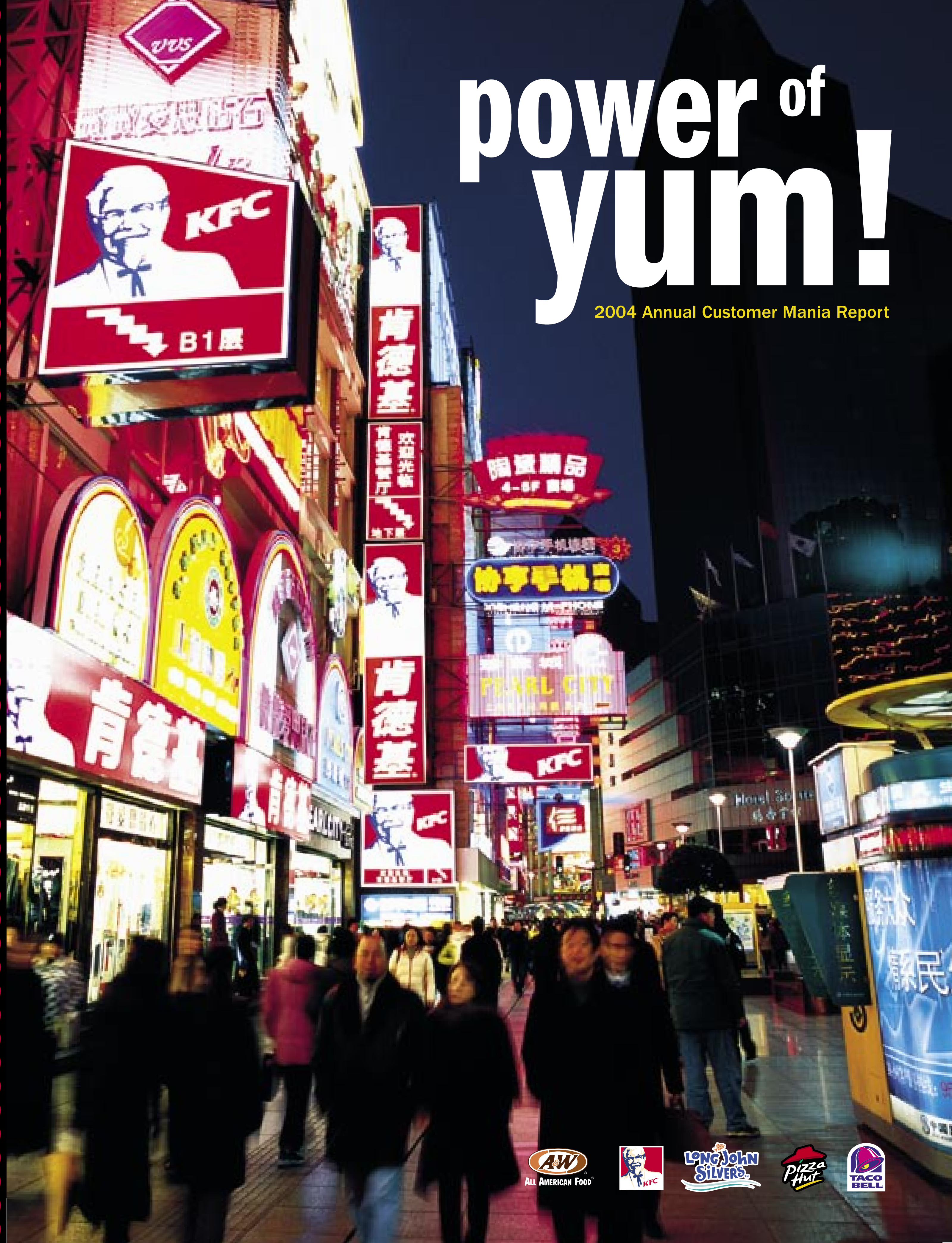
power of yum!

2004 Annual Customer Mania Report



financial highlights

(In millions, except per share amounts)	**2004**	2003	% B/(W) Change
Company sales	**$ 7,992**	$ 7,441	7
Franchise and license fees	**1,019**	939	8
Total revenues	**$ 9,011**	$ 8,380	8
Operating profit	**$ 1,155**	$ 1,059	9
Earnings before special items	**$ 721**	$ 628	15
Special items, net of tax	**19**	(11)	NM
Net income	**$ 740**	$ 617	20
Wrench litigation income (expense)	**$ 14**	$ (42)	NM
AmeriServe and other (charges) credits	**16**	26	NM
Cumulative effect of accounting change	**—**	(2)	NM
Special items	**30**	(18)	NM
Income tax on special items	**(11)**	7	NM
Special items, net of tax	**$ 19**	$ (11)	NM
Diluted earnings per common share:			
Earnings before special items	**$ 2.36**	$ 2.06	15
Special items, net of tax	**0.06**	(0.04)	NM
Reported	**$ 2.42**	$ 2.02	20
Cash flows provided by operating activities	**$ 1,131**	$ 1,053	7

AVERAGE U.S. SALES PER SYSTEM UNIT[a]

(In thousands)	**2004**	2003	2002	2001	2000	5-year growth[b]
KFC	**$ 896**	$ 898	$ 898	$ 865	$ 833	1%
Pizza Hut	**794**	748	748	724	712	3%
Taco Bell	**1,069**	1,005	964	890	896	3%

(a) Excludes license units.
(b) Compound annual growth rate.

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Front and Back Cover: KFC and Pizza Hut in Shanghai, China

David C. Novak, Chairman and Chief Executive Officer, pictured in his office literally filled from floor to ceiling with “customer maniac” recognition photos.

Dear Partners,

I’m pleased to report 2004 was another year where we demonstrated the underlying power of our global portfolio of leading restaurant brands.

Fueled by continued profitable international expansion, dynamic growth in China, and strong momentum at Taco Bell and Pizza Hut in the United States, we achieved 15% earnings per share growth prior to special items. Highlights include a number of firsts: a record $1.2 billion in operating profit; a record $1.1 billion in cash provided by operating activities and a record $1.0 billion in franchise and license fees.

We also reached our goal to achieve an investment grade rating from each major rating agency after paying off nearly $3 billion in debt the past seven years. Armed with increasing cash flow and a powerful balance sheet, we increased our shareholder payout by initiating the first dividend in our history and buying back a record $569 million of Yum! shares. Given this overall strong performance, our share price climbed 37% in 2004. We’re pleased our annual return to shareholders is 22% for the first half of this decade.

Most importantly, we remain confident we will continue our track record of growing earnings per share at least 10% each year. We have four powerfully unique growth opportunities that differentiate us from the competition and bolster our belief that we are Not Your Ordinary Restaurant Company. Let me give you my perspective on each of these strategies and hopefully you will come to the same conclusion.

#1 BUILD DOMINANT CHINA BRANDS

There’s nothing like making a strategic investment in the right place at the right time and that’s exactly what we’ve done in China. With KFC and Pizza Hut, we already have the dominant brands in the fastest growing economy in the world populated with 1.3 billion people. To be more specific, KFC has 1,243 quick service restaurants compared to approximately 600 for McDonald’s. Pizza Hut has 171 casual dining restaurants and there is no other substantial casual dining chain in China.

We have an outstanding tenured team, which has worked together for over ten years building the business from scratch. Our China Division now generates over $1 billion in revenue and $200 million in operating profit, up over 20% versus a year ago. What’s more, it is our highest return international equity business with a +20% store level margin. In fact, China has grown to the point that the team will now report into Yum! as a separate operating division.

Consider the powerful competitive advantages we have in China. We uniquely own our own food distribution system that gives us coverage in every major Chinese province and has allowed us to expand KFC to over 280 cities. We also have one of the largest real estate development teams of any retailer in the world that opened up over 350 new restaurants in 2004.

Our China operations are best in class. In fact, 81% of our restaurant managers have at least a college education (the rest are just plain smart!). We also have highly sought after jobs with 13,000 team members. This investment in infrastructure has given us an incredible opportunity and

Our China Division is our highest return international equity business generating over $1 billion in revenue and $200 million in operating profit, up over 20% versus a year ago.

an incredible head start. We estimate there are already 500 million urban Chinese customers who can afford our food. There's no question, we are on the ground floor with an unprecedented opportunity. I liken it to the days when Colonel Sanders, Glen Bell, Dan Carney and Ray Kroc started KFC, Taco Bell, Pizza Hut and McDonald's, respectively, and created fast-food categories in the U.S., leading to 270,000 units today. We have the first mover advantage and the opportunity to do the same thing in China.

