of Topic<br>606<br>1/1/2018 |
|--|------------------------------|-------------|---|
| <b>ASSETS</b>                                  |                              |             |   |
| Current Assets                                 |                              |             |   |
| Cash and cash equivalents                      | \$ 1,522                     | \$ 11       | \$ 1,533  |
| Accounts and notes receivable, net             | 400                          | 112         | 512   |
| Prepaid expenses and other current assets      | 384                          | 76          | (a) 460   |
| Advertising cooperative assets, restricted     | 201                          | (201)       | —   |
| Total Current Assets                           | 2,507                        | (2)         | 2,505   |
| Property, plant and equipment, net             | 1,697                        | 11          | 1,708   |
| Goodwill                                       | 512                          | —           | 512   |
| Intangible assets, net                         | 110                          | —           | 110   |
| Other assets                                   | 346                          | 118         | 464   |
| Deferred income taxes                          | 139                          | 26          | 165   |
| Total Assets                                   | \$ 5,311                     | \$ 153      | \$ 5,464  |
| <b>LIABILITIES AND SHAREHOLDERS' DEFICIT</b>   |                              |             |   |
| Current Liabilities                            |                              |             |   |
| Accounts payable and other current liabilities | \$ 813                       | \$ 220      | \$ 1,033  |
| Income taxes payable                           | 123                          | —           | 123   |
| Short-term borrowings                          | 375                          | —           | 375   |
| Advertising cooperative liabilities            | 201                          | (201)       | —   |
| Total Current Liabilities                      | 1,512                        | 19          | 1,531   |
| Long-term debt                                 | 9,429                        | —           | 9,429   |
| Other liabilities and deferred credits         | 704                          | 353         | 1,057   |
| Total Liabilities                              | 11,645                       | 372         | 12,017  |
| Shareholders' Deficit                          |                              |             |   |
| Accumulated deficit                            | (6,063)                      | (240)       | (6,303)   |
| Accumulated other comprehensive loss           | (271)                        | 21          | (250)   |
| Total Shareholders' Deficit                    | (6,334)                      | (219)       | (6,553)   |
| Total Liabilities and Shareholders' Deficit    | \$ 5,311                     | \$ 153      | \$ 5,464  |

(a) Includes \$58 million of restricted cash related to advertising cooperatives. These balances can only be used to settle obligations of the respective cooperatives.

We recorded an increase in Accounts payable and other current liabilities and Other liabilities and deferred credits of \$57 million and \$335 million, respectively, as part of our cumulative adjustment related to unamortized upfront franchise fees, with a corresponding \$392 million increase in Accumulated deficit. We recorded increases in Prepaid expenses and other current assets and Other assets of \$18 million and \$118 million, respectively, as part of our cumulative adjustment related to unamortized franchise incentives, with a corresponding \$136 million decrease in Accumulated deficit.

Deferred income taxes increased \$26 million as a result of recording the tax effects of the two adjustments noted above, with a corresponding decrease to Accumulated deficit. Accumulated other comprehensive loss decreased \$21 million as a result of recognizing the impact of foreign currency translation related to the three adjustments noted above, with a corresponding increase in Accumulated deficit.

The remaining adjustments to our December 31, 2017 Condensed Consolidated Balance Sheet are primarily a result of reclassifying the assets and liabilities of our consolidated advertising cooperates from Advertising cooperative assets, restricted and Advertising cooperative liabilities to the respective balance sheet caption to which the assets and liabilities relate.

The following tables reflect the impact of the adoption of Topic 606 on our Condensed Consolidated Statement of Income for the quarter and year to date ended September 30, 2018 and our Condensed Consolidated Balance Sheet as of September 30, 2018.

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME

|  | Quarter ended 9/30/2018 |                  | Balances<br>under<br>Legacy<br>GAAP |
|--|-------------------------|------------------|-------------------------------------|
|  | As<br>Reported          | Impact           |                                     |
| Revenues   |                         |                  |                                     |
| Company sales  | \$499                   | \$—              | \$ 499                              |
| Franchise and property revenues                            | 605                     | 11               | 616                                 |
| Franchise contributions for advertising and other services | 287                     | (287 )           | —                                   |
| Total revenues   | 1,391                   | (276 )           | 1,115                               |
| Costs and Expenses, Net                                    |                         |                  |                                     |
| Company restaurant expenses                                | 399                     | —                | 399                                 |
| General and administrative expenses                        | 204                     | —                | 204                                 |
| Franchise and property expenses                            | 40                      | 10               | 50                                  |
| Franchise advertising and other services expense           | 288                     | (288 )           | —                                   |
| Refranchising (gain) loss                                  | (100 )                  | —                | (100 )                              |
| Other (income) expense                                     | 7                       | —                | 7                                   |
| Total costs and expenses, net                              | 838                     | (278 )           | 560                                 |
| Operating Profit   | 553                     | 2 <sup>(a)</sup> | 555                                 |
| Investment (income) expense, net                           | (96 )                   | —                | (96 )                               |
| Other pension (income) expense                             | 4                       | —                | 4                                   |
| Interest expense, net                                      | 111                     | —                | 111                                 |
| Income before income taxes                                 | 534                     | 2                | 536                                 |
| Income tax provision (benefit)                             | 80                      | (2 )             | 78                                  |
| Net Income   | \$454                   | \$4              | \$ 458                              |
| Basic Earnings Per Common Share                            | \$1.43                  | \$0.01           | \$ 1.44                             |
| Diluted Earnings Per Common Share                          | \$1.40                  | \$0.01           | \$ 1.41                             |

|  | Year to date ended<br>9/30/2018 |                     | Balances<br>under<br>Legacy<br>GAAP |
|--|---------------------------------|---------------------|-------------------------------------|
|  | As<br>Reported                  | Impact              |                                     |
| Revenues   |                                 |                     |                                     |
| Company sales  | \$1,523                         | \$—                 | \$1,523                             |
| Franchise and property revenues                            | 1,773                           | 23                  | 1,796                               |
| Franchise contributions for advertising and other services | 834                             | (834 )              | —                                   |
| Total revenues   | 4,130                           | (811 )              | 3,319                               |
| Costs and Expenses, Net                                    |                                 |                     |                                     |
| Company restaurant expenses                                | 1,258                           | —                   | 1,258                               |
| General and administrative expenses                        | 631                             | —                   | 631                                 |
| Franchise and property expenses                            | 127                             | 21                  | 148                                 |
| Franchise advertising and other services expense           | 834                             | (834 )              | —                                   |
| Refranchising (gain) loss                                  | (285 )                          | 4                   | (281 )                              |
| Other (income) expense                                     | 10                              | —                   | 10                                  |
| Total costs and expenses, net                              | 2,575                           | (809 )              | 1,766                               |
| Operating Profit   | 1,555                           | (2 ) <sup>(a)</sup> | 1,553                               |
| Investment (income) expense, net                           | (185 )                          | —                   | (185 )                              |
| Other pension (income) expense                             | 10                              | —                   | 10                                  |
| Interest expense, net                                      | 330                             | —                   | 330                                 |
| Income before income taxes                                 | 1,400                           | (2 )                | 1,398                               |
| Income tax provision (benefit)                             | 192                             | (3 )                | 189                                 |
| Net Income   | \$1,208                         | \$1                 | \$1,209                             |
| Basic Earnings Per Common Share                            | \$3.72                          | \$0.01              | \$3.73                              |
| Diluted Earnings Per Common Share                          | \$3.64                          | \$—                 | \$3.64                              |

Includes \$2 million and \$11 million of franchise incentive payments related to the KFC U.S. Acceleration Agreement or the Pizza Hut U.S. Transformation Agreement that would have been expensed immediately and that (a) we would not have allocated to the KFC Division or the Pizza Hut Division under Legacy GAAP for the quarter and year to date ended September 30, 2018, respectively. Upon the adoption of Topic 606, these payments have been capitalized as assets.

Upon the adoption of Topic 606, the timing and amount of revenue recognized for upfront franchise fees and franchise incentives changed from upfront recognition under Legacy GAAP to recognition over the term of the franchise agreement to which the fees and incentives relate. Also, under Legacy GAAP, amounts reported as Franchise contributions for advertising and other services and Franchise advertising and other services expense were presented on a net basis. Upon the adoption of Topic 606, these amounts require gross presentation in our Condensed Consolidated Statements of Income. Lastly, Legacy GAAP required that certain value-added taxes withheld and remitted on our behalf by our franchisees be reported as revenue and corresponding expense in our Condensed Consolidated Statements of Income. Upon adoption of Topic 606, these taxes are reported on a net basis as a reduction in Franchise and property revenues.

## CONDENSED CONSOLIDATED BALANCE SHEET

|  | As<br>Reported<br>9/30/2018 | Impact   | Balances<br>under<br>Legacy<br>GAAP<br>9/30/2018 |
|--|-----------------------------|----------|--|
| <b>ASSETS</b>                                  |                             |          |  |
| Current Assets                                 |                             |          |  |
| Cash and cash equivalents                      | \$ 198                      | \$(22 )  | \$ 176   |
| Accounts and notes receivable, net             | 528                         | (101 )   | 427  |
| Prepaid expenses and other current assets      | 443                         | (71 )    | 372  |
| Advertising cooperative assets, restricted     | —                           | 197      | 197  |
| Total Current Assets                           | 1,169                       | 3        | 1,172  |
| Property, plant and equipment, net             | 1,378                       | (19 )    | 1,359  |
| Goodwill                                       | 489                         | —        | 489  |
| Intangible assets, net                         | 84                          | —        | 84   |
| Other assets                                   | 886                         | (117 )   | 769  |
| Deferred income taxes                          | 149                         | (25 )    | 124  |
| Total Assets                                   | \$ 4,155                    | \$(158 ) | \$ 3,997   |
| <b>LIABILITIES AND SHAREHOLDERS' DEFICIT</b>   |                             |          |  |
| Current Liabilities                            |                             |          |  |
| Accounts payable and other current liabilities | \$ 885                      | \$(239 ) | \$ 646   |
| Income taxes payable                           | 14                          | —        | 14   |
| Short-term borrowings                          | 295                         | —        | 295  |
| Advertising cooperative liabilities            | —                           | 197      | 197  |
| Total Current Liabilities                      | 1,194                       | (42 )    | 1,152  |
| Long-term debt                                 | 9,405                       | —        | 9,405  |
| Other liabilities and deferred credits         | 1,014                       | (337 )   | 677  |
| Total Liabilities                              | 11,613                      | (379 )   | 11,234   |
| Shareholders' Deficit                          |                             |          |  |
| Accumulated deficit                            | (7,141 )                    | 241      | (6,900 )   |
| Accumulated other comprehensive loss           | (317 )                      | (20 )    | (337 )   |
| Total Shareholders' Deficit                    | (7,458 )                    | 221      | (7,237 )   |
| Total Liabilities and Shareholders' Deficit    | \$ 4,155                    | \$(158 ) | \$ 3,997   |

The significant impacts resulting from the adoption of Topic 606 on our Condensed Consolidated Balance Sheet as of September 30, 2018, are consistent with those recorded as of January 1, 2018 as described previously.

Under Legacy GAAP, Cash, Cash Equivalents, Restricted Cash, and Restricted Cash Equivalents pertaining to advertising cooperatives that we were required to consolidate were classified within Advertising cooperative assets, restricted. Upon adoption of Topic 606, these amounts are reflected on our Condensed Consolidated Balance Sheet and changes in these balances are reported within our Condensed Consolidated Statement of Cash Flows.

Investment in Grubhub

On February 7, 2018, certain of our subsidiaries entered into a master services agreement with a subsidiary of Grubhub, the leading online and mobile takeout food-ordering company in the U.S., which is intended to provide dedicated support for the KFC and Taco Bell branded online delivery channels in the U.S. through Grubhub's online ordering platform, logistics and last-mile support for delivery orders, as well as point-of-sale integration to streamline operations. Concurrently with the master services agreement, one of our subsidiaries entered into an investment agreement with Grubhub to invest \$200 million in exchange for approximately 2.8 million shares of Grubhub common stock. In April 2018, all necessary regulatory approvals were obtained and the purchase

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of Grubhub shares was consummated. Shares acquired as part of this purchase are restricted from being transferred until the earlier of the two-year anniversary of closing the investment agreement or 30 days following the termination of our master services agreement with Grubhub. In the quarter and year to date ended September 30, 2018 we recognized pre-tax income of \$94 million and \$185 million, respectively, which includes the appreciation in the market price of Grubhub common stock less valuation adjustments related to the transfer restrictions. Changes in the fair value of our investment in Grubhub common stock are presented as Investment (income) expense, net within our Condensed Consolidated Statements of Income.