That's why our goal is to build dominant restaurant brands in ***every*** significant category. So, in addition to KFC and Pizza Hut casual dining, we've recently developed Pizza Hut Home Service and our Taco Bell Grande dine-in format. The team has also enthusiastically developed and is now testing East Dawning, which is a Chinese fast-food concept that is geared to provide the everyday local favorite foods of Chinese customers.

With all the good news in China, the leading question is, what can go wrong? Well, the past two years we've weathered SARS, the Avian Flu and events like that are always a possibility. And I'll leave it to you to predict the future economy or potential political issues. One thing I'm sure of is we'll have our ups and some unforeseen downs but as I said last year and I'll say it again, there's no doubt in my mind that one day we will have more restaurants in China than we do in the U.S.

China Division Key Measures: +20% operating profit growth; +22% system sales growth; +375 new units/year.

#2 DRIVE PROFITABLE INTERNATIONAL EXPANSION

Since China is now a separate division, the remainder of our international business is now reported excluding our China Division. It too is a large and growing business. For the fifth straight year we opened up over 700 restaurants in countries outside of China and the U.S. The International Division generates over $335 million in operating profit, with a solid record of growing at least 10% in operating profits.

The foundation of this consistent growth comes from the competitive advantage of the strong infrastructure we already have in place. For this we are largely indebted to PepsiCo who, prior to our spin-off in 1997, invested 40 years and billions of dollars to establish the global network we inherited.

The tough reality for our competition is that it would take the same kind of time and commitment to reach our size and scale. The obvious exception, of course, is McDonald's. McDonald's already makes $1.8 billion outside the U.S. demonstrating the clear profit opportunity we can capture in the international arena.

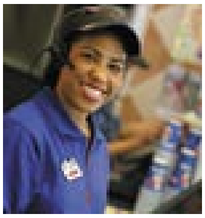
That's because the great reality for us is we already have strong local teams and operate in approximately 100 countries around the world with nearly 600 international franchisees growing *two* popular global brands, KFC and Pizza Hut. In fact, our franchisees opened up over 80% of the 738 new restaurants we added this year. This helps make our international business high return because our franchisees are using their capital, not ours, to grow.

Our plan is to continue to leverage our big scale markets. We have nine countries and franchise-only business units that have over 600 restaurants each. We're focusing our international company operations investment in four of these countries where we are building scale and expect to produce excellent returns over time (U.K., Australia, South Korea, Mexico). The largest of these markets is the U.K. where we have great KFC and Pizza Hut businesses. Here, we have almost 1,300 restaurants generating $115 million in operating profits with a 24% 5-year growth rate.

When you look at our franchise-only business, you'll see we have nearly 4,500 restaurants generating $154 million in operating profit and a 16% 5-year growth rate. What's more we have broad-based growth evidenced by the fact we opened new units in 60 countries this year.

Going forward, we want to continue to add at least 700 new units each year and do it profitably. Consider this, excluding the China Division we only have 6,100 KFCs and 4,500 Pizza Huts compared to over 16,000 units McDonald's has in international markets outside of China.

On the international front we have an undeniable competitive advantage and growth opportunity with two global brands, KFC and Pizza Hut!



To attack this opportunity, we are making targeted investments to develop new markets, with the goal to eventually get to scale in India, Brazil, Russia, France, Germany and Holland. We are especially pleased with our progress in India and France. Pizza Hut is the number one most trusted brand in India with almost 100 units and we are now developing KFC with an offering that includes a vegetarian menu.

KFC in France is generating huge sales volume and good unit economics so we are beginning to expand. While we've made some progress, we are struggling with our unit economics in Germany and Holland.

Developing new markets is tough because building consumer awareness and acceptance takes time. Just as importantly, it takes time to build local operating capability. Our approach is to continue to be patient and ever mindful of overall profitability and returns. The potential is obvious and we are determined to build our international business the right way.

International Division Key Measures: +10–15% operating profit growth; +5% system sales growth; +700 new units/year.

#3 BE THE BEST AT PROVIDING BRANDED RESTAURANT CHOICE AND MULTIBRANDING GREAT BRANDS

The foundation of our company is category-leading U.S. brands with proprietary products and operating systems that are highly successful on a stand alone basis. Our strategy is to make our brands more and more powerful each year by building even more relevance, energy and differentiation for our customers. Let me post you on our U.S. progress.

Taco Bell generated 5% same store sales growth, hit the $1 million mark again for average unit volumes and is now the second most profitable Quick Service Restaurant brand. We're especially pleased that Taco Bell is becoming a model for consistency, growing its same store sales at least 2% the past three years. This result is coming from a focus on "exceptional execution of the basics" which is driving continuous improvement in both operations and marketing. Taco Bell has made dramatic improvement in speed of service and cleanliness. And Taco Bell's "Think Outside the Bun" marketing campaign which features a steady stream of product and value news continues to build what we call "big brand momentum" with our customers.

Pizza Hut also had strong same store sales performance, +5%. Pizza Hut did this by staying one step ahead of our competition, introducing innovative new pizzas like The 4forALL®, The Full House XL Pizza™ and limited time only offerings like Buffalo Chicken Pizza. The brand's "Gather 'Round the Good Stuff" advertising campaign is building real traction with the heart of the pizza category by focusing on the family and the primary decision maker, Mom. And importantly, Pizza Hut is also steadily improving its operations, targeting improving delivery phone service and dine-in table service.

Our single biggest disappointment in the U.S. was negative 2% same store sales at KFC. It would be easy to blame increasing competition from McDonald's and Wendy's since both had national introductions of chicken strips representing 20,000 units. But we know we can grow this brand by simply doing a much better job of marketing and operations execution. One big advantage we have at Yum! is the ability to spread best practices. As a result, our new management team is now implementing the product innovation and operating processes used successfully at both Taco Bell and Pizza Hut. KFC also introduced a new menu board that lays the foundation for upcoming product and value innovation. Much needs to be done, but we expect to turn the corner this year.

Our other setback in the U.S. performance was unusually high commodity inflation resulting in approximately $70 million in unplanned food and paper costs. We expect this inflation to moderate somewhat this year and to improve our U.S. profits.

U.S. Brand Key Measures: +5–7% operating profit growth; +1–2% blended same store sales growth.

Multibranding is becoming a big business for Yum!, accounting for 14% of our U.S. traditional restaurant base and an estimated $224 million in U.S. company store profits and franchisee fees.

Given the fact we are the only restaurant company to have a portfolio of leading brands, we have the unique opportunity to offer our customers two great brands in one restaurant.

Not surprisingly, when you think about it, our customers tell us they prefer multibranding over single brands because it provides more choice and convenience under one roof. For example, if someone doesn't want chicken, they can have tacos, thereby canceling a veto vote. The response we hear most often from our customers who experience multibranding is, "What took you so long?"

As a result, multibranding is becoming a big business for Yum!, accounting for 14% of our U.S. traditional restaurant base and an estimated $224 million in U.S. company store profits and franchise fees. Sales of our new multibranding restaurants are typically $250,000 a year higher than our single brands and same store sales for restaurants opened more than a year are also higher.

To give you a historical perspective, we started with combinations of KFC/Taco Bell and Taco Bell/Pizza Hut Express. We learned that we were able to add significant incremental average sales per unit, dramatically improving unit cash flows. Our franchisees then pioneered multibrand combinations by pairing KFC and Taco Bell with Long John Silver's, the country's leading quick-service seafood restaurant, and A&W All American Food, which offers purebeef hamburgers and hot dogs along with its signature Root Beer Float. Based on outstanding customer feedback and results, we acquired Long John Silver's and A&W in 2002. With this acquisition we significantly expanded our multibranding potential in the U.S.

We can now open high return new restaurants in trade areas that used to be too expensive or did not have enough population density to allow us to go to market with one brand. With multibranding, we believe we can eventually take both KFC and Taco Bell to 8,000 units in the U.S. compared to the over 5,000 each we have today.

I'm happy to report 2004 was another year of solid progress for multibranding.

Our KFC/Taco Bell concept had solid same store sales growth and achieved parity margins with our single brands. Taco Bell/Long John Silver's is showing promise with high volume and good margins. Given the results, we will begin to more aggressively expand this combination. While it's too early to make a call, we have expanded testing of our new Long John Silver's/A&W combos. Given the softness in KFC's core business, we have delayed expansion of multibranding in company stores until we improve our operations. However, our best KFC franchise operators are continuing to develop multibrand units.