#### Non-cash Pension Adjustment

During the first quarter of 2017, as a result of the completion of a pension data review and reconciliation, we recorded a non-cash, out-of-year charge of \$22 million to Other pension (income) expense to adjust our historical U.S. pension liability related to our deferred vested participants. Our CODM did not consider the impact of this charge when assessing segment performance given the number of years over which it accumulated. As such, this cost was not allocated to any of our segment operating results for performance reporting purposes.

#### **Note 6 - Other (Income) Expense**

Other (income) expense primarily includes net foreign exchange (gains) losses and store closure and impairment expenses.

#### **Note 7 - Supplemental Balance Sheet Information**

##### Accounts and Notes Receivable, net

The Company's receivables are primarily generated as a result of ongoing business relationships with our franchisees as a result of franchise and lease agreements. Trade receivables consisting of royalties from franchisees are generally due within 30 days of the period in which the corresponding sales occur and are classified as Accounts and notes receivable, net in our Condensed Consolidated Balance Sheets. Upon adoption of Topic 606, Accounts and notes receivable, net also includes receivables generated from advertising cooperatives that we consolidate which were previously recorded in Advertising cooperative assets, restricted.

|                                      | 9/30/2018 | 12/31/2017 |
|--------------------------------------|-----------|------------|
| Accounts and notes receivable, gross | \$ 560    | \$ 419     |
| Allowance for doubtful accounts      | (32 )     | (19 )      |
| Accounts and notes receivable, net   | \$ 528    | \$ 400     |

##### Property, Plant and Equipment, net

|   | 9/30/2018 | 12/31/2017 |
|---|-----------|------------|
| Property, plant and equipment, gross      | \$ 2,669  | \$ 3,177   |
| Accumulated depreciation and amortization | (1,291 )  | (1,480 )   |
| Property, plant and equipment, net        | \$ 1,378  | \$ 1,697   |

Assets held-for-sale at September 30, 2018 and December 31, 2017 total \$129 million and \$37 million, respectively, and are included in Prepaid expenses and other current assets in our Condensed Consolidated Balance Sheets. 2018 amounts include assets related to approximately 210 KFC restaurants in Russia, France and the UK and approximately 80 Taco Bell restaurants in the U.S.





Reconciliation of Cash and cash equivalents for Condensed Consolidated Statements of Cash Flows

|   | 9/30/2018 | 12/31/2017 |
|---|-----------|------------|
| Cash and cash equivalents as presented in Condensed Consolidated Balance Sheets   | \$ 198    | \$ 1,522   |
| Restricted cash included in Prepaid expenses and other current assets <sup>(a)</sup>                                      | 108       | 60         |
| Restricted cash and restricted cash equivalents included in Other assets <sup>(b)</sup>                                   | 31        | 17         |
| Cash, Cash Equivalents and Restricted Cash as presented in Condensed Consolidated Statements of Cash Flows <sup>(c)</sup> | \$ 337    | \$ 1,599   |

Restricted cash within Prepaid expenses and other current assets primarily relates to the Taco Bell Securitization interest reserves and cash related to advertising cooperatives that we consolidate which can only be used to settle (a) obligations of the respective cooperatives. As of September 30, 2018, Restricted cash within Prepaid expenses and other current assets also includes \$9 million of cash held by an entity that will be refranchised whose assets are classified as held for sale.

(b) Primarily trust accounts related to our self-insurance program and cash balances required, to the extent necessary, to meet statutory minimum net worth requirements for legal entities which enter into U.S. franchise agreements.

Upon adoption of Topic 606 we reclassified \$11 million and \$58 million, respectively, from Advertising cooperative assets, restricted to Cash and cash equivalents and Prepaid expenses and other current assets. These (c) amounts are included in the Beginning of Period balance of Cash, Cash Equivalents, Restricted Cash and Restricted Cash equivalents in our Condensed Consolidated Statement of Cash Flows for the year to date ended September 30, 2018.

**Note 8 - Income Taxes**

|                      | Quarter ended |        | Year to date |        |
|----------------------|---------------|--------|--------------|--------|
|                      | 2018          | 2017   | 2018         | 2017   |
| Income tax provision | \$80          | \$106  | \$192        | \$278  |
| Effective tax rate   | 15.1%         | 20.2 % | 13.7 %       | 23.5 % |

Our third quarter effective tax rate was lower than prior year primarily due to the favorable impact of the reduction in the U.S. federal statutory tax rate, as described below, the favorable impact of the \$16 million benefit described below, and lapping the prior year cost of repatriating foreign earnings. This benefit was partially offset by the unfavorable impacts associated with lapping the benefit of loss carryovers recognized due to an international refranchising transaction in the prior year and less in excess tax benefits on share-based compensation recognized than in the prior year.

Our year to date effective tax rate was lower than prior year primarily due to the favorable impact of the reduction in the U.S. federal statutory tax rate, as described below, the favorable impact of the \$32 million benefit described below and lapping the prior year cost of repatriating foreign earnings. This benefit was partially offset by less in excess tax benefits on share-based compensation recognized than in the prior year, lapping the benefit of loss carryovers recognized due to an international refranchising transaction in the prior year, and a current year charge related to the correction of an error associated with the tax recorded on a prior year divestiture.

On December 22, 2017, the U.S. government enacted comprehensive Federal tax legislation commonly referred to as the Tax Cuts and Jobs Act of 2017 (the "Tax Act"). The Tax Act significantly modified the U.S. corporate income tax system by, among other things, reducing the federal income tax rate from 35% to 21%, limiting certain deductions, including limiting the deductibility of interest expense to 30% of U.S. earnings before interest, taxes, depreciation and amortization, imposing a mandatory one-time deemed repatriation tax on accumulated foreign earnings and creating a

territorial tax system that changes the manner in which future foreign earnings are subject to U.S. tax including the elimination of U.S. federal tax on dividends from foreign subsidiaries, a provision designed to tax global intangible low-taxed income ("GILTI") of foreign subsidiaries and a lower U.S. effective tax rate on certain revenues from sources outside the U.S. On December 22, 2017, the SEC staff issued Staff Accounting Bulletin 118 ("SAB 118") that allows us to record provisional amounts related to the impacts of the Tax Act during a measurement period not to extend beyond one year of the enactment date.

In the fourth quarter of 2017, we recorded a provisional discrete net tax expense associated with the Tax Act of \$434 million. In the quarter and year to date ended September 30, 2018, we recorded a provisional benefit of \$16 million and \$32 million, respectively, as an adjustment to the amounts recorded at December 31, 2017.

As of September 30, 2018, the amounts recorded for the Tax Act remain provisional for the mandatory one-time deemed repatriation tax on accumulated foreign earnings, the remeasurement of deferred taxes, and our reassessment of permanently reinvested earnings, uncertain tax positions and valuation allowances. These estimates may be impacted by further analysis and future clarification and guidance regarding available tax accounting methods and elections, earnings and profits computations, state tax conformity to federal tax changes and the impact of the GILTI provisions. We expect to complete our analysis of the amounts recorded upon enactment of the Tax Act within SAB 118's measurement period of one year.

Companies subject to GILTI have the option to account for the GILTI tax as a period cost if and when incurred, or to recognize deferred taxes for temporary differences including outside basis differences expected to reverse as GILTI. The Company has elected to account for GILTI as a period cost, and therefore is including GILTI in the effective tax rate calculation.

### Note 9 - Reportable Operating Segments

We identify our operating segments based on management responsibility. The following tables summarize Revenues and Operating Profit for each of our reportable operating segments:

| Revenues           | Quarter ended |         | Year to date |         |
|--------------------|---------------|---------|--------------|---------|
|                    | 2018          | 2017    | 2018         | 2017    |
| KFC Division       | \$649         | \$794   | \$1,958      | \$2,296 |
| Pizza Hut Division | 229           | 203     | 713          | 659     |
| Taco Bell Division | 513           | 442     | 1,459        | 1,349   |
| Unallocated        | —             | (3 )    | —            | (3 )    |
|                    | \$1,391       | \$1,436 | \$4,130      | \$4,301 |

  

| Operating Profit   | Quarter ended |        | Year to date |         |
|--|---------------|--------|--------------|---------|
|  | 2018          | 2017   | 2018         | 2017    |
| KFC Division   | \$248         | \$260  | \$704        | \$710   |
| Pizza Hut Division   | 88            | 82     | 257          | 250     |
| Taco Bell Division   | 161           | 147    | 442          | 440     |
| Corporate and unallocated G&A expenses <sup>(a)</sup>      | (38 )         | (45 )  | (122 )       | (167 )  |
| Unallocated restaurant costs                               | 1             | 5      | 2            | 5       |
| Unallocated Franchise and property revenues <sup>(b)</sup> | —             | (3 )   | —            | (3 )    |
| Unallocated Franchise and property expenses <sup>(b)</sup> | (2 )          | (5 )   | (4 )         | (21 )   |
| Unallocated Refranchising gain (loss) (See Note 5)         | 100           | 201    | 285          | 331     |
| Unallocated Other income (expense)                         | (5 )          | 1      | (9 )         | 1       |
| Operating Profit   | \$553         | \$643  | \$1,555      | \$1,546 |
| Investment income (expense), net (See Note 5)              | 96            | 1      | 185          | 3       |
| Other pension income (expense) (See Note 10)               | (4 )          | (10 )  | (10 )        | (42 )   |
| Interest expense, net                                      | (111 )        | (110 ) | (330 )       | (325 )  |
| Income before income taxes                                 | \$534         | \$524  | \$1,400      | \$1,182 |

<sup>(a)</sup> Includes non-cash adjustments associated with share-based compensation and charges associated with YUM's Strategic Transformation Initiatives. See Note 5.

<sup>(b)</sup> Represents costs associated with the KFC U.S. Acceleration Agreement and Pizza Hut U.S. Transformation Agreement. See Note 5.

**Note 10 - Pension Benefits**

We sponsor qualified and supplemental (non-qualified) noncontributory defined benefit pension plans covering certain full-time salaried and hourly U.S. employees. The most significant of these plans, the YUM Retirement Plan (the "Plan"), is funded. We fund our other U.S. plans as benefits are paid. The Plan and our most significant non-qualified plan in the U.S. are closed to new salaried participants.

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The components of net periodic benefit cost associated with our significant U.S. pension plans are as follows:

|  | Quarter ended |      | Year to date |      |
|--|---------------|------|--------------|------|
|  | 2018          | 2017 | 2018         | 2017 |
| Service cost   | \$1           | \$2  | \$5          | \$8  |
| Interest cost  | 9             | 9    | 27           | 29   |
| Expected return on plan assets                               | (10)          | (10) | (31)         | (33) |
| Amortization of net loss                                     | 4             | 1    | 11           | 4    |
| Amortization of prior service cost                           | 1             | 2    | 4            | 4    |
| Net periodic benefit cost                                    | \$5           | \$4  | \$16         | \$12 |
| Additional loss recognized due to settlements <sup>(a)</sup> | \$—           | \$8  | \$—          | \$16 |
| Pension data adjustment <sup>(b)</sup>                       | \$—           | \$—  | \$—          | \$22 |
| Special termination benefits                                 | \$1           | \$2  | \$1          | \$2  |

(a) Losses are a result of settlement transactions which exceeded the sum of annual service and interest costs for the applicable plan. These losses were recorded in Other pension (income) expense.

(b) Reflects a non-cash, out-of-year charge related to the adjustment of certain historical deferred vested liability balances in the Plan during the first quarter of 2017 recorded in Other pension (income) expense. See Note 5.