After seeing the power of multibranding, our Pizza Hut team successfully created and tested its own multibranding concept for home delivery called WingStreet, which is a tasty line of flavored bone-in and bone-out chicken wings. We also took the menu and learnings from our Pasta Bravo acquisition and created Italian Bistro as a partner brand with Pizza Hut's traditional dine-in restaurants. Again, early results are extremely promising.

We are now confident the potential for multibranding at Pizza Hut is as strong as it is for our other brands. In fact, our interests and capabilities to take advantage of the multibranding opportunity for all our brands has never been greater than it is today.

However, our biggest challenge for multibranding remains the same. We must continue to get better and better at building the operating capability to successfully run these restaurants. And the plain fact is it's harder to run a restaurant with two brands. With more variety comes more complexity, so we've been dedicated to improving the capability of our people to deliver our customers a great experience. We have simplified our back of house systems and are reducing costs by value engineering our facilities, while at the same time offering more exciting building designs.

Again, this is an opportunity we created and is unique to Yum! and again, we continue to have first mover advantage. Our operational learnings put us well ahead of the

Whether you're one of our smallest customers enjoying a special Chicky party, a delicious A&W hamburger and shake or a lunch date with mom, our Customer Maniacs are putting smiles on customers' faces around the world.

pack and no one else has the power to combine leading brands like we do. The challenge we have is to execute it right and more progress needs to be done before we accelerate our growth rate. To borrow a famous phrase from the legendary basketball coach John Wooden, our strategy is to "be quick, but not hurry" so we take advantage of the unique opportunity by building the business the right way.

Multibrand Key Measures: at least 550 multibranding additions per year, earning a return on company additions several points above the company's cost of capital.

#4 RUN GREAT RESTAURANTS

As I stated last year, we have pockets of operating excellence around the globe. For example, our operations in countries like China and Australia are first class. I also wrote that we had climbed from the bottom to the middle of the pack versus competition in the U.S. I'm pleased we continued to make progress across almost all our key operating measures this year, especially at Taco Bell, but objectively we can only give ourselves no more than a C+ grade on our 2004 performance.

"Mediocrity plus" clearly isn't good enough for you or us and most importantly, it's not good enough for our customers. In fact, our customers in the U.S. are telling us we are giving them a 100% CHAMPS experience only 53% of the time (up from 49% in 2003). CHAMPS stands for executional basics (Cleanliness, Hospitality, Accuracy, Maintenance, Product Quality and Speed) and we are only delivering the basic expectations of our customers half of the time.

We realize consistent execution of our brand experience is the cornerstone to consumer trust, which is critical to consistent same store sales growth. So we're working hard on operational enablers, like new point of sale and drive thru systems, telephone access for home delivery, and technology for back of house systems. Most importantly,

Our formula for success is simple: put people capability first. When we do that, we'll satisfy our customers better than anyone and generate more profits.

it's also why our single biggest global initiative is what we've coined Customer Mania. Customer Mania is defined as delivering our customers 100% CHAMPS with a "Yes!" attitude every single time. We've been on this journey for three years now training our 850,000 team members once a quarter on how to be Customer Maniacs.

In fact, Ken Blanchard, the author of *One Minute Manager* was so impressed with the operating culture and processes he learned Yum! is putting in place to create Customer Mania that he wrote a book on our approach and progress entitled *Customer Mania! It's Never Too Late To Build A Customer-Focused Company.*

While Ken gives us high marks on process, recognition and leadership, he only gave us a rating of six on a scale of one to 10 on having Customer Mania being executed by our team members at our restaurants. Clearly we can do better and we are committed to improving with urgency. We've made progress and can tell you with certainty we have the people, tools and processes to make a lot more. Our goal is to run the best restaurants in the business and we are on a march to make it happen. Just think what we can do as we take our operations from mediocre to good to great. Our best run restaurants always make more sales and profits so the payoff will come.

Operations Key Measures: 100% CHAMPS with a "Yes!" attitude in *Every* Store and Same Store Sales Growth in *Every* Store.

Going forward, we are galvanized around building what we call the Yum! Dynasty, driving consistent results year after year, which as you know, is the hallmark of truly great companies.

On the next page, you can see the roadmap we've laid out for dynasty-like performance, along with handwritten comments I always include in my New Year's letter to our restaurant teams.

I'm often asked by investors what I see going on in our company that they don't see. What you can't see in the numbers is the quality way in which we are achieving them.

First, we now have process and discipline around the things that *really* matter in our restaurants and in every function at our restaurant support centers.

Second, and most importantly, if you talk to our people you'd hear a universal conviction that our distinct culture is our biggest competitive advantage. It's a high energy, people capability-first, Customer Mania work environment that is centered on spirited recognition that drives performance.

There's no doubt in my mind that continuing to build a work environment where everyone knows they can make a difference will make the biggest difference for shareholders today and tomorrow. This has been and will remain my number one priority.

I'd like to thank our dedicated team members, restaurant managers, franchise partners, and outstanding Board of Directors for their many contributions and commitment to Customer Mania. I'd particularly like to thank Jamie Dimon and Sidney Kohl who retired from our board this year, and Pete Bassi, who retired as the President of Yum! Restaurants International. Jamie, Sidney and Pete made lasting contributions to the formation and growth of our company. I would also like to thank Bonnie Hill, David Grissom, Dave Dorman and Jon Linen for the contributions they are making as our newest board members.

We have the power of Yum! and the unique growth opportunities to build one of the world's most consistent and highest performing companies. I hope you agree we are anything but your ordinary restaurant company.

Yum! to You!

David Novak

David C. Novak
Chairman and Chief Executive Officer

CUSTOMER MANIACS

The Yum! Dynasty Model

The customer is why we have jobs!

CONSISTENTLY BEAT YEAR AGO

Yum!

A&W ALL AMERICAN FOOD · KFC · LONG JOHN SILVER'S · PIZZA HUT · TACO BELL · Yum! Restaurants International

Our Passion

100% Customer Maniacs! act as ONE SYSTEM to put a YUM on customers' faces around the world.

Are you building Customer Mania

Our Formula for Success

People Capability First... satisfied customers and profitability follow.

The only way we win!

How We Lead

This means You!

1. Be a Customer Maniac
2. Know and Drive the Business
3. Build and Align Teams

INSPIRE

1) SSS growth in every store
2) 100% CHAMPS
3) Beat Year Ago

How We Win

Why not? Be the best at providing customers branded restaurant choice... multibranding great brands.

- Run great restaurants
- Differentiate the brands in everything we do
- Drive explosive global expansion
- Lead the way in Multibranding Innovation
- Convert cash flow into high value

Advertising
Products
Facilities

TB-LJS
LAW
WINGSTREET

100% CHAMPS MEANS EVERY LETTER

1000+ More in '05

ACT LIKE OWNERS

How We Work Together

Our HWWT Leadership Principles
Our Franchise Partnership Pact

We have great franchisees

Our Culture is #1

YOU MAKE THE DIFFERENCE!!

Yum to You ☺ David

“China power”

The China business has come a long way since we started our first KFC store in Beijing in 1987. Today, we are by far the largest restaurant company—and a pioneer of franchising—in China. And we’ve only just begun. Over the last four years we’ve been adding restaurants at a 22% growth rate—not many restaurant companies in the world can say that. And we’re pulling away from our competitors with increasing margins. But why are we so successful? We have tremendous branding power, a highly educated workforce, an incredible supply-chain infrastructure, ownership of the distribution system and finally, a strong, tenured leadership team averaging 17 years of experience in the business. With a population of 5 times that of the United States and a rapidly developing economy, the opportunities are unlimited. We’ve only just scratched the surface!

SAM SU, PRESIDENT, Yum! RESTAURANTS CHINA

Our China Division includes: Mainland China, Thailand and KFC Taiwan.

OVER $1.1 BILLION IN REVENUE

1,900 SYSTEM RESTAURANTS

OVER $200 MILLION IN OPERATING PROFIT

AVERAGE SALES PER SYSTEM UNIT OF $1.0 MILLION
(U.S. DOLLARS)

OVER 85,000 EMPLOYEES IN OVER 280 CITIES!