#### Note 11 - Short-term Borrowings and Long-term Debt

| <b>Short-term Borrowings</b>                              | 9/30/2018 | 12/31/2017 |
|---|-----------|------------|
| Current maturities of long-term debt                      | \$ 301    | \$ 386     |
| Less current portion of debt issuance costs and discounts | (6 )      | (11 )      |
| Short-term borrowings                                     | \$ 295    | \$ 375     |

| <b>Long-term Debt</b>                     |          |          |
|---|----------|----------|
| Securitization Notes                      | \$ 2,265 | \$ 2,271 |
| Subsidiary Senior Unsecured Notes         | 2,850    | 2,850    |
| Revolving Facility                        | 273      | —        |
| Term Loan A Facility                      | 494      | 500      |
| Term Loan B Facility                      | 1,960    | 1,975    |
| YUM Senior Unsecured Notes <sup>(a)</sup> | 1,875    | 2,200    |
| Capital lease obligations                 | 80       | 105      |
|   | \$ 9,797 | \$ 9,901 |
| Less debt issuance costs and discounts    | (91 )    | (86 )    |
| Less current maturities of long-term debt | (301 )   | (386 )   |
| Long-term debt                            | \$ 9,405 | \$ 9,429 |

(a) During the first quarter of 2018, we repaid \$325 million in YUM Senior Unsecured Notes that matured in March 2018.

Credit Agreement Repricing

On April 3, 2018, KFC Holding Co., Pizza Hut Holdings, LLC, a limited liability company, and Taco Bell of America, LLC, a limited liability company, as co-borrowers (collectively, the “Borrowers”), each of which is a wholly-owned subsidiary of the Company, completed the repricing of the then existing \$1.97 billion under the Term Loan B Facility pursuant to an amendment to the Credit Agreement (as defined in our 2017 Form 10-K). The amendment reduces the interest rate applicable to the Term Loan

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B Facility by 25 basis points to adjusted LIBOR plus 1.75% or Base Rate plus 0.75%, at the Borrowers' election, and extends the maturity date for the Term Loan B Facility by 2 years to April 3, 2025. All other material provisions under the Credit Agreement remained unchanged as a result of this amendment.

Details of our short-term borrowings and long-term debt as of December 31, 2017 can be found within our 2017 Form 10-K. Cash paid for interest during the years to date ended September 30, 2018 and 2017 was \$300 million and \$275 million, respectively.

## **Note 12 - Derivative Instruments**

We use derivative instruments to manage certain of our market risks related to fluctuations in interest and foreign currency exchange rates.

### Interest Rate Swaps

We enter into interest rate swaps with the objective of reducing our exposure to interest rate risk for a portion of our variable-rate debt interest payments. On July 25, 2016, we agreed with multiple counterparties to swap the variable LIBOR-based component of the interest payments related to \$1.55 billion of borrowings under our Term Loan B Facility for a fixed rate. These interest rate swaps will expire in July 2021. Further, on May 14, 2018 we entered into forward-starting interest rate swaps to fix the interest rate on \$1.5 billion of borrowings under our Term Loan B Facility from the date the July 2016 swaps expire through March 2025. The interest rate swaps executed in May 2018 will result in a fixed rate of 4.81% on the swapped portion of the Term Loan B Facility from July 2021 through March 2025. These interest rate swaps are designated cash flow hedges as the changes in the future cash flows of the swaps are expected to offset changes in expected future interest payments on the related variable-rate debt. There were no other interest rate swaps outstanding as of September 30, 2018.

Gains or losses on the interest rate swaps are reported as a component of AOCI and reclassified into Interest expense, net in our Condensed Consolidated Statements of Income in the same period or periods during which the related hedged interest payments affect earnings. Through September 30, 2018, the swaps were highly effective cash flow hedges.

### Foreign Currency Contracts

We have entered into foreign currency forward and swap contracts with the objective of reducing our exposure to earnings volatility arising from foreign currency fluctuations associated with certain foreign currency denominated intercompany receivables and payables. The notional amount, maturity date, and currency of these contracts match those of the underlying intercompany receivables or payables. These foreign currency contracts are designated cash flow hedges as the future cash flows of the contracts are expected to offset changes in intercompany receivables and payables due to foreign currency exchange rate fluctuations.

Gains or losses on the foreign currency contracts are reported as a component of AOCI. Amounts are reclassified from AOCI each quarter to offset foreign currency transaction gains or losses recorded within Other (income) expense when the related intercompany receivables and payables affect earnings due to their functional currency remeasurements. Through September 30, 2018, all foreign currency forward and swap contracts related to intercompany receivables and payables were highly effective cash flow hedges.

As of both September 30, 2018 and December 31, 2017, foreign currency forward and swap contracts outstanding related to intercompany receivables and payables had total notional amounts of \$456 million. As of September 30, 2018 these foreign currency forward and swap contracts have durations expiring as late as 2020.

As a result of the use of interest rate swaps and foreign currency contracts, the Company is exposed to risk that the counterparties will fail to meet their contractual obligations. To mitigate the counterparty credit risk, we only enter into contracts with major financial institutions carefully selected based upon their credit ratings and other factors, and continually assess the creditworthiness of counterparties. At September 30, 2018, all of the counterparties to our interest rate swaps and foreign currency contracts had investment grade ratings according to the three major ratings agencies. To date, all counterparties have performed in accordance with their contractual obligations.

Gains and losses on derivative instruments designated as cash flow hedges recognized in OCI and reclassifications from AOCI into Net Income:

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|                              | Quarter ended       |      |                     |      | Year to date        |        |                     |      |
|------------------------------|---------------------|------|---------------------|------|---------------------|--------|---------------------|------|
|                              | 2018                |      | 2017                |      | 2018                |        | 2017                |      |
|                              | (Gains)/Losses      |      | (Gains)/Losses      |      | (Gains)/Losses      |        | (Gains)/Losses      |      |
|                              | Recognized from OCI |      | Recognized from OCI |      | Recognized from OCI |        | Recognized from OCI |      |
|                              | into Net            |      | into Net            |      | into Net            |        | into Net            |      |
|                              | Income              |      | Income              |      | Income              |        | Income              |      |
| Interest rate swaps          | \$12                | \$ — | \$ (4 )             | \$ — | \$28                | \$(8 ) | \$(7 )              | \$ 2 |
| Foreign currency contracts   | 4                   | (17) | (4 )                | 15   | 15                  | (49 )  | (16 )               | 50   |
| Income tax benefit/(expense) | (3 )                | 2    | 1                   | (2 ) | (8 )                | 5      | 3                   | (3 ) |

As of September 30, 2018, the estimated net gain included in AOCI related to our cash flow hedges that will be reclassified into earnings in the next 12 months is \$22 million, based on current LIBOR interest rates.

See Note 13 for the fair value of our derivative assets and liabilities.

### Note 13 - Fair Value Disclosures

As of September 30, 2018, the carrying values of cash and cash equivalents, restricted cash, short-term investments, accounts receivable, short-term borrowings, accounts payable and borrowings under our Revolving Facility approximated their fair values because of the short-term nature of these instruments. The fair value of notes receivable net of allowances and lease guarantees less subsequent amortization approximates their carrying value. The following table presents the carrying value and estimated fair value of the Company's debt obligations:

|  | 9/30/2018      |                      | 12/31/2017     |                      |
|--|----------------|----------------------|----------------|----------------------|
|  | Carrying Value | Fair Value (Level 2) | Carrying Value | Fair Value (Level 2) |
| Securitization Notes <sup>(a)</sup>              | \$2,265        | \$2,289              | \$2,271        | \$2,367              |
| Subsidiary Senior Unsecured Notes <sup>(b)</sup> | 2,850          | 2,858                | 2,850          | 2,983                |
| Term Loan A Facility <sup>(b)</sup>              | 494            | 495                  | 500            | 503                  |
| Term Loan B Facility <sup>(b)</sup>              | 1,960          | 1,968                | 1,975          | 1,990                |
| YUM Senior Unsecured Notes <sup>(b)</sup>        | 1,875          | 1,871                | 2,200          | 2,277                |

We estimated the fair value of the Securitization Notes by obtaining broker quotes from two separate brokerage firms that are knowledgeable about the Company's Securitization Notes and, at times, trade these notes. The markets in which the Securitization Notes trade are not considered active markets.

<sup>(b)</sup> We estimated the fair value of the YUM and Subsidiary Senior Unsecured Notes, Term Loan A Facility, and Term Loan B Facility using market quotes and calculations based on market rates.

### Recurring Fair Value Measurements

The Company has interest rate swaps, foreign currency contracts, an investment in Grubhub common stock and other investments, all of which are required to be measured at fair value on a recurring basis (See Note 12 for discussion regarding derivative instruments). The following table presents fair values for those assets and liabilities measured at fair value on a recurring basis and the level within the fair value hierarchy in which the measurements fall.

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|  | Level | Fair Value |            | Condensed Consolidated Balance Sheet      |
|--|-------|------------|------------|---|
|  |       | 9/30/2018  | 12/31/2017 |   |
| Interest Rate Swaps - Asset            | 2     | 21         | 9          | Prepaid expenses and other current assets |
| Interest Rate Swaps - Asset            | 2     | 51         | 40         | Other assets                              |
| Interest Rate Swaps - Liability        | 2     | 2          | —          | Other liabilities and deferred credits    |
| Foreign Currency Contracts - Liability | 2     | 28         | 46         | Other liabilities and deferred credits    |
| Foreign Currency Contracts - Asset     | 2     | 1          | 5          | Prepaid expenses and other current assets |
| Investment in Grubhub Common Stock     | 1     | 385        | —          | Other assets                              |
| Other Investments                      | 1     | 32         | 29         | Other assets                              |

The fair value of the Company's foreign currency contracts and interest rate swaps were determined based on the present value of expected future cash flows considering the risks involved, including nonperformance risk, and using discount rates appropriate for the duration based on observable inputs. The fair value of the investment in Grubhub common stock was determined primarily based on closing market prices for the shares. The other investments include investments in mutual funds, which are used to offset fluctuations for a portion of our deferred compensation liabilities. The other investments' fair value is determined based on the closing market prices of the respective mutual funds as of September 30, 2018 and December 31, 2017.

#### **Note 14 - Contingencies**

##### Lease Guarantees

As a result of having assigned our interest in obligations under real estate leases as a condition to the refranchising of certain Company restaurants and guaranteeing certain other leases, we are frequently contingently liable on lease agreements. These leases have varying terms, the latest of which expires in 2065. As of September 30, 2018, the potential amount of undiscounted payments we could be required to make in the event of non-payment by the primary lessees was approximately \$600 million. The present value of these potential payments discounted at our pre-tax cost of debt at September 30, 2018, was approximately \$500 million. Our franchisees are the primary lessees under the vast majority of these leases. We generally have cross-default provisions with these franchisees that would put them in default of their franchise agreements in the event of non-payment under the leases. We believe these cross-default provisions significantly reduce the risk that we will be required to make payments under these leases. Accordingly, the liability recorded for our probable exposure under such leases as of September 30, 2018 was not material.

##### Franchise Loan Pool and Equipment Guarantees

We have agreed to provide financial support, if required, to a variable interest entity that operates a franchisee lending program used primarily to assist franchisees in the development of new restaurants or the upgrade of existing restaurants and, to a lesser extent, in connection with the Company's refranchising programs in the U.S. We have determined that we are not required to consolidate this entity as we share the power to direct this entity's lending activity with other parties. We have provided guarantees of 20% of the outstanding loans of the franchisee loan program. As such, at September 30, 2018, our guarantee exposure under this program is approximately \$2 million based on total loans outstanding of \$9 million.

In addition to the guarantees described above, YUM has agreed to provide guarantees of up to approximately \$26 million on behalf of franchisees for several programs related to equipment purchases and refranchising. At September 30, 2018, our guarantee exposure under these financing programs is approximately \$10 million.

##### Legal Proceedings

We are subject to various claims and contingencies related to lawsuits, real estate, environmental and other matters arising in the normal course of business. An accrual is recorded with respect to claims or contingencies for which a loss is determined to be probable and reasonably estimable.

In August 2011, Ameranth, Inc. (“Ameranth”) filed a patent infringement action against a number of defendants, including Pizza Hut, LLC, in the U.S. District Court for the Southern District of California (the “Court”) (“2011 Action”), asserting infringement of a family of three patents. In March 2012, Ameranth initiated additional actions for infringement of a related patent, U.S. Patent No. 8,146,077 (“077 patent”), in the same forum, including an action against Pizza Hut, LLC and its service provider, QuikOrder, Inc. (“077 Action”). The Court later consolidated for certain purposes the cases against Pizza Hut, LLC and QuikOrder, Inc. and the approximately 40 other defendants filed by Ameranth in the same district, along with the original 2011 Action. In their answer,

Pizza Hut, LLC and QuikOrder, Inc. denied infringement and asserted various defenses, including non-infringement, invalidity, unenforceability and inequitable conduct. The consolidated district court case was stayed until 2017 while various of the defendants brought Covered Business Method patent review actions before the Patent Trial and Appeal Board (“PTAB”). Three of the four patents were invalidated by the PTAB. The PTAB declined to review the ‘077 Patent. In January 2017, the Court granted Ameranth’s motion to lift the stay and set a jury trial date of September 4, 2018 for the claims against Pizza Hut, LLC and QuikOrder, Inc. Prior to the commencement of the trial, the parties agreed to settle this matter. The costs associated with the settlement were not material.

We are currently engaged in various other legal proceedings and have certain unresolved claims pending, the ultimate liability for which, if any, cannot be determined at this time. However, based upon consultation with legal counsel, we are of the opinion that such other proceedings and claims are not expected to have a material adverse effect, individually or in the aggregate, on our Condensed Consolidated Financial Statements.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

### Introduction and Overview

Yum! Brands, Inc. ("YUM" or the "Company") operates or franchises a worldwide system of over 45,000 restaurants in more than 140 countries and territories, primarily through the concepts of KFC, Pizza Hut and Taco Bell. These three concepts are the global leaders in the chicken, pizza and Mexican-style food categories, respectively. Of the over 45,000 restaurants, 3% are operated by the Company and its subsidiaries and 97% are operated by franchisees.

This Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with the unaudited Condensed Consolidated Financial Statements ("Financial Statements"), the Forward-Looking Statements and our Annual Report on Form 10-K for the fiscal year ended December 31, 2017 ("2017 Form 10-K"). References to YUM throughout this discussion are made in first person notations of "we," "us" or "our."

YUM currently consists of three reporting segments:

- The KFC Division which includes our worldwide operations of the KFC concept
- The Pizza Hut Division which includes our worldwide operations of the Pizza Hut concept
- The Taco Bell Division which includes our worldwide operations of the Taco Bell concept

On October 11, 2016, we announced our strategic transformation plans to drive global expansion of our KFC, Pizza Hut and Taco Bell brands ("YUM's Strategic Transformation Initiatives") following the separation of our business in China. Major features of the Company's transformation and growth strategy involve being more focused, franchised and efficient. YUM's Strategic Transformation Initiatives below represent the continuation of YUM's transformation of its operating model and capital structure.

**More Focused.** Four growth drivers form the basis of YUM's strategic plans and repeatable business model to accelerate same-store sales growth and net-new restaurant development at KFC, Pizza Hut and Taco Bell around the world over the long term. The Company is focused on becoming best-in-class in:

- Building Distinctive, Relevant and Easy Brands
- Developing Unmatched Franchise Operating Capability
- Driving Bold Restaurant Development
- Growing Unrivaled Culture and Talent

**More Franchised.** YUM intends franchise restaurant ownership to be at least 98% by the end of 2018.

**More Efficient.** The Company is revamping its financial profile, improving the efficiency of its organization and cost structure globally, by:

- Reducing annual capital expenditures to approximately \$100 million in 2019;
- Lowering General and administrative expenses ("G&A") to 1.7% of system sales in 2019; and
- Maintaining an optimized capital structure of ~5.0x Earnings Before Interest, Taxes, Depreciation and Amortization ("EBITDA") leverage.

From 2017 through 2019, we intend to return \$6.5 - \$7.0 billion to shareholders through share repurchases and cash dividends. We intend to fund these shareholder returns through a combination of refranchising proceeds, free cash flow generation and maintenance of our five times EBITDA leverage. We anticipate generating proceeds in excess of \$2 billion, net of tax, through our refranchising initiatives. Refer to the Liquidity and Capital Resources section of this MD&A for additional details.

We intend for this MD&A to provide the reader with information that will assist in understanding our results of operations, including performance metrics that management uses to assess the Company's performance. Throughout this MD&A, we commonly discuss the following performance metrics:

• Same-store sales growth is the estimated percentage change in sales of all restaurants that have been open and in the YUM system for one year or more.

• Net new units represents new unit openings, offset by store closures.

• Company restaurant profit ("Restaurant profit") is defined as Company sales less expenses incurred directly by our Company-owned restaurants in generating Company sales. Company restaurant margin as a percentage of sales is defined as Restaurant profit divided by Company sales. Within the Company sales and Restaurant profit sections of this MD&A,

Store Portfolio Actions represent the net impact of new unit openings, acquisitions, refranchising and store closures, and Other primarily represents the impact of same-store sales as well as the impact of changes in costs such as inflation/deflation.

In addition to the results provided in accordance with Generally Accepted Accounting Principles in the United States of America ("GAAP"), the Company provides the following non-GAAP measurements:

System sales and System sales excluding the impacts of foreign currency translation ("FX"). System sales include the results of all restaurants regardless of ownership, including Company-owned and franchise restaurants that operate our Concepts. Sales of franchise restaurants typically generate ongoing franchise and license fees for the Company at a rate of 3% to 6% of sales. Franchise restaurant sales are not included in Company sales on the Condensed Consolidated Statements of Income; however, the franchise and license fees are included in the Company's revenues. We believe System sales growth is useful to investors as a significant indicator of the overall strength of our business as it incorporates our primary revenue drivers, Company and franchise same-store sales as well as net unit growth.

Diluted Earnings Per Share excluding Special Items (as defined below);

Effective Tax Rate excluding Special Items;

Core Operating Profit. Core Operating Profit excludes Special Items and FX and we use Core Operating Profit for the purposes of evaluating performance internally.

These non-GAAP measurements are not intended to replace the presentation of our financial results in accordance with GAAP. Rather, the Company believes that the presentation of these non-GAAP measurements provide additional information to investors to facilitate the comparison of past and present operations.

Special Items are not included in any of our Division segment results as the Company does not believe they are indicative of our ongoing operations due to their size and/or nature. Our chief operating decision maker does not consider the impact of Special Items when assessing segment performance.

Certain non-GAAP measurements are presented excluding the impact of FX. These amounts are derived by translating current year results at prior year average exchange rates. We believe the elimination of the FX impact provides better year-to-year comparability without the distortion of foreign currency fluctuations.

All Note references herein refer to the Notes to the Financial Statements. Tabular amounts are displayed in millions of U.S. dollars except per share and unit count amounts, or as otherwise specifically identified. Percentages may not recompute due to rounding.

## **Results of Operations**

### ***Summary***

All comparisons within this summary are versus the same period a year ago.

For the quarter ended September 30, 2018, GAAP diluted EPS increased 18% to \$1.40 per share, and diluted EPS, excluding Special Items, increased 52% to \$1.04 per share.

For the year to date ended September 30, 2018, GAAP diluted EPS increased 44% to \$3.64 per share, and diluted EPS, excluding Special Items, increased 37% to \$2.75 per share.





## Quarterly Financial highlights:

|                    | % Change            |                  |               |                       |                       |
|--------------------|---------------------|------------------|---------------|-----------------------|-----------------------|
|                    | System Sales, ex FX | Same-Store Sales | Net New Units | GAAP Operating Profit | Core Operating Profit |
| KFC Division       | +7                  | +3               | +5            | (5)                   | (2)                   |
| Pizza Hut Division | Even                | (1)              | +2            | +7                    | +9                    |
| Taco Bell Division | +8                  | +5               | +3            | +10                   | +10                   |
| Worldwide          | +5                  | +2               | +4            | (14)                  | +2                    |

## Year to date Financial highlights:

|                    | % Change            |                  |               |                       |                       |
|--------------------|---------------------|------------------|---------------|-----------------------|-----------------------|
|                    | System Sales, ex FX | Same-Store Sales | Net New Units | GAAP Operating Profit | Core Operating Profit |
| KFC Division       | +6                  | +2               | +5            | (1)                   | (3)                   |
| Pizza Hut Division | +1                  | (1)              | +2            | +3                    | +2                    |
| Taco Bell Division | +5                  | +3               | +3            | —                     | +1                    |
| Worldwide          | +5                  | +2               | +4            | +1                    | (1)                   |

## Additionally:

We opened 410 and 892 net new units for the quarter and year to date, respectively, for 4% net new unit growth.

During the quarter, we refranchised 134 restaurants, including 57 KFC, 46 Taco Bell and 31 Pizza Hut units, for pre-tax proceeds of \$193 million. We recorded refranchising gains of \$100 million in Special Items. During the year to date, we refranchised 329 restaurants, including 137 KFC, 97 Pizza Hut and 95 Taco Bell units, for pre-tax proceeds of \$445 million. We recorded refranchising gains of \$285 million in Special Items.

During the quarter, we repurchased 6.3 million shares totaling \$527 million at an average price of \$83. During the year to date, we repurchased 20.5 million shares totaling \$1,698 million at an average price of \$83.

We reflected the change in fair value of our investment in Grubhub Inc. ("Grubhub") by recording \$94 million and \$185 million of pre-tax investment income during the quarter and year to date, respectively.

Foreign currency translation impacted Divisional Operating Profit unfavorably for the quarter by \$9 million and favorably year to date by \$15 million.

*Worldwide*GAAP Results

|  | Quarter ended |         |         | Year to date |         |         |       |
|--|---------------|---------|---------|--------------|---------|---------|-------|
|  | 2018          | 2017    | % B/(W) | 2018         | 2017    | % B/(W) |       |
| Company sales  | \$499         | \$871   | (43 )   | \$1,523      | \$2,682 | (43 )   |       |
| Franchise and property revenues                            | 605           | 565     | 7       | 1,773        | 1,619   | 10      |       |
| Franchise contributions for advertising and other services | 287           | —       | N/A     | 834          | —       | N/A     |       |
| Total revenues   | \$1,391       | \$1,436 | (3 )    | \$4,130      | \$4,301 | (4 )    |       |
| Restaurant profit  | \$100         | \$154   | (35 )   | \$265        | \$459   | (42 )   |       |
| Restaurant margin %  | 20.1          | % 17.7  | % 2.4   | ppts. 17.4   | % 17.1  | % 0.3   | ppts. |
| G&A expenses   | \$204         | \$215   | 5       | \$631        | \$699   | 10      |       |
| Franchise and property expenses                            | 40            | 61      | 35      | 127          | 161     | 21      |       |
| Franchise advertising and other services expense           | 288           | —       | N/A     | 834          | —       | N/A     |       |
| Refranchising (gain) loss                                  | (100 )        | (201 )  | (50 )   | (285 )       | (331 )  | (14 )   |       |
| Other (income) expense                                     | 7             | 1       | NM      | 10           | 3       | NM      |       |
| Operating Profit   | \$553         | \$643   | (14 )   | \$1,555      | \$1,546 | 1       |       |
| Investment (income) expense, net                           | \$(96 )       | \$(1 )  | NM      | \$(185 )     | \$(3 )  | NM      |       |
| Other pension (income) expense                             | 4             | 10      | 59      | 10           | 42      | 76      |       |
| Interest expense, net                                      | 111           | 110     | —       | 330          | 325     | (1 )    |       |
| Income tax provision                                       | 80            | 106     | 24      | 192          | 278     | 31      |       |
| Net Income   | \$454         | \$418   | 9       | \$1,208      | \$904   | 34      |       |
| Diluted EPS <sup>(a)</sup>                                 | \$1.40        | \$1.18  | 18      | \$3.64       | \$2.52  | 44      |       |
| Effective tax rate   | 15.1          | % 20.2  | % 5.1   | ppts. 13.7   | % 23.5  | % 9.8   | ppts. |

(a) See Note 3 for the number of shares used in this calculation.