KFC IS THE LARGEST AND FASTEST GROWING RESTAURANT CHAIN IN CHINA

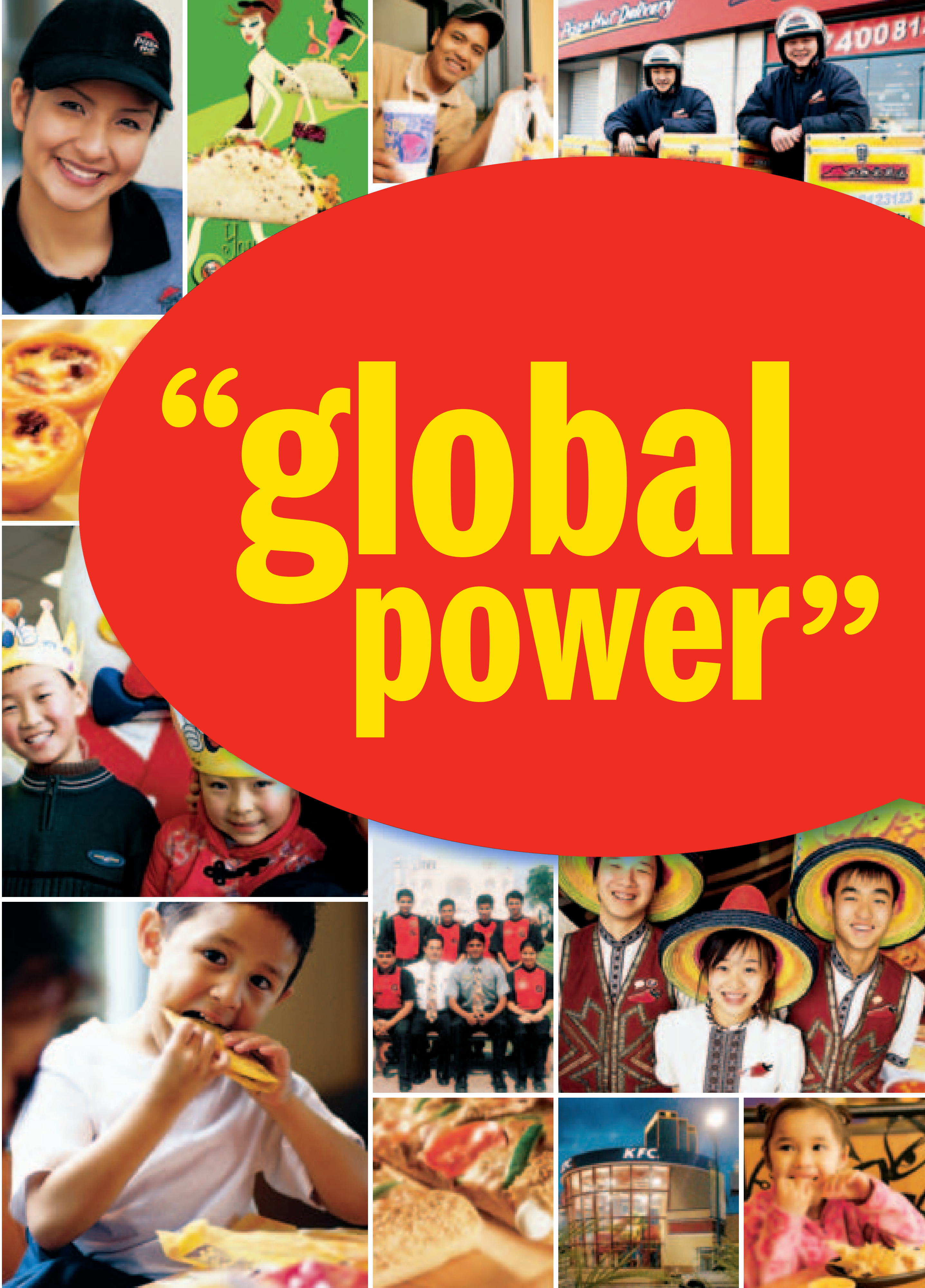
PIZZA HUT IS THE #1 CASUAL DINING BRAND IN CHINA

RECENTLY INTRODUCED PIZZA HUT HOME SERVICE AND TACO BELL GRANDE DINE-IN

KFC RGM, Din Jing, celebrating with some of her smallest customers!

PLEASE OPEN

We served nearly a billion customers in China alone in 2004!



“global power”

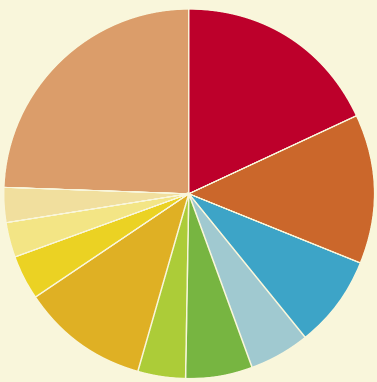
Our International Division continues to set new records in terms of revenues, profits and new unit development. In 2004, we achieved $2 billion in revenues, generated over $335 million in operating profit — up 20% — and we opened 738 new restaurants outside of the United States. That brings us to an impressive 11,093 units outside of the U.S. with a presence in approximately 100 countries and territories. Now that's undeniable growth!

INTERNATIONAL DIVISION SYSTEM SALES[a] BY KEY MARKET

Includes all operations outside the U.S., with the exception of those reported in the China Division.

Year-end 2004

U.K.	19%
Asia Franchise	13%
Caribbean/Latin America Franchise	8%
Middle East/Northern Africa Franchise	5%
Continental Europe Franchise	6%
Southern Africa Franchise	4%
Australia	11%
PH Korea	4%
Mexico	3%
Early-Stage Growth Markets[b]	3%
Other Markets[c]	24%
International Division	**100%**



(a) System sales represents the combined sales of Company, franchise, unconsolidated affiliate and license restaurants.
(b) Includes KFC Germany, KFC Netherlands, KFC France, Brazil and India.
(c) Includes Japan, Canada, PH France and Poland.

We are proud of the strong track record of growth of the international business and we're excited by the opportunities still in front of us. This combination of a solid, established international base and huge untapped potential makes us truly unique in the restaurant business.

Each of our major equity markets — United Kingdom, Australia, South Korea and Mexico — have category-leading market positions and powerful local leadership teams. Even with their scale, these businesses still have significant new unit potential and exciting future prospects.

So too do our franchisees which generate nearly $400 million in franchise fees. In all, nearly 600 franchisees are building our brands across the globe. And they are as passionate about growth as we are.

Despite our current size, attractive new opportunities abound. We expect growth in all of our current markets, equity and franchise. But, we're also investing in high potential markets where we have a modest presence today — Western Europe, Eastern Europe, India, and Brazil in particular.

All in all, ours is a balanced portfolio which is delivering broad-based unit development and strong growth in system sales. In 2004, we opened new units in 60 countries and achieved positive same store sales growth in most major markets. We're targeting similar performance in 2005.

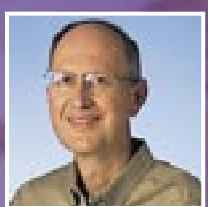
Great brands. Motivated people. Strong results. Huge potential. That's why the International business is the envy of our industry.

GRAHAM ALLAN
PRESIDENT Yum! RESTAURANTS INTERNATIONAL

We’re the leader in the chicken, pizza, Mexican-style food and quick-service seafood categories. Taco Bell continues to invite customers to “Think Outside the Bun” with their exciting line-up of Mexican-inspired signature products. While Pizza Hut gave us even more reasons to “Gather ’Round the Good Stuff” creating dinner solutions that are pleasing the entire family. C is inviting cu rs to visit “Chicken Capital USA” to try some of the Colonel’s secret 11 herbs and spices. Long John Silver’s is giving seafood lov chance to “Get Coastal” with the sign eafood tastes you crave. And in 2004, A&W All-American Restaurants celebrated 85 years of satisfying customers, sharing their “Hometown Favorites Made Fun” with everyone.

“brand power x5”

Think Outside the Bun!™



2004 was a year of significant progress for Taco Bell®. We delivered **positive same store sales growth** in every period—with over three consecutive years of sustained growth. Throughout the year we continued to set **weekly sales records** systemwide, fueled by innovative marketing and a commitment to Running Great Restaurants. We're proud of the fact that our **One System Operating Platform** helped our Restaurant General Managers and their teams drive more consistent execution and greater Customer Mania. As a result, our Speed with Service improved, with *QSR Magazine* rating us third in the overall drive-thru experience in their 2004 Drive-Thru Survey. We also continued to deepen our **people-first, recognition culture** as seen by the fact that our team member turnover was down from 221% in 2001 to just 108% in 2004.

And then there's our food! Already delighting customers with our existing lineup of Mexican-inspired products, like our delicious Grilled Stuft Burritos, signature Quesadillas and Fiesta Taco Salad™—in 2004 we invited consumers to **Think Outside The Bun™** with our new Big Bell Value Menu™. Priced at just 99¢–$1.29, customers can keep their stomachs and wallets full with items like our 1/2 lb Beef & Potato Burrito, Spicy Chicken Soft Taco, and Caramel Apple Empanada.