Performance Metrics

| Unit Count    | 9/30/2018 | 9/30/2017 | % Increase<br>(Decrease) |
|---------------|-----------|-----------|--------------------------|
| Franchise     | 44,803    | 42,017    | 7                        |
| Company-owned | 1,173     | 2,335     | (50)                     |
|               | 45,976    | 44,352    | 4                        |

|                           | Quarter ended |      | Year to date |      |
|---------------------------|---------------|------|--------------|------|
|                           | 2018          | 2017 | 2018         | 2017 |
| Same-store Sales Growth % | 2             | 3    | 2            | 2    |

Non-GAAP Items

Non-GAAP Items, along with the reconciliation to the most comparable GAAP financial measure, as presented below.

|   | Quarter ended |       | Year to date |       |
|---|---------------|-------|--------------|-------|
|   | 2018          | 2017  | 2018         | 2017  |
| System Sales Growth %, reported               | 4             | 6     | 6            | 5     |
| System Sales Growth %, excluding FX           | 5             | 6     | 5            | 5     |
| Core Operating Profit % Growth                | 2             | 11    | (1)          | 13    |
| Diluted EPS Growth %, excluding Special Items | 52            | 22    | 37           | 20    |
| Effective Tax Rate excluding Special Items    | 22.3%         | 27.8% | 18.4%        | 22.8% |

| Detail of Special Items  | Quarter ended |        | Year to date |        |
|--|---------------|--------|--------------|--------|
|  | 2018          | 2017   | 2018         | 2017   |
| Refranchising gain (loss) (See Note 5)   | \$100         | \$201  | \$285        | \$331  |
| YUM's Strategic Transformation Initiatives (See Note 5)                          | (1)           | (4)    | (2)          | (15)   |
| Costs associated with Pizza Hut U.S. Transformation Agreement (See Note 5)       | (1)           | (8)    | (3)          | (20)   |
| Costs associated with KFC U.S. Acceleration Agreement (See Note 5)               | —             | (4)    | (2)          | (12)   |
| Non-cash credits (charges) associated with share-based compensation (See Note 5) | 2             | —      | 3            | (18)   |
| Other Special Items Income (Expense)   | —             | 5      | 1            | 3      |
| Special Items Income (Expense) - Operating Profit                                | 100           | 190    | 282          | 269    |
| Special Items - Other Pension Income (Expense) (See Note 5)                      | —             | (1)    | —            | (23)   |
| Special Items Income (Expense) before Income Taxes                               | 100           | 189    | 282          | 246    |
| Tax Benefit (Expense) on Special Items <sup>(a)</sup>                            | (12)          | (13)   | (49)         | (64)   |
| Tax Benefit (Expense) - U.S. Tax Act <sup>(b)</sup>                              | 28            | —      | 62           | —      |
| Special Items Income (Expense), net of tax                                       | \$116         | \$176  | \$295        | \$182  |
| Average diluted shares outstanding   | 325           | 353    | 332          | 358    |
| Special Items diluted EPS  | \$0.36        | \$0.50 | \$0.89       | \$0.51 |

Reconciliation of GAAP Operating Profit to Core Operating Profit

Consolidated

|   |       |       |         |         |
|---|-------|-------|---------|---------|
| GAAP Operating Profit   | \$553 | \$643 | \$1,555 | \$1,546 |
| Special Items Income  | 100   | 190   | 282     | 269     |
| Foreign Currency Impact on Divisional Operating Profit <sup>(c)</sup> | (9 )  | N/A   | 15      | N/A     |
| Core Operating Profit   | \$462 | \$453 | \$1,258 | \$1,277 |

KFC Division

|   |       |       |       |       |
|---|-------|-------|-------|-------|
| GAAP Operating Profit   | \$248 | \$260 | \$704 | \$710 |
| Foreign Currency Impact on Divisional Operating Profit <sup>(c)</sup> | (8 )  | N/A   | 12    | N/A   |
| Core Operating Profit   | \$256 | \$260 | \$692 | \$710 |

Pizza Hut Division

|   |      |      |       |       |
|---|------|------|-------|-------|
| GAAP Operating Profit   | \$88 | \$82 | \$257 | \$250 |
| Foreign Currency Impact on Divisional Operating Profit <sup>(c)</sup> | (1 ) | N/A  | 3     | N/A   |
| Core Operating Profit   | \$89 | \$82 | \$254 | \$250 |

Taco Bell Division

|   |       |       |       |       |
|---|-------|-------|-------|-------|
| GAAP Operating Profit   | \$161 | \$147 | \$442 | \$440 |
| Foreign Currency Impact on Divisional Operating Profit <sup>(c)</sup> | —     | N/A   | —     | N/A   |
| Core Operating Profit   | \$161 | \$147 | \$442 | \$440 |

Reconciliation of Diluted EPS to Diluted EPS excluding Special Items

|                                     |        |        |        |        |
|-------------------------------------|--------|--------|--------|--------|
| Diluted EPS                         | \$1.40 | \$1.18 | \$3.64 | \$2.52 |
| Special Items Diluted EPS           | 0.36   | 0.50   | 0.89   | 0.51   |
| Diluted EPS excluding Special Items | \$1.04 | \$0.68 | \$2.75 | \$2.01 |

Reconciliation of GAAP Effective Tax Rate to Effective Tax Rate excluding Special Items

|   |        |         |         |         |   |
|---|--------|---------|---------|---------|---|
| GAAP Effective Tax Rate   | 15.1   | % 20.2  | % 13.7  | % 23.5  | % |
| Impact on Tax Rate as a result of Special Items <sup>(a)(b)</sup> | (7.2 ) | )(7.6 ) | )(4.7 ) | )(0.7 ) | % |
| Effective Tax Rate excluding Special Items                        | 22.3   | % 27.8  | % 18.4  | % 22.8  | % |

Reconciliation of Company sales to System sales

Consolidated

|  |          |          |          |          |
|--|----------|----------|----------|----------|
| GAAP Company sales <sup>(d)</sup>                      | \$499    | \$871    | \$1,523  | \$2,682  |
| Franchise sales  | 11,589   | 10,800   | 33,962   | 30,729   |
| System sales   | 12,088   | 11,671   | 35,485   | 33,411   |
| Foreign Currency Impact on System sales <sup>(e)</sup> | (203 )   | N/A      | 526      | N/A      |
| System sales, excluding FX                             | \$12,291 | \$11,671 | \$34,959 | \$33,411 |

KFC Division

|  |        |       |        |         |
|--|--------|-------|--------|---------|
| GAAP Company sales <sup>(d)</sup>                      | \$221  | \$498 | \$707  | \$1,465 |
| Franchise sales  | 6,334  | 5,784 | 18,483 | 16,223  |
| System sales   | 6,555  | 6,282 | 19,190 | 17,688  |
| Foreign Currency Impact on System sales <sup>(e)</sup> | (158 ) | N/A   | 408    | N/A     |

|                            |         |         |          |          |
|----------------------------|---------|---------|----------|----------|
| System sales, excluding FX | \$6,713 | \$6,282 | \$18,782 | \$17,688 |
|----------------------------|---------|---------|----------|----------|

Pizza Hut Division

|  |         |         |         |         |
|--|---------|---------|---------|---------|
| GAAP Company sales <sup>(d)</sup>                      | \$13    | \$55    | \$55    | \$226   |
| Franchise sales  | 2,916   | 2,911   | 8,800   | 8,439   |
| System sales   | 2,929   | 2,966   | 8,855   | 8,665   |
| Foreign Currency Impact on System sales <sup>(e)</sup> | (43 )   | N/A     | 116     | N/A     |
| System sales, excluding FX                             | \$2,972 | \$2,966 | \$8,739 | \$8,665 |

Taco Bell Division

|  |         |         |         |         |
|--|---------|---------|---------|---------|
| GAAP Company sales <sup>(d)</sup>                      | \$265   | \$318   | \$761   | \$991   |
| Franchise sales  | 2,339   | 2,105   | 6,679   | 6,067   |
| System sales   | 2,604   | 2,423   | 7,440   | 7,058   |
| Foreign Currency Impact on System sales <sup>(e)</sup> | (2 )    | N/A     | 2       | N/A     |
| System sales, excluding FX                             | \$2,606 | \$2,423 | \$7,438 | \$7,058 |

(a) Tax Benefit (Expense) on Special Items was determined based upon the impact of the nature, as well as the jurisdiction of the respective individual components within Special Items. Additionally, during the second quarter of 2018, we recorded a \$19 million increase to our Income tax provision for the correction of an error associated with the tax recorded on a prior year divestiture, the effects of which were previously recorded as a Special Item.

(b) For the quarter and year to date ended September 30, 2018, we recorded \$16 million and \$32 million decreases, respectively, related to the provisional deemed repatriation tax expense recorded in the fourth quarter of 2017 associated with the Tax Cuts and Jobs Act of 2017 ("Tax Act") that was reported as a Special Item. We also recorded tax benefit in the quarter and year to date ended September 30, 2018 related to current year U.S. foreign tax credits that became realizable directly as a result of the impact of the deemed repatriation.

(c) The foreign currency impact on reported Operating Profit is presented in relation only to the immediately preceding year presented. When determining applicable Core Operating Profit growth percentages, the Core Operating Profit for the current year should be compared to the prior year GAAP Operating Profit adjusted only for any prior year Special Items Income (Expense).

(d) Company Sales represents sales from our Company-operated stores as presented on our Condensed Consolidated Statements of Income.

(e) The foreign currency impact on System sales is presented in relation only to the immediately preceding year presented. When determining applicable System sales growth percentages, the System sales excluding FX for the current year should be compared to the prior year System sales.

*Items Impacting Current Quarter and Expected to Impact Future Results*Strategic Transformation Initiatives Impact

We have refranchised a significant number of Company-owned restaurants since the announcement of YUM's Strategic Transformation Initiatives in October 2016, and additional, significant refranchising is occurring in 2018. The impact on Operating Profit due to refranchising includes the loss of Restaurant profit, which reflects the decrease in Company sales, and the increase in franchise fees from restaurants that have been refranchised. We expect to reduce G&A, including reductions directly attributable to refranchising, such that upon completion of YUM's Strategic Transformation Initiatives in 2019, on an annual basis, the cumulative impact of lost Operating Profit from refranchising will be largely offset by G&A reductions we have made. However, we expect that Operating Profit will be negatively impacted throughout 2018 as certain G&A reductions lag the loss of Operating Profit due to

refranchising. We currently anticipate the negative impact to Core Operating Profit growth for 2018 as a result of refranchising, net of G&A reductions, to be slightly below the low end of the 6 to 7 percentage points we were previously expecting. However, we do not expect our overall 2018 Core Operating Profit to increase as the decreased impact described above is anticipated to be offset by reduced Core Operating Profit contribution from Pizza Hut, particularly in the International business.



KFC United Kingdom ("UK") Supply Availability Issues

On February 14, 2018, we and our franchisees transitioned to a new distributor for the products supplied to our approximately 900 KFCs in the United Kingdom and Ireland (those restaurants accounted for approximately 3% of YUM's global system sales in the year ended December 31, 2017). In connection with this transition, certain of the restaurants experienced supply availability issues which resulted in store closures or stores operating under a limited menu. Beginning mid-May 2018, all restaurants opened for business, offering their full menus, with advertising beginning at the end of May. On a full-year basis, we continue to expect that Core Operating Profit growth will be negatively impacted by 2 percentage points for KFC Division and 1 percentage point for YUM as a result of these first-half supply availability issues. The estimated negative impact to full-year same-store sales growth continues to be 50 basis points for our KFC Division and 25 basis points for YUM.

Investment in Grubhub

For the quarter and year to date ended September 30, 2018 we recognized income of \$94 million and \$185 million, respectively, related to our investment in Grubhub. See Note 5 for further discussion of our investment in Grubhub.