We also had customers *Drinking* Outside the Bun with the introduction of Mountain Dew Baja Blast™, our new carbonated soft drink that combines the flavor and energy of Mountain Dew with a bold tropical lime blast, available only at participating Taco Bell restaurants. Another industry first was Taco Bell becoming the "Official Quick Service Restaurant" of Major League Baseball® (MLB).* Our exciting three-year partnership includes advertising, on-site signage and fan promotions during MLB™ events.

So in 2005, we're going to build on our success and continue to: put our People first so they can be great Customer Maniacs; get better and better at Execution; and deliver that "Taco Bell taste" and spirit that keep our customers coming back for more!

*Major League Baseball trademarks and copyrights are used with the permission of Major League Baseball Properties, Inc.

Emil J Brolick

EMIL BROLICK, PRESIDENT AND CHIEF CONCEPT OFFICER, TACO BELL


Pizza Hut
Pizza Hut

Gather ’Round the Good Stuff®

In 2004, Pizza Hut gave us even more reasons to “Gather ’Round the Good Stuff,®” kicking off the year in a big way by creating dinner solutions that please the entire family. The 4forAll® Pizza is a revolutionary pizza that gives everyone what they want, because it’s four individually topped pizzas in one. Not only did this innovative pizza drive strong same store sales growth, it was one of the most successful new product launches in Pizza Hut history, with the highest consumer awareness of any new product. This success was followed closely by Buffalo Chicken Pizza and our unique Fit ’N Delicious™ line of “keep it balanced” products. To further bring to life our brand positioning, we introduced The Full House XL Pizza™ providing families a 30 percent bigger pizza than a traditional large pizza (based on size comparison).

With a focus on Customer and Sales Mania, our operators have gone all out building sales, focusing on the basics and creating year-over-year improvement. We’ve seen sales growth for 15 straight periods and increased our market share for the first time in 10 years. We’ve also done a great job of retaining our people and keeping our team member turnover at 100%—some of the lowest in the industry.

We’ve driven incremental sales too, by creating two profitable new concept layers: with 327 WingStreet™ restaurants, we have the largest dedicated, wing delivery brand in the U.S. (based on comparison of total units vs. other national dedicated wing brands), and we have a proven dine-in solution with 58 Pizza Hut Italian Bistro restaurants.

2004 was a banner year, filled with differentiated products, new concept layers, and a sharp focus on operations driving same store sales growth of 5 percent for the year. Over the past four decades, we’ve satisfied customers all around the world, serving more than 1.7 million pizzas every day to approximately 4 million customers worldwide. Now that’s just one more reason to “Gather ’Round the Good Stuff.”

PETER HEARL, PRESIDENT AND CHIEF CONCEPT OFFICER, PIZZA HUT


CHICKEN
CAPITAL
USA

Chicken Capital USA

2004 was a year of rebuilding for KFC. The KFC team was aggressive with its plan—installing new menuboards in every restaurant, adding new products to the menu and launching a new advertising campaign: "Chicken Capital USA."

We're also proud to have brought back one of our most important icons to our restaurants—the Bucket. Introduced in 1957 by Colonel Harland Sanders and KFC's first franchisee, Pete Harman, the bucket symbolizes the heart and soul of our brand.

KFC also spent the year organizing around a restaurant readiness process to build a pipeline of products and promotions that will yield positive results in 2005 and beyond. The first promotion to come through the restaurant readiness process came in December with our new Variety Bucket. Just as its name suggests, the Variety Bucket gives customers a variety of chicken choices—our famous **Kentucky Fried Chicken**, **Strips** and **Popcorn Chicken**—in one bucket. This promotion helped KFC end the year with momentum leading in to 2005.

On the operations side KFC made improvements in speed that bumped up the brand to being named the eighth fastest drive-thru in America, according to *QSR Magazine*. Harvey Brownlee joined KFC in November as Chief Operating Officer and brought a renewed focus to building the brand through better operations. Under Harvey's leadership, we are now testing simplified back of house systems to help improve speed and efficiencies. Harvey is also leading our efforts to continue to grow KFC through multibranding with our Yum! partners.

We are excited about the progress made to rebuild KFC in 2004. In 2005, stay tuned…we have more exciting news coming your way from Chicken Capital USA.

Gregg Dedrick

GREGG DEDRICK, PRESIDENT AND CHIEF CONCEPT OFFICER, KFC

Get Coastal! Long John Silver's signature battered fish and shrimp has been an "Escape from the Ordinary" since 1969. With the opening of 175 new points of distribution in 2004, we've made it more convenient than ever for seafood lovers across the nation to "Get Coastal." That's more openings than in any other year in LJS history. In fact, that seafood excitement translated into another record-breaking Lenten season, achieving the highest weekly sales in the brand's history.

While we still have work to do, we're getting better at satisfying our customers and employees. We've seen customer complaints fall 35% and we've cut our drive-through speed of service time by 50 seconds. Our team member turnover continues to drop from 232% in 2002 to 157% in 2004. We're proud to be a leading Multibrand partner and through our operations simplicity and a focus on delivering outstanding core products, we're looking forward to the possibilities in 2005. So if you love seafood, it's time to "Get Coastal" at Long John Silver's.

Hometown Food Made Fun Free Root Beer Floats, curiously delicious Cheese Curds and the reintroduction of the famous Papa Burger were highlights for A&W Restaurants in 2004. A&W celebrated its 85th anniversary by giving away free Root Beer Floats and our "Hometown Food Made Fun" brand position guided marketing and operations activities all year—featuring new, improved menu items. Going forward, we will continue to build our brand by leveraging our history and equity in both single and multibrand formats.

Steve A. Davis

STEVE DAVIS, PRESIDENT, LONG JOHN SILVER'S/A&W AND Yum! MULTIBRANDING


FLAKY
FISH
LONG
JOHN
SILVER'S


"multibrand power"
LONG JOHN SILVERS
YUM
HUNGRY?
TACO BELL
Chalupa Style!

Today, we're changing the industry with Multibrand innovation and providing the choice and convenience our customers prefer. Yum! is the undeniable world leader in multibranding with over 2,600 combination restaurants accounting for:

- More than 14% of our U.S. traditional restaurant base with a potential to grow to 23% in 2007
- Estimated $224 million in restaurant profits and franchise fees (excluding G&A expenses), or about 17% of the U.S. total
- Significant incremental average sales per units, dramatically improving our unit cash flows

500+
new multibrand units in 2004

2,600+
multibranded units in the U.S.

Multibrand average unit volumes are typically
$250,000 a year higher
than single-brand restaurants.

The bottom line is: we're always getting better. Whether we're improving our people capability, simplifying our back of the house systems, or value-engineering our facilities and creating more exciting designs, it's for one reason only: our customers. With all that choice and convenience under one roof, it's an undeniable win!

CLEANLINESS Shine, all the time. RGM Richard Goebel's restaurant sparkles. When 60% of your business is carry-out, cleanliness is the key. This 17-year veteran is a five-time Pizza Hut Star Tracks Champion (the best operators in the system!) and he delivered a 95% CHAMPS average last year!
Richard Goebel, Pizza Hut

HOSPITALITY 你好 (*Ni hao*): that's "hello" in Chinese. Everyone feels welcomed in RGM Pan Ye's restaurant in Shanghai, China. Pan is part of the elite group — the Champion's Club — that is the top 3% of all RGMs in China. Her CHAMPS average is nearly perfect for the year — 99%! — while growing her same store sales.
Pan Ye, KFC

ACCURACY Getting it right: that's Merhrdad Khorramiam's motto. With an amazing 99.3% CHAMPS average, including a perfect 100% in Accuracy, this 14-year veteran was named "2004 Company RGM of the Year." His perfect Balanced Scorecard of 5.0 and his CHAMPS Excellence Review of 100% was the highest in the company!
Merhrdad Khorramiam, Taco Bell

H

M

C

A

MAINTENANCE "We're always ready for our customers." That's how 19-year veteran RGM Jim Gribble runs his restaurant and keeps it humming. Last year he boosted sales by 32%! Jim is always running a great restaurant and serving up delicious root beer floats with a smile.
Jim Gribble, A&W All American Food, Daugharthy, Inc. franchisee

PRODUCT QUALITY How do you say Yum? Just ask RGM Diane Oney. This 28-year veteran drives a passionate Customer Mania culture in her restaurant with consistent CHAMPS scores in the high 90's. Just listen to the rings of satisfaction on the Long John Silver's bell in her lobby. Ring!
Diane Oney, Long John Silver's, Sterling Silver Restaurants franchisee

SPEED OF SERVICE Don't blink. You might miss RGM Abul Azad making things happen—fast. Abul runs one of KFC's best restaurants! In 2004, he maintained a 97% CHAMPS average and a near-perfect 5.0 Balanced Scorecard. Abul constantly reinforces CHAMPS with a Yes!—serving up his special brand of Customer Mania—in a snap.
Abul Azad, KFC

“customer mania power”

C	H	A	M	P	S
Cleanliness	Hospitality	Accuracy	Maintenance	Product Quality	Speed of Service

The power of our people is our secret ingredient, and what sets us apart from the competition.