Adoption of Topic 606, "Revenue from Contracts with Customers"

The Financial Accounting Standards Board ("FASB") has issued standards to provide principles within a single framework for revenue recognition of transactions involving contracts with customers across all industries ("Topic 606"). As a result, the Company has changed its accounting policy for revenue recognition as detailed in Note 2. We adopted Topic 606 beginning with the quarter ended March 31, 2018, using the modified retrospective method. Therefore, the comparative information for fiscal 2017 has not been adjusted and continues to be reported under our accounting policies related to revenue recognition prior to the adoption of Topic 606 ("Legacy GAAP"). GAAP Operating Profit for the quarter ended September 30, 2018 was \$2 million lower and Core Operating Profit was \$4 million lower than what would have been recognized under Legacy GAAP. GAAP Operating Profit for the year to date ended September 30, 2018 was \$2 million higher and Core Operating Profit was \$13 million lower than what would have been recognized under Legacy GAAP.

| Increase (Decrease) vs. Legacy GAAP          | Quarter ended |                    |                    |                            | Total  |
|--|---------------|--------------------|--------------------|----------------------------|--------|
|  | KFC Division  | Pizza Hut Division | Taco Bell Division | Unallocated <sup>(a)</sup> |        |
| Amortization of upfront fees                 | \$9           | \$ 4               | \$ 3               | \$ —                       | \$16   |
| Amortization of franchise incentive payments | (2 )          | (1 )               | —                  | —                          | (3 )   |
| Upfront fee cash received                    | (16)          | (2 )               | (2 )               | —                          | (20 )  |
| Incentive payments made                      | —             | —                  | —                  | —                          | —      |
| Franchise and property revenues              | (9 )          | 1                  | 1                  | —                          | (7 )   |
| Franchise and property expenses              | 2             | 1                  | —                  | 2                          | 5      |
| Refranchising gain                           | —             | —                  | —                  | —                          | —      |
| Operating Profit                             | \$(7)         | \$ 2               | \$ 1               | \$ 2                       | \$(2 ) |

| Increase (Decrease) vs. Legacy GAAP          | Year to date    |                          |                          |                            | Total |
|--|-----------------|--------------------------|--------------------------|----------------------------|-------|
|  | KFC<br>Division | Pizza<br>Hut<br>Division | Taco<br>Bell<br>Division | Unallocated <sup>(a)</sup> |       |
| Amortization of upfront fees                 | \$28            | \$ 12                    | \$ 7                     | \$ —                       | \$47  |
| Amortization of franchise incentive payments | (9 )            | (3 )                     | —                        | —                          | (12 ) |
| Upfront fee cash received                    | (36 )           | (9 )                     | (8 )                     | —                          | (53 ) |
| Incentive payments made                      | —               | 1                        | 1                        | 7                          | 9     |
| Franchise and property revenues              | (17 )           | 1                        | —                        | 7                          | (9 )  |
| Franchise and property expenses              | 2               | 1                        | —                        | 4                          | 7     |
| Refranchising gain                           | —               | —                        | —                        | 4                          | 4     |
| Operating Profit                             | \$(15)          | \$ 2                     | \$ —                     | \$ 15                      | \$2   |

Reflects incentive payments made to or on behalf of franchisees during 2018 that under Legacy GAAP would have been recognized as expense in full in 2018. Due to the size and nature of such payments, we historically would have included such amounts as Special Items and thus in the table above have not allocated their impact to our Divisional results. Such amounts are now being capitalized with related amortization recognized as a reduction of Franchise and property revenues over the period of expected cash flows from the franchise agreements to which the payments relate. Also reflects the recognition of deferred franchise fees upon the modification of existing franchise agreements when entering into master franchise agreements.

Topic 606 also impacted transactions that were not historically included in our revenues and expenses such as franchisee contributions to, and subsequent expenditures from, advertising cooperatives that we are required to consolidate, as well as receipts and expenditures for other services we provide to our franchisees. Based on Legacy GAAP, these transactions were reported on a net basis in our Condensed Consolidated Statements of Income. This change did not have a significant impact on Operating Profit, as the contributions that are now recorded in Franchise contributions for advertising and other services are largely offset by the expenditures recorded in Franchise advertising and other services expense. Refer to Notes 2 and 5 for further details of the significant changes and quantitative impact of Topic 606.

We expect the adoption of Topic 606 to negatively impact Core Operating Profit growth for 2018 by 2 to 3 percentage points. This impact is weighted towards the fourth quarter due to the timing of our expected new unit development and the resulting collection of upfront fees that will now be deferred under Topic 606.

### ***KFC Division***

The KFC Division has 22,104 units, 82% of which are located outside the U.S. Additionally, 98% of the KFC Division units were operated by franchisees as of September 30, 2018.

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|  | Quarter ended |           |             |             | Year to date |          |             |             |
|--|---------------|-----------|-------------|-------------|--------------|----------|-------------|-------------|
|  | 2018          | 2017      | % B/(W)     |             | 2018         | 2017     | % B/(W)     |             |
|  |               |           | Reported    | Ex FX       |              |          | Reported    | Ex FX       |
| System Sales   | \$6,555       | \$6,282   | 4           | 7           | \$19,190     | \$17,688 | 8           | 6           |
| Same-Store Sales Growth %                                  | 3             | 4         | N/A         | N/A         | 2            | 3        | N/A         | N/A         |
| Company sales  | \$221         | \$498     | (55 )       | (53 )       | \$707        | \$1,465  | (52 )       | (52 )       |
| Franchise and property revenues                            | 320           | 296       | 8           | 11          | 937          | 831      | 13          | 10          |
| Franchise contributions for advertising and other services | 108           | —         | N/A         | N/A         | 314          | —        | N/A         | N/A         |
| Total revenues   | \$649         | \$794     | (18 )       | (16 )       | \$1,958      | \$2,296  | (15 )       | (16 )       |
| Restaurant profit  | \$34          | \$79      | (57 )       | (54 )       | \$90         | \$221    | (59 )       | (59 )       |
| Restaurant margin %  | 15.4 %        | 15.9 %    | (0.5 )ppts. | (0.4 )ppts. | 12.7 %       | 15.1 %   | (2.4 )ppts. | (2.2 )ppts. |
| G&A expenses   | \$81          | \$85      | 5           | 3           | \$247        | \$259    | 5           | 6           |
| Franchise and property expenses                            | 24            | 29        | 17          | 15          | 78           | 80       | 4           | 6           |
| Franchise advertising and other services expense           | 107           | —         | N/A         | N/A         | 312          | —        | N/A         | N/A         |
| Operating Profit   | \$248         | \$260     | (5 )        | (2 )        | \$704        | \$710    | (1 )        | (3 )        |
|  |               |           | % Increase  |             |              |          |             |             |
| Unit Count   | 9/30/2018     | 9/30/2017 | (Decrease)  |             |              |          |             |             |
| Franchise  | 21,554        | 19,745    | 9           |             |              |          |             |             |
| Company-owned  | 550           | 1,318     | Ø58         |             |              |          |             |             |
|  | 22,104        | 21,063    | 5           |             |              |          |             |             |

Company sales and Restaurant profit

The changes in Company sales and Restaurant profit were as follows:

| Income / (Expense)          | Quarter ended |                               |        |        | 2018    |
|-----------------------------|---------------|-------------------------------|--------|--------|---------|
|                             | 2017          | Store<br>Portfolio<br>Actions | Other  | FX     |         |
| Company sales               | \$498         | \$ (269 )                     | \$6    | \$(14) | \$221   |
| Cost of sales               | (172 )        | 93                            | (5 )   | 5      | (79 )   |
| Cost of labor               | (114 )        | 62                            | (2 )   | 3      | (51 )   |
| Occupancy and other         | (133 )        | 72                            | 1      | 3      | (57 )   |
| Company restaurant expenses | \$(419 )      | \$ 227                        | \$(6 ) | \$11   | \$(187) |
| Restaurant profit           | \$79          | \$ (42 )                      | \$—    | \$(3 ) | \$34    |

| Income / (Expense)          | Year to date |                               |        |        | 2018    |
|-----------------------------|--------------|-------------------------------|--------|--------|---------|
|                             | 2017         | Store<br>Portfolio<br>Actions | Other  | FX     |         |
| Company sales               | \$1,465      | \$ (762 )                     | \$6    | \$(2 ) | \$707   |
| Cost of sales               | (504 )       | 258                           | (11 )  | 1      | (256 )  |
| Cost of labor               | (345 )       | 180                           | (3 )   | (1 )   | (169 )  |
| Occupancy and other         | (395 )       | 205                           | (2 )   | —      | (192 )  |
| Company restaurant expenses | \$(1,244)    | \$ 643                        | \$(16) | \$—    | \$(617) |
| Restaurant profit           | \$221        | \$ (119 )                     | \$(10) | \$(2 ) | \$90    |

The quarterly and year to date decreases in Company sales and Restaurant Profit associated with store portfolio actions were driven by refranchising. For the year to date, Company sales and Restaurant profit were also impacted by the supply interruptions in our KFC UK business. Company same-store sales growth was 3% and 1% for the quarter and year to date, respectively.

Franchise and property revenues

The quarterly and year to date increases in Franchise and property revenues, excluding the impacts of foreign currency translation and the adoption of Topic 606, were driven by refranchising, international net new unit growth, and franchise same-store sales growth of 3% for the quarter and 2% for the year to date, including the impact of the supply interruptions in our KFC UK business on our year to date results, partially offset by lapping higher than normal renewal and transfer fees that were recognized upfront in the prior year.

G&A

The quarterly and year to date decreases in G&A, excluding the impacts of foreign currency translation, were driven by the positive impact of YUM's Transformation initiatives, including reductions in G&A directly attributable to refranchising.

Operating Profit

The quarterly increase in Operating Profit, excluding the impacts of foreign currency translation and the adoption of Topic 606, was driven by net new unit growth, same-store sales growth and lower G&A, partially offset by refranchising and lapping higher than normal renewal and transfer fees that were recognized upfront in the prior year.

The year to date decrease in Operating Profit, excluding the impacts of foreign currency translation and the adoption of Topic 606, was driven by refranchising, the supply interruptions in our KFC UK business and lapping higher than normal renewal and transfer fees that were recognized upfront in the prior year, partially offset by net new unit growth and lower G&A.

***Pizza Hut Division***

The Pizza Hut Division has 16,930 units, 44% of which are located in the U.S. The Pizza Hut Division operates as one brand that uses multiple distribution channels including delivery, dine-in and express (e.g. airports). Additionally, over 99% of the Pizza Hut Division units were operated by franchisees as of September 30, 2018.

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|  | Quarter ended |           |                     |             | Year to date |         |                     |             |
|--|---------------|-----------|---------------------|-------------|--------------|---------|---------------------|-------------|
|  | 2018          | 2017      | % B/(W)<br>Reported | Ex FX       | 2018         | 2017    | % B/(W)<br>Reported | Ex FX       |
| System Sales   | \$2,929       | \$2,966   | (1 )                | Even        | \$8,855      | \$8,665 | 2                   | 1           |
| Same-Store Sales Growth<br>(Decline) %                           | (1 )          | 1         | N/A                 | N/A         | (1 )         | (1 )    | N/A                 | N/A         |
| Company sales  | \$13          | \$55      | (77 )               | (77 )       | \$55         | \$226   | (76 )               | (76 )       |
| Franchise and property<br>revenues                               | 143           | 148       | (3 )                | (2 )        | 432          | 433     | Even                | (1 )        |
| Franchise contributions for<br>advertising and other<br>services | 73            | —         | N/A                 | N/A         | 226          | —       | N/A                 | N/A         |
| Total revenues   | \$229         | \$203     | 12                  | 13          | \$713        | \$659   | 8                   | 7           |
| Restaurant profit  | \$—           | \$1       | NM                  | NM          | \$(1 )       | \$14    | NM                  | NM          |
| Restaurant margin %  | (2.2 )%       | 1.9 %     | (4.1 )ppts.         | (4.1 )ppts. | (1.3 )%      | 6.0 %   | (7.3 )ppts.         | (7.3 )ppts. |
| G&A expenses   | \$45          | \$44      | (2 )                | (3 )        | \$141        | \$151   | 6                   | 7           |
| Franchise and property<br>expenses                               | 9             | 21        | 61                  | 60          | 28           | 44      | 37                  | 38          |
| Franchise advertising and<br>other services expense              | 74            | —         | N/A                 | N/A         | 229          | —       | N/A                 | N/A         |
| Operating Profit   | \$88          | \$82      | 7                   | 9           | \$257        | \$250   | 3                   | 2           |
|  |               |           | % Increase          |             |              |         |                     |             |
| Unit Count   | 9/30/2018     | 9/30/2017 | (Decrease)          |             |              |         |                     |             |
| Franchise  | 16,868        | 16,245    | 4                   |             |              |         |                     |             |
| Company-owned  | 62            | 306       | Ø80                 |             |              |         |                     |             |
|  | 16,930        | 16,551    | 2                   |             |              |         |                     |             |

Company sales and Restaurant profit

The changes in Company sales and Restaurant profit were as follows:

| Income / (Expense)          | Quarter ended |                               |       |             |
|-----------------------------|---------------|-------------------------------|-------|-------------|
|                             | 2017          | Store<br>Portfolio<br>Actions | Other | FX 2018     |
| Company sales               | \$55          | \$ (43 )                      | \$ 1  | \$ -\$13    |
| Cost of sales               | (16 )         | 13                            | (1 )  | — (4 )      |
| Cost of labor               | (19 )         | 14                            | —     | — (5 )      |
| Occupancy and other         | (19 )         | 14                            | 1     | — (4 )      |
| Company restaurant expenses | \$(54 )       | \$ 41                         | \$ —  | \$ -\$ (13) |
| Restaurant profit           | \$ 1          | \$ (2 )                       | \$ 1  | \$ -\$ —    |

| Income / (Expense)          | Year to date |                               |         |             |
|-----------------------------|--------------|-------------------------------|---------|-------------|
|                             | 2017         | Store<br>Portfolio<br>Actions | Other   | FX 2018     |
| Company sales               | \$226        | \$ (172 )                     | \$ 1    | \$ -\$55    |
| Cost of sales               | (65 )        | 50                            | (1 )    | — (16 )     |
| Cost of labor               | (74 )        | 54                            | (1 )    | — (21 )     |
| Occupancy and other         | (73 )        | 55                            | (1 )    | — (19 )     |
| Company restaurant expenses | \$(212)      | \$ 159                        | \$ (3 ) | \$ -\$ (56) |
| Restaurant profit           | \$ 14        | \$ (13 )                      | \$ (2 ) | \$ -\$ (1 ) |

The quarterly and year to date decreases in Company sales and Restaurant profit associated with store portfolio actions were driven by refranchising. Company same-store sales growth was 3% and even for the quarter and year to date, respectively.

Franchise and property revenues

The quarterly decrease in Franchise and property revenues, excluding the impacts of foreign currency translation and the adoption of Topic 606, was driven by franchise same-store sales declines of 1%, partially offset by net new unit growth and the impact of refranchising.

The year to date decrease in Franchise and property revenues, excluding the impacts of foreign currency translation and the adoption of Topic 606, was driven by franchise same-store sales declines of 1%, partially offset by net new unit growth and the impact of refranchising.

G&A

The quarterly increase in G&A, excluding the impact of foreign currency translation, was driven by higher various costs, partially offset by YUM's Strategic Transformation Initiatives, including reductions in G&A directly attributable to refranchising.

The year to date decrease in G&A, excluding the impact of foreign currency translation, was driven by YUM's Strategic Transformation Initiatives, including reductions in G&A directly attributable to refranchising, and lapping higher litigation costs.

Operating Profit

The quarterly increase in Operating Profit, excluding the impacts of foreign currency translation and the adoption of Topic 606, was driven by lower advertising costs associated with the Pizza Hut Transformation Agreement, net new unit growth and refranchising, partially offset by same-store sales declines.

The year to date increase in Operating Profit, excluding the impacts of foreign currency translation and the adoption of Topic 606, was driven by net new unit growth, lower G&A and refranchising, partially offset by same-store sales declines.

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**Taco Bell Division**

The Taco Bell Division has 6,942 units, the vast majority of which are in the U.S. The Company owned 9% of the Taco Bell units in the U.S. as of September 30, 2018.

|  | Quarter ended |           |                       |           | Year to date |         |                     |           |
|--|---------------|-----------|-----------------------|-----------|--------------|---------|---------------------|-----------|
|  | 2018          | 2017      | % B/(W)<br>Reported   | Ex FX     | 2018         | 2017    | % B/(W)<br>Reported | Ex FX     |
| System Sales   | \$2,604       | \$2,423   | 7                     | 8         | \$7,440      | \$7,058 | 5                   | 5         |
| Same-Store Sales Growth %                                  | 5             | 3         | N/A                   | N/A       | 3            | 5       | N/A                 | N/A       |
| Company sales  | \$265         | \$318     | (17 )                 | (17 )     | \$761        | \$991   | (23 )               | (23 )     |
| Franchise and property revenues                            | 142           | 124       | 15                    | 15        | 404          | 358     | 13                  | 13        |
| Franchise contributions for advertising and other services | 106           | —         | N/A                   | N/A       | 294          | —       | N/A                 | N/A       |
| Total revenues   | \$513         | \$442     | 16                    | 16        | \$1,459      | \$1,349 | 8                   | 8         |
| Restaurant profit  | \$65          | \$69      | (6 )                  | (6 )      | \$174        | \$219   | (21 )               | (21 )     |
| Restaurant margin %  | 24.7          | % 21.9    | % 2.8                 | ppts. 2.8 | 22.9         | % 22.1  | % 0.8               | ppts. 0.8 |
| G&A expenses   | \$40          | \$41      | 3                     | 3         | \$121        | \$122   | 1                   | 1         |
| Franchise and property expenses                            | 5             | 6         | 9                     | 9         | 17           | 16      | (10 )               | (10 )     |
| Franchise advertising and other services expense           | 107           | —         | N/A                   | N/A       | 293          | —       | N/A                 | N/A       |
| Operating Profit   | \$161         | \$147     | 10                    | 10        | \$442        | \$440   | —                   | 1         |
| Unit Count   | 9/30/2018     | 9/30/2017 | % Increase (Decrease) |           |              |         |                     |           |
| Franchise  | 6,381         | 6,027     | 6                     |           |              |         |                     |           |
| Company-owned  | 561           | 711       | (150)                 |           |              |         |                     |           |
|  | 6,942         | 6,738     | 3                     |           |              |         |                     |           |

Company sales and Restaurant profit

The changes in Company sales and Restaurant profit were as follows:

| Income / (Expense)         | Quarter ended |                               |        |         |
|----------------------------|---------------|-------------------------------|--------|---------|
|                            | 2017          | Store<br>Portfolio<br>Actions | Other  | 2018    |
| Company sales              | \$318         | \$ (68 )                      | \$ 15  | \$265   |
| Cost of sales              | (87 )         | 20                            | —      | (67 )   |
| Cost of labor              | (91 )         | 19                            | (2 )   | (74 )   |
| Occupancy and other        | (71 )         | 13                            | (1 )   | (59 )   |
| Company restaurant expense | \$(249)       | \$ 52                         | \$(3 ) | \$(200) |
| Restaurant profit          | \$69          | \$ (16 )                      | \$ 12  | \$65    |

| Income / (Expense)         | Year to date |                               |        |         |
|----------------------------|--------------|-------------------------------|--------|---------|
|                            | 2017         | Store<br>Portfolio<br>Actions | Other  | 2018    |
| Company sales              | \$991        | \$ (255 )                     | \$ 25  | \$761   |
| Cost of sales              | (262 )       | 69                            | —      | (193 )  |
| Cost of labor              | (288 )       | 73                            | (8 )   | (223 )  |
| Occupancy and other        | (222 )       | 52                            | (1 )   | (171 )  |
| Company restaurant expense | \$(772)      | \$ 194                        | \$(9 ) | \$(587) |
| Restaurant profit          | \$219        | \$ (61 )                      | \$ 16  | \$174   |

The decrease in Company Sales and Restaurant profit for the quarter associated with store portfolio actions was driven by refranchising, partially offset by net unit growth. Significant other factors impacting Company sales and/or Restaurant profit were company same-store sales growth of 6% and commodity cost deflation, partially offset by higher labor costs.

The year to date decrease in Company Sales and Restaurant profit associated with store portfolio actions was driven by refranchising, partially offset by net unit growth. Significant other factors impacting Company sales and/or Restaurant profit were company same-store sales growth of 3%, partially offset by higher labor costs.

Franchise and property revenues

The quarterly and year-to-date increase in Franchise and property revenues, excluding the adoption of Topic 606, was driven by refranchising, quarterly and year to date franchise same-store sales growth of 5% and 3%, respectively, and net new unit growth.

G&A

The quarterly decrease in G&A was driven by the positive impact of YUM's Transformation initiatives, including reductions in G&A directly attributable to refranchising.

The year to date decrease in G&A was driven by the positive impact of YUM's Transformation initiatives, including reductions in G&A directly attributable to refranchising and the favorable impact of forfeitures related to share based compensation awards, partially offset by lapping lower litigation costs.

Operating Profit

The quarterly increase in Operating Profit, excluding the impacts of the adoption of Topic 606, was driven by same-store sales growth and net new unit growth, partially offset by refranchising.

The year to date increase in Operating Profit, excluding the impacts of the adoption of Topic 606, was driven by same-store sales growth and net new unit growth, partially offset by refranchising and higher restaurant operating costs.

***Corporate & Unallocated***

| (Expense) / Income                            | Quarter ended |        |           | Year to date |         |           |
|---|---------------|--------|-----------|--------------|---------|-----------|
|   | 2018          | 2017   | % B/(W)   | 2018         | 2017    | % B/(W)   |
| Corporate and unallocated G&A                 | \$(38)        | \$(45) | 16        | \$(122)      | \$(167) | 27        |
| Unallocated restaurant costs                  | 1             | 5      | (78 )     | 2            | 5       | (65 )     |
| Unallocated Franchise and property revenues   | —             | (3 )   | NM        | —            | (3 )    | NM        |
| Unallocated Franchise and property expenses   | (2 )          | (5 )   | 57        | (4 )         | (21 )   | 78        |
| Refranchising gain (loss) (See Note 5)        | 100           | 201    | (50 )     | 285          | 331     | (14 )     |
| Unallocated Other income (expense)            | (5 )          | 1      | NM        | (9 )         | 1       | NM        |
| Investment income (expense), net (See Note 5) | 96            | 1      | NM        | 185          | 3       | NM        |
| Other pension income (expense) (See Note 10)  | (4 )          | (10 )  | 59        | (10 )        | (42 )   | 76        |
| Interest expense, net                         | (111)         | (110)  | 0         | (330 )       | (325 )  | (1 )      |
| Income tax provision (See Note 8)             | (80 )         | (106)  | 24        | (192 )       | (278 )  | 31        |
| Effective tax rate (See Note 8)               | 15.1 %        | 20.2 % | 5.1 ppts. | 13.7 %       | 23.5 %  | 9.8 ppts. |

**Corporate and unallocated G&A**

The decrease in Corporate G&A expenses for the quarter was driven by lapping charges related to the Pizza Hut U.S. Transformation Agreement (see Note 5) and current year G&A reductions due to the impact of YUM's Strategic Transformation Initiatives.

The decrease in Corporate G&A expenses for the year to date was driven by lapping non-cash charges associated with the modification of Executive Income Deferral ("EID") share-based compensation awards (See Note 5), current year G&A reductions due to the impact of YUM's Strategic Transformation Initiatives, lapping costs associated with YUM's Strategic Transformation Initiatives (See Note 5) and lapping charges related to the Pizza Hut U.S. Transformation Agreement (See Note 5).

**Unallocated Franchise and property revenues**

Unallocated Franchise and property revenues reflect charges related to the KFC U.S. Acceleration Agreement. See Note 5.

**Unallocated Franchise and property expenses**

Unallocated Franchise and property expenses reflect charges related to the Pizza Hut U.S. Transformation Agreement and/or the KFC U.S. Acceleration Agreement. See Note 5.

**Unallocated Other income (expense)**

Unallocated Other income (expense) primarily includes foreign exchange gains (losses).

**Other Pension (Income) Expense**

The decrease in Other Pension (Income) Expense for the quarter was driven by lapping settlement charges in our US plans. See Note 10.

The decrease in Other Pension (Income) Expense for the year to date was driven by lapping an adjustment to our deferred vested pension obligation and lapping settlement charges in our US plans. See Note 10.

## Consolidated Cash Flows

**Net cash provided by operating activities** was \$796 million in 2018 versus \$718 million in 2017. The increase was largely driven by lower compensation payments.

**Net cash provided by investing activities** was \$89 million in 2018 versus \$489 million in 2017. The decrease was primarily driven by lower franchising proceeds in 2018 and our \$200 million investment in Grubhub common stock in 2018.

**Net cash used in financing activities** was \$2,161 million in 2018 versus \$1,029 million in 2017. The increase was primarily

driven by lower net borrowings and higher share repurchases.

### **Consolidated Financial Condition**

Our Condensed Consolidated Balance Sheet was impacted by the adoption of Topic 606. See Note 5 for further discussion. Other assets also increased \$385 million as of September 30, 2018 due to the inclusion of our investment in Grubhub common stock (see Note 5).