Around the world, our 850,000 Customer Maniacs are striving each and every day to put a smile on our customers' faces. At Yum! Brands, we're building an operating culture dedicated to **100% CHAMPS with a Yes! Attitude.** It's a daily focus on executing the basics with passion, urgency and excellence so that we will drive **Same Store Sales Growth in every restaurant.** We know that if we put the customer first in everything we do, then we're running great restaurants. And when we do that, we're driving consistent performance year over year.

This is our fifth year of executing against our operational framework and our fourth year of Customer and Sales Mania training every quarter in every restaurant. Throughout our journey we have not changed our focus, we've just become more maniacal about driving our unique operating culture deep to our restaurant teams. And I'm proud to report that we're making steady progress in our operating measures. While we still have work to do, we're committed to continuing our efforts to satisfy our customers better than anyone in the industry. It's that commitment to Customer Mania that will take this company to the next level!

Please open this page to meet some of our very best Customer Maniacs from around the world.

DAVE DENO, CHIEF OPERATING OFFICER

PLEASE OPEN

Customer Mania = 100% CHAMPS with a Yes! Attitude

Global Facts

INTERNATIONAL OPERATING PROFIT BY KEY MARKET

(in millions)	2004
China Division	**$ 205**
U.K.	**115**
Asia Franchise	**54**
Caribbean/Latin America Franchise	**42**
Middle East/Northern Africa Franchise	**23**
Continental Europe Franchise	**18**
Southern Africa Franchise	**17**
Australia	**61**
PH Korea	**34**
Mexico	**9**
Early-Stage Growth Markets (a)	**(29)**
Other Markets (b)	**52**
Headquarters General & Administrative Costs	**(59)**
International Division	**337**
International Operating Profit	**$ 542**

(a) Includes KFC Germany, KFC Netherlands, KFC France, Brazil and India.
(b) Includes Japan, Canada, PH France and Poland.

“power of results”

WORLDWIDE SALES

(in billions)	2004	2003	2002	2001	2000	5-Year Growth(a)
UNITED STATES						
KFC						
Company sales	**$ 1.4**	$ 1.4	$ 1.4	$ 1.4	$ 1.4	(2)%
Franchisee sales (b)	**3.6**	3.5	3.4	3.3	3.0	5%
PH						
Company sales	**$ 1.6**	$ 1.6	$ 1.5	$ 1.5	$ 1.8	(5)%
Franchisee sales (b)	**3.6**	3.5	3.6	3.5	3.2	5%
TACO BELL						
Company sales	**$ 1.7**	$ 1.6	$ 1.6	$ 1.4	$ 1.4	1%
Franchisee sales (b)	**4.0**	3.8	3.6	3.5	3.7	2%
LONG JOHN SILVER'S (c)						
Company sales	**$ 0.5**	$ 0.5	$ 0.3	—	—	NM
Franchisee sales (b)	**0.3**	0.3	0.2	—	—	NM
A&W (c)						
	—	—	—	—	—	NM
Franchisee sales (b)	**$ 0.2**	$ 0.2	$ 0.2	—	—	NM
TOTAL U.S.						
Company sales	**$ 5.2**	$ 5.1	$ 4.8	$ 4.3	$ 4.6	(2)%
Franchisee sales (b)	**11.7**	11.3	11.0	10.3	9.9	4%
INTERNATIONAL						
KFC						
Company sales	**$ 1.9**	$ 1.7	$ 1.5	$ 1.2	$ 1.1	11%
Franchisee sales (b)	**5.3**	4.6	3.9	3.8	3.9	9%
PIZZA HUT						
Company sales	**$ 0.9**	$ 0.6	$ 0.6	$ 0.6	$ 0.6	5%
Franchisee sales (b)	**2.6**	2.4	2.2	2.0	2.0	7%
TACO BELL						
Company sales	**—**	—	—	—	—	NM
Franchisee sales (b)	**$ 0.2**	$ 0.1	$ 0.2	$ 0.1	$ 0.1	5%
LONG JOHN SILVER'S (c)						
Company sales	**—**	—	—	—	—	NM
Franchisee sales (b)	**—**	—	—	—	—	NM
A&W (c)						
Company sales	**—**	—	—	—	—	NM
Franchisee sales (b)	**$ 0.1**	$ 0.1	—	—	—	NM
TOTAL INTERNATIONAL						
Company sales	**$ 2.8**	$ 2.3	$ 2.1	$ 1.8	$ 1.7	9%
Franchisee sales (b)	**8.2**	7.2	6.3	5.9	6.0	8%
TOTAL WORLDWIDE						
Company sales	**$ 8.0**	$ 7.4	$ 6.9	$ 6.1	$ 6.3	1%
Franchisee sales (b)	**19.9**	18.5	17.3	16.2	15.9	6%

, Inc.

Unit Information

WORLDWIDE SYSTEM UNITS

	2004	2003	% B/(W) Change
Company	**7,743**	7,854	(1%)
Unconsolidated affiliates	**1,662**	1,512	10%
Franchisees	**21,858**	21,471	2%
Licensees	**2,345**	2,362	(1%)
Total	**33,608**	33,199	1%

	2004	2003	2002	2001	2000	5-Year Growth[a][b]
UNITED STATES						
KFC	**5,525**	5,524	5,472	5,399	5,364	1%
Pizza Hut	**7,500**	7,523	7,599	7,719	7,927	(1%)
Taco Bell	**5,900**	5,989	6,165	6,444	6,746	(3%)
Long John Silver's	**1,200**	1,204	1,221	—	—	NM
A&W	**485**	576	665	—	—	NM
Total U.S.[c]	**20,610**	20,822	21,126	19,562	20,037	(1%)
INTERNATIONAL						
KFC	**7,741**	7,354	6,890	6,416	5,974	7%
Pizza Hut	**4,774**	4,560	4,431	4,272	4,157	4%
Taco Bell	**238**	249	267	239	249	1%
Long John Silver's	**34**	31	28	—	—	NM
A&W	**210**	183	182	—	—	NM
Total International[d]	**12,998**	12,377	11,798	10,927	10,380	5%
Total[c][d]	**33,608**	33,199	32,924	30,489	30,417	1%

(a) Compound annual growth rate; total U.S., International and Worldwide exclude the impact of Long John Silver's and A&W.
(b) Compound annual growth rate excludes the impact of transferring 30 units from Taco Bell U.S. to Taco Bell International in 2002.
(c) Includes 6 and 4 Yan Can units in 2003 and 2002, respectively.
(d) Includes 1 unit in 2004 for an Asian food concept in China.

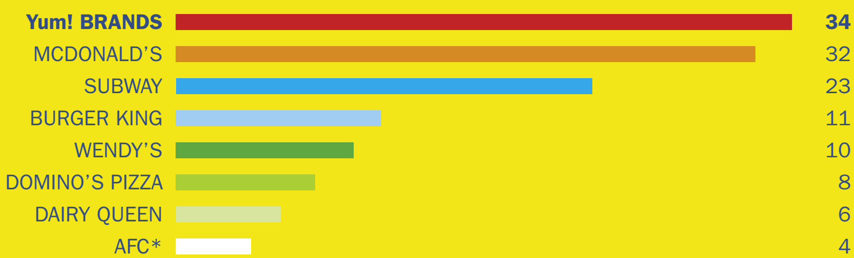
BREAKDOWN OF WORLDWIDE SYSTEM UNITS

2004	Company	Unconsolidated Affiliate	Franchised	Licensed	Total
UNITED STATES					
KFC	1,248	—	4,202	75	5,525
Pizza Hut	1,741	—	4,565	1,194	7,500
Taco Bell	1,283	—	3,747	870	5,900
Long John Silver's	700	—	500	—	1,200
A&W	17	—	468	—	485
Total U.S.	4,989	—	13,482	2,139	20,610
INTERNATIONAL					
KFC	1,751	897	5,028	65	7,741
Pizza Hut	989	765	2,926	94	4,774
Taco Bell	13	—	180	45	238
Long John Silver's	—	—	33	1	34
A&W	—	—	209	1	210
Total International[a]	2,754	1,662	8,376	206	12,998
Total[a]	7,743	1,662	21,858	2,345	33,608

(a) Includes 1 unit in 2004 for an Asian food concept in China.