### **Liquidity and Capital Resources**

In October 2016, we announced YUM's Strategic Transformation Initiatives to drive global expansion of the KFC, Pizza Hut and Taco Bell brands following the separation of our China business on October 31, 2016. As part of this transformation, we intend to own less than 1,000 stores by the end of 2018 and, by 2019, reduce annual recurring capital expenditures to approximately \$100 million, improve our efficiency by lowering G&A to 1.7% of system sales and increase free cash flow conversion to 100%.

From 2017 through 2019, we intend to return \$6.5 to \$7.0 billion to shareholders through share repurchases and cash dividends. We intend to fund these shareholder returns through a combination of free cash flow generation, refranchising proceeds and maintenance of our five times EBITDA leverage. During the year to date ended September 30, 2018, we have used cash to repurchase 20.5 million shares of our Common Stock for \$1.7 billion and pay cash dividends of \$349 million.

Our primary sources of liquidity are cash on hand, cash generated by operations and our revolving facilities. As of September 30, 2018, we had Cash and cash equivalents of \$198 million. Cash and cash equivalents decreased from \$1,522 million at December 31, 2017 due to share repurchases, dividend payments, the repayment of \$325 million in YUM Senior Unsecured Notes that matured in March 2018 and our investment in Grubhub. We have historically generated substantial cash flows from the operations of our Company-owned stores and from our extensive franchise operations, which require a limited YUM investment. Our annual operating cash flows have historically been in excess of \$1 billion each of the past three years. We anticipate that the decrease in operating cash flows from the operation of fewer Company-owned stores due to refranchising will be offset going forward with savings generated from decreased capital investment and G&A required to support company operations. To the extent operating cash flows plus other sources of cash such as refranchising proceeds do not cover our anticipated cash needs, we maintain a \$1 billion Revolving Facility under our existing Credit Agreement. As of September 30, 2018, there were \$273 million of outstanding borrowings under the Revolving Facility.

Our balance sheet often reflects a working capital deficit, which is not uncommon in our industry and is also historically common for YUM. Company sales are paid in cash or by credit card (which is quickly converted into cash) and our royalty receivables from franchisees are generally due within 30 days of the period in which the related sales occur. Substantial amounts of cash received have historically been either invested in new restaurant assets which are non-current in nature or returned to shareholders. As part of our working capital strategy we negotiate favorable credit terms with vendors and, as a result, our on-hand inventory turns faster than the related short-term liabilities. Accordingly, it is not unusual for current liabilities to exceed current assets. We believe such a deficit has no significant impact on our liquidity or operations.

### **Debt Instruments**

As of September 30, 2018, our Long-term debt is comprised primarily of borrowings under our Securitization Notes, the Credit Agreement, Subsidiary Senior Unsecured Notes and YUM Senior Unsecured Notes. See Note 11 for additional details. The following table summarizes the future maturities of our outstanding long-term debt, excluding

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capital leases, as of September 30, 2018.

|                                   | 2018  | 2019   | 2020     | 2021   | 2022   | 2023   | 2024     | 2025     | 2026     | 2027   | 2037   | 2043   | Total    |
|-----------------------------------|-------|--------|----------|--------|--------|--------|----------|----------|----------|--------|--------|--------|----------|
| Securitization Notes              |       |        | \$ 788   |        |        | \$ 493 |          |          | \$ 984   |        |        |        | \$ 2,265 |
| Credit Agreement                  | 11    | 45     | 51       | 76     | 395    | 19     | 20       | 1,837    |          |        |        |        | 2,454    |
| Subsidiary Senior Unsecured Notes |       |        |          |        |        |        | 1,050    |          | 1,050    | 750    |        |        | 2,850    |
| YUM Senior Unsecured Notes        |       | 250    | 350      | 350    |        | 325    |          |          |          |        | 325    | 275    | 1,875    |
| Revolving facility                |       |        |          |        | 273    |        |          |          |          |        |        |        | 273      |
| Total                             | \$ 11 | \$ 295 | \$ 1,189 | \$ 426 | \$ 668 | \$ 837 | \$ 1,070 | \$ 1,837 | \$ 2,034 | \$ 750 | \$ 325 | \$ 275 | \$ 9,717 |

On November 1, 2018, we announced our intention to refinance the Securitization Notes that are due in 2020 with a new series of notes (the “New Notes”) issued under the Company’s existing securitization financing facility. The New Notes are expected to total \$1.2 billion and will be used to pay off the \$788 million in Securitization Notes that are due in 2020 and certain, other outstanding indebtedness of YUM. Any additional proceeds will be used to pay certain transaction-related expenses or for general corporate purposes and may be used to return capital to shareholders of YUM. There can be no assurance regarding the timing of a refinancing transaction, the interest rate at which the specified Securitization Notes would be refinanced, or that a refinancing transaction will be completed.

### **New Accounting Pronouncements Not Yet Adopted**

Starting in February 2016 and continuing into 2018, the FASB issued standards on the recognition and measurement of leases that are intended to increase transparency and comparability among organizations by requiring that substantially all lease assets and liabilities be recognized on the balance sheet and by requiring the disclosure of key information about leasing arrangements. We will adopt these standards using a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the first quarter of 2019 and will not recast the comparative periods presented in the Financial Statements upon adoption.

The standards provide a number of optional practical expedients and policy elections in transition. We currently expect to elect the ‘package of practical expedients’ under which we will not reassess under the standards our prior conclusions about lease identification, lease classification and initial direct costs. We do not expect to elect the use-of-hindsight or the practical expedient pertaining to land easements; the latter not being applicable to us. We currently expect to elect the short-term lease recognition exemption for all leases that qualify, meaning we would not recognize right-of-use assets or lease liabilities for those leases. We are still evaluating whether we will make an election to not separate lease and non-lease components and, if so, to which class of underlying asset the election would relate.

We are evaluating the impact the adoption of the standards will have on our Financial Statements. We have made significant progress in assessing the impact of the standards and planning for their adoption and implementation. We have completed an initial scoping analysis and worldwide data gathering process of our current lease portfolio. We are currently reviewing the preliminary information for completeness of the lease portfolio, analyzing the financial statement impact of adopting the standards, and evaluating the impact of adoption on our existing accounting policies and disclosures.

Based on our current volume of store leases we expect this adoption will result in a material increase in the Total Assets and Total Liabilities on our Consolidated Balance Sheet. We do not anticipate adoption will have a significant impact on our Consolidated Statements of Income or Cash Flows.

In June 2016, the FASB issued a standard that requires measurement and recognition of expected versus incurred credit losses for financial assets held. The standard is effective for the Company in our first quarter of fiscal 2020 with early adoption permitted beginning in the first quarter of fiscal 2019. We are currently evaluating the impact the adoption of this standard will have on our Financial Statements.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

There were no material changes during the quarter ended September 30, 2018 to the disclosures made in Item 7A of the Company’s 2017 Form 10-K.

### **Item 4. Controls and Procedures**



Evaluation of Disclosure Controls and Procedures

The Company has evaluated the effectiveness of the design and operation of its disclosure controls and procedures pursuant to Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 as of the end of the period covered by this report. Based on the evaluation, performed under the supervision and with the participation of the Company's management, including the Chief Executive Officer (the "CEO") and the Chief Financial Officer (the "CFO"), the Company's management, including the CEO and CFO, concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by the report.

### Changes in Internal Control

There were no changes with respect to the Company's internal control over financial reporting or in other factors that materially affected, or are reasonably likely to materially affect, internal control over financial reporting during the quarter ended September 30, 2018.

### **Forward-Looking Statements**

Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts and by the use of forward-looking words such as "expect," "expectation," "believe," "anticipate," "may," "could," "intend," "b," "plan," "estimate," "target," "predict," "likely," "seek," "project," "model," "ongoing," "will," "should," "forecast," "outlook" terminology. Forward-looking statements are based on our current expectations, estimates, assumptions and/or projections, our perception of historical trends and current conditions, as well as other factors that we believe are appropriate and reasonable under the circumstances. Forward-looking statements are neither predictions nor guarantees of future events, circumstances or performance and are inherently subject to known and unknown risks, uncertainties and assumptions that could cause our actual results to differ materially from those indicated by those statements. There can be no assurance that our expectations, estimates, assumptions and/or projections will be achieved. Factors that could cause actual results and events to differ materially from our expectations and forward-looking statements include (i) the factors described in Management's Discussion and Analysis of Financial Condition and Results of Operations included in Part I, Item 2 of this report, (ii) any risks and uncertainties described in the Risk Factors included in Part II, Item 1A of this report, (iii) the factors described in the Management's Discussion and Analysis of Financial Condition and Results of Operations included in Part II, Item 7 of our Form 10-K for the year ended December 31, 2017 and (iv) the risks and uncertainties described in the Risk Factors included in Part I, Item 1A of our Form 10-K for the year ended December 31, 2017. You should not place undue reliance on forward-looking statements, which speak only as of the date hereof. We are not undertaking to update any of these statements.

## Report of Independent Registered Public Accounting Firm

To the Stockholders and Board of Directors  
YUM! Brands, Inc.:

### *Results of Review of Interim Financial Information*

We have reviewed the condensed consolidated balance sheet of YUM! Brands, Inc. and Subsidiaries (YUM) as of September 30, 2018, the related condensed consolidated statements of income and comprehensive income for the quarter and year-to-date periods ended September 30, 2018 and 2017, the related condensed consolidated statements of cash flows for the year-to-date periods ended September 30, 2018 and 2017, and the related notes (collectively, the consolidated interim financial information). Based on our reviews, we are not aware of any material modifications that should be made to the consolidated interim financial information for it to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheet of YUM as of December 31, 2017, and the related consolidated statements of income, comprehensive income, shareholders' (deficit), and cash flows for the year then ended (not presented herein); and in our report dated February 21, 2018, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2017, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

### *Basis for Review Results*

This consolidated interim financial information is the responsibility of YUM's management. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to YUM in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our reviews in accordance with the standards of the PCAOB. A review of consolidated interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the PCAOB, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

/s/ KPMG LLP  
Louisville, Kentucky  
November 7, 2018

**PART II – OTHER INFORMATION AND SIGNATURES****Item 1. Legal Proceedings**

Information regarding legal proceedings is incorporated by reference from Note 14 to the Company's Condensed Consolidated Financial Statements set forth in Part I of this report.

**Item 1A. Risk Factors**

We face a variety of risks that are inherent in our business and our industry, including operational, legal, regulatory and product risks. Such risks could cause our actual results to differ materially from our forward-looking statements, expectations and historical trends. There have been no material changes from the risk factors disclosed in Part I, Item 1A "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2017.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The following table provides information as of September 30, 2018 with respect to shares of Common Stock repurchased by the Company during the quarter then ended:

| Fiscal Periods | Total number of shares purchased (thousands) | Average price paid per share | Total number of shares purchased as part of publicly announced plans or programs (thousands) | Approximate dollar value of shares that may yet be purchased under the plans or programs (millions) |
|----------------|--|------------------------------|--|---|
| 7/1/18-7/31/18 | 2,312  | \$78.78                      | 2,312  | \$147   |
| 8/1/18-8/31/18 | 2,159  | \$83.26                      | 2,159  | \$1,968   |
| 9/1/18-9/30/18 | 1,866  | \$88.51                      | 1,866  | \$1,802   |
| Total          | 6,337  | \$83.17                      | 6,337  | \$1,802   |

On August 10, 2018 our Board of Directors authorized share repurchases through December 2019 of up to \$2 billion (excluding applicable transaction fees) of our outstanding Common Stock.

**Item 6. Exhibits**

**(a) Exhibit  
Index**

**Exhibit No. Exhibit Description**

|         |  |
|---------|--|
| 15      | <u>Letter from KPMG LLP regarding Unaudited Interim Financial Information (Acknowledgement of Independent Registered Public Accounting Firm)</u>   |
| 31.1    | <u>Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) of Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u> |
| 31.2    | <u>Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) of Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u> |
| 32.1    | <u>Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>                            |
| 32.2    | <u>Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>                            |
| 101.INS | XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.                          |
| 101.SCH | XBRL Taxonomy Extension Schema Document  |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document  |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document  |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document   |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document   |

SIGNATURES

Pursuant to the requirement of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, duly authorized officer of the registrant.

YUM! BRANDS, INC.  
(Registrant)

Date: November 7, 2018 /s/ David E. Russell  
Senior Vice President, Finance and Corporate Controller  
(Principal Accounting Officer)

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