WORLDWIDE UNITS

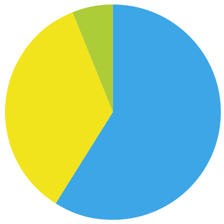
2004 (in thousands)



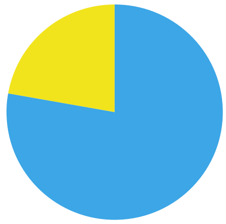
* Includes Popeye's, Church's, Cinnabon & Seattle's Best Coffee

Yum! at a glance

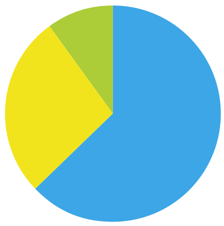
U.S. SALES | **BY DAYPART** | **BY DISTRIBUTION CHANNEL**



Dinner 59% · Lunch 35% · Snacks/Breakfast 6%

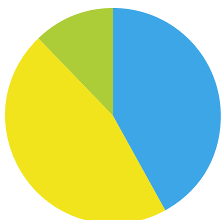


Dine Out 78% · Dine In 22%

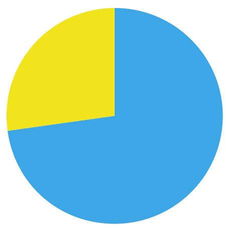


Dinner 63% · Lunch 27% · Snacks/Breakfast 10%

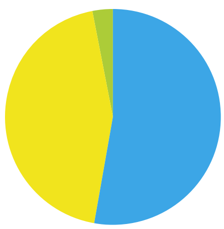
Dine Out 72% · Dine In 28%



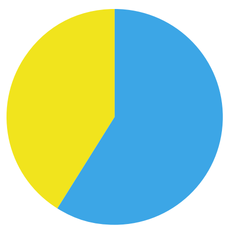
Dinner 42% · Lunch 46% · Snacks/Breakfast 12%



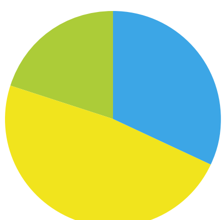
Dine Out 73% · Dine In 27%



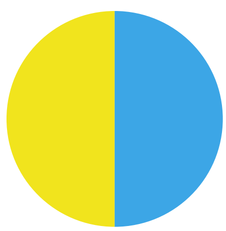
Dinner 53% · Lunch 44% · Snacks/Breakfast 3%



Dine Out 59% · Dine In 41%



Dinner 32% · Lunch 48% · Snacks/Breakfast 20%



Dine Out 50% · Dine In 50%

Source: The NPD Group, Inc.; NPD Foodworld; CREST

Management's Discussion and Analysis of Financial Condition and Results of Operations

INTRODUCTION AND OVERVIEW

YUM! Brands, Inc. and Subsidiaries (collectively referred to as "YUM" or the "Company") comprises the worldwide operations of KFC, Pizza Hut, Taco Bell, Long John Silver's ("LJS") and A&W All-American Food Restaurants ("A&W") (collectively "the Concepts") and is the world's largest quick service restaurant ("QSR") company based on the number of system units. LJS and A&W were added when YUM acquired Yorkshire Global Restaurants, Inc. ("YGR") on May 7, 2002. With 12,998 international units, YUM is the second largest QSR company outside the U.S. YUM became an independent, publicly-owned company on October 6, 1997 (the "Spin-off Date") via a tax-free distribution of our Common Stock (the "Distribution" or "Spin-off") to the shareholders of our former parent, PepsiCo, Inc. ("PepsiCo").

Through its Concepts, YUM develops, operates, franchises and licenses a system of both traditional and non-traditional QSR restaurants. Traditional units feature dine-in, carryout and, in some instances, drive-thru or delivery services. Non-traditional units, which are typically licensed outlets, include express units and kiosks which have a more limited menu and operate in non-traditional locations like malls, airports, gasoline service stations, convenience stores, stadiums, amusement parks and colleges, where a full-scale traditional outlet would not be practical or efficient.

The retail food industry, in which the Company competes, is made up of supermarkets, supercenters, warehouse stores, convenience stores, coffee shops, snack bars, delicatessens and restaurants (including the QSR segment), and is intensely competitive with respect to food quality, price, service, convenience, location and concept. The industry is often affected by changes in consumer tastes; national, regional or local economic conditions; currency fluctuations; demographic trends; traffic patterns; the type, number and location of competing food retailers and products; and disposable purchasing power. Each of the Concepts competes with international, national and regional restaurant chains as well as locally-owned restaurants, not only for customers, but also for management and hourly personnel, suitable real estate sites and qualified franchisees.

The Company's key strategies are:

- Building dominant restaurant brands in China
- Driving profitable international expansion
- Improving restaurant operations
- Multibranding category-leading brands

The Company is focused on five long-term measures identified as essential to our growth and progress. These five measures and related key performance indicators are as follows:

- International expansion
  - International system-sales growth (local currency)
  - Number of new international restaurant openings
  - Net international unit growth
- Multibrand innovation and expansion
  - Number of multibrand restaurant locations
  - Number of multibrand units added
  - Number of franchise multibrand units added
- Portfolio of category-leading U.S. brands
  - U.S. blended same store sales growth
  - U.S. system sales growth
- Global franchise fees
  - New restaurant openings by franchisees
  - Franchise fee growth
- Strong cash generation and returns
  - Cash generated from all sources
  - Cash generated from all sources after capital spending
  - Restaurant margins

Our progress against these measures is discussed throughout the Management's Discussion and Analysis ("MD&A").

Throughout the MD&A, the Company provides the percentage change excluding the impact of foreign currency translation. These amounts are derived by translating current year results at prior year average exchange rates. We believe the elimination of the foreign currency translation impact provides better year-to-year comparability without the distortion of foreign currency fluctuations.

This MD&A should be read in conjunction with our Consolidated Financial Statements on pages 47 through 50 and the Cautionary Statements on page 46. All Note references herein refer to the Notes to the Consolidated Financial Statements on pages 51 through 73. Tabular amounts are displayed in millions except per share and unit count amounts, or as otherwise specifically identified.

FACTORS AFFECTING COMPARABILITY OF 2004 RESULTS TO 2003 RESULTS AND 2003 RESULTS TO 2002 RESULTS

Lease Accounting Adjustments In late 2004 and early 2005, a number of companies within the QSR industry announced adjustments to their accounting for leases and the depreciation of leasehold improvements. In consultation with our external auditors, we also determined that an adjustment was necessary to modify our accounting in these areas. Accordingly, in the fourth quarter of 2004, we recorded an adjustment such that all of our leasehold improvements are now being depreciated over the shorter of their useful lives or the term of the lease, including options in some instances, over which we are recording rent expense, including escalations, on a straight-line basis.

The cumulative adjustment, primarily through increased U.S. depreciation expense, totaled $11.5 million ($7 million after tax). The portions of this adjustment that related to 2004 full year and 2004 fourth quarter were approximately $3 million and $1 million, respectively. As the portion of our adjustment recorded that was a correction of errors of amounts reported in our prior period financial statements was not material to any of those prior period financial statements, the entire adjustment was recorded in the 2004 Consolidated Financial Statements and no adjustment was made to any prior period financial statements. We anticipate that the impact of this accounting change will result in additional expense of $3 million in 2005.

YGR Acquisition On May 7, 2002, the Company completed its acquisition of YGR, the parent company of LJS and A&W. See Note 4 for a discussion of the acquisition.

As of the date of the acquisition, YGR consisted of 742 and 496 company and franchise LJS units, respectively, and 127 and 742 company and franchise A&W units, respectively. In addition, 133 multibranded LJS/A&W restaurants were included in the LJS unit totals. Except as discussed in certain sections of the MD&A, the impact of the acquisition on our results of operations in 2003 was not significant relative to 2002.

Amendment of Sale-Leaseback Agreements As discussed in Note 14, on August 15, 2003 we amended two sale-leaseback agreements assumed in our 2002 acquisition of YGR such that the agreements now qualify for sale-leaseback accounting. Restaurant profit decreased by $5 million and by $3 million in 2004 and 2003, respectively, as a result of the two amended agreements being accounted for as operating leases subsequent to the amendment. The decrease in restaurant profit was largely offset by a similar decrease in interest expense.

Canada Unconsolidated Affiliate Dissolution On November 10, 2003, we dissolved our unconsolidated affiliate that previously operated 733 restaurants in Canada. We owned 50% of this unconsolidated affiliate prior to its dissolution and accounted for our interest under the equity method. Of the restaurants previously operated by the unconsolidated affiliate, we now operate the vast majority of Pizza Huts and Taco Bells, while almost all KFCs are operated by franchisees. As a result of operating certain restaurants that were previously operated by the unconsolidated affiliate, our Company sales, restaurant profit and general and administrative expenses increased and our franchise fees decreased. Additionally, on a full year basis other income increased as we recorded a loss from our investment in the Canadian unconsolidated affiliate in 2003.

As a result of the dissolution of our Canadian unconsolidated affiliate, Company sales increased $147 million, franchise fees decreased $9 million, restaurant profit increased $8 million, general and administrative expenses increased $11 million and other income increased $4 million for the year ended December 25, 2004 compared to the year ended December 27, 2003. The impact on 2004 net income was not significant. The impact of the dissolution on our 2003 results was also not significant.

Sale of Puerto Rico Business Our Puerto Rico business was held for sale since the fourth quarter of 2002 and was sold on October 4, 2004 for an amount approximating its then carrying value. Company sales and restaurant profit decreased $27 million and $4 million, respectively, franchise fees increased $1 million and general and administrative expenses decreased $1 million for the year ended December 25, 2004 as compared to the year ended December 27, 2003.

Commodity Inflation The increased cost of certain commodities negatively impacted our U.S. margins for the year ended December 25, 2004. Higher commodity costs, particularly in cheese and meat prices, negatively impacted U.S. restaurant margins as a percentage of sales by approximately 160 basis points for the year ended December 25, 2004.

Wrench Litigation We recorded income of $14 million in 2004 and expense of $42 million in 2003. See Note 24 for a discussion of the Wrench litigation.

AmeriServe and Other Charges (Credits) We recorded income of $16 million in 2004, $26 million in 2003 and $27 million in 2002. See Note 7 for a detailed discussion of AmeriServe and other charges (credits).

Store Portfolio Strategy From time to time we sell Company restaurants to existing and new franchisees where geographic synergies can be obtained or where their expertise can generally be leveraged to improve our overall operating performance, while retaining Company ownership of key U.S. and International markets. Such refranchisings reduce our reported revenues and restaurant profits and increase the importance of system sales growth as a key performance measure.

The following table summarizes our refranchising activities:

	2004	2003	2002
Number of units refranchised	**317**	228	174
Refranchising proceeds, pre-tax	**$ 140**	$ 92	$ 81
Refranchising net gains, pre-tax[(a)]	**$ 12**	$ 4	$ 19

(a) Refranchising net gains for the year ended December 25, 2004 include charges to write down our Puerto Rico business to our then estimate of its fair value and charges to write down certain U.S. restaurants we currently own but we have offered to sell at amounts lower than their carrying values. Refranchising net gains for the year ended December 27, 2003 also include charges to write down our Puerto Rico business to our then estimate of its fair value. As previously noted, we sold our Puerto Rico business effective October 4, 2004 for an amount approximating its then carrying value.

In addition to our refranchising program, from time to time we close restaurants that are poor performing, we relocate restaurants to a new site within the same trade area or we consolidate two or more of our existing units into a single unit (collectively "store closures").

The following table summarizes Company store closure activities:

	2004	2003	2002
Number of units closed	**319**	287	224
Store closure costs (income)[(a)]	**$ (3)**	$ 6	$ 15
Impairment charges for stores to be closed	**$ 5**	$ 12	$ 9

(a) Store closure income in 2004 is primarily the result of gains from the sale of properties on which we formerly operated restaurants.

The impact on operating profit arising from refranchising and Company store closures is the net of (a) the estimated reductions in restaurant profit, which reflects the decrease in Company sales, and general and administrative expenses and (b) the estimated increase in franchise fees from the stores refranchised. The amounts presented below reflect the estimated impact from stores that were operated by us for all or some portion of the respective previous year and were no longer operated by us as of the last day of the respective year. The amounts do not include results from new restaurants that we opened in connection with a relocation of an existing unit or any incremental impact upon consolidation of two or more of our existing units into a single unit.

The following table summarizes the estimated impact on revenue of refranchising and Company store closures:

2004	U.S.	International	Worldwide
Decreased sales	**$(241)**	**$(131)**	**$(372)**
Increased franchise fees	**7**	**5**	**12**
Decrease in total revenues	**$(234)**	**$(126)**	**$(360)**

2003	U.S.	International	Worldwide
Decreased sales	$(148)	$(120)	$(268)
Increased franchise fees	1	5	6
Decrease in total revenues	$(147)	$(115)	$(262)

The following table summarizes the estimated impact on operating profit of refranchising and Company store closures:

2004	U.S.	International	Worldwide
Decreased restaurant profit	**$ (18)**	**$ (11)**	**$ (29)**
Increased franchise fees	**7**	**5**	**12**
Decreased general and administrative expenses	**—**	**6**	**6**
Decrease in operating profit	**$ (11)**	**$ —**	**$ (11)**

2003	U.S.	International	Worldwide
Decreased restaurant profit	$ (18)	$ (15)	$ (33)
Increased franchise fees	1	5	6
Decreased general and administrative expenses	—	6	6
Decrease in operating profit	$ (17)	$ (4)	$ (21)

RESULTS OF OPERATIONS

	2004	% B/(W) vs. 2003	2003	% B/(W) vs. 2002
Company sales	**$ 7,992**	**7**	$ 7,441	8
Franchise and license fees	**1,019**	**8**	939	9
Revenues	**$ 9,011**	**8**	$ 8,380	8
Company restaurant profit	**$ 1,159**	**5**	$ 1,104	—
% of Company sales	**14.5%**	**(0.3)ppts.**	14.8%	(1.2)ppts.
Operating profit	**1,155**	**9**	1,059	3
Interest expense, net	**129**	**25**	173	(1)
Income tax provision	**286**	**(7)**	268	3
Income before cumulative effect of accounting change	**740**	**20**	618	6
Cumulative effect of accounting change, net of tax	**—**	**—**	(1)	NM
Net income	**$ 740**	**20**	$ 617	6
Diluted earnings per share[(a)]	**$ 2.42**	**20**	$ 2.02	7

(a) See Note 6 for the number of shares used in this calculation.

RESTAURANT UNIT ACTIVITY

Worldwide	Company	Unconsolidated Affiliates	Franchisees	Total Excluding Licensees
Balance at end of 2002	7,526	2,148	20,724	30,398
New Builds	454	176	868	1,498
Acquisitions	389	(736)	345	(2)
Refranchising	(228)	(1)	227	(2)
Closures	(287)	(75)	(691)	(1,053)
Other	—	—	(2)	(2)
Balance at end of 2003	7,854	1,512	21,471	30,837
New Builds	457	178	815	1,450
Acquisitions	72	11	(83)	—
Refranchising	(317)	—	316	(1)
Closures	(319)	(31)	(651)	(1,001)
Other	(4)	(8)	(10)	(22)
Balance at end of 2004	**7,743**	**1,662**	**21,858**	**31,263**
% of Total	**25%**	**5%**	**70%**	**100%**

The above total excludes 2,345 and 2,362 licensed units at the end of 2004 and 2003, respectively.

United States	Company	Unconsolidated Affiliates	Franchisees	Total Excluding Licensees
Balance at end of 2002	5,193	4	13,663	18,860
New Builds	142	3	245	390
Acquisitions	106	—	(108)	(2)
Refranchising	(150)	—	148	(2)
Closures	(197)	(1)	(386)	(584)
Other	—	—	4	4
Balance at end of 2003	5,094	6	13,566	18,666
New Builds	146	—	227	373
Acquisitions	61	—	(61)	—
Refranchising	(113)	—	112	(1)
Closures	(199)	(6)	(365)	(570)
Other	—	—	3	3
Balance at end of 2004	**4,989**	**—**	**13,482**	**18,471**
% of Total	**27%**	**—**	**73%**	**100%**

The above total excludes 2,139 and 2,156 licensed units at the end of 2004 and 2003, respectively.

International	Company	Unconsolidated Affiliates	Franchisees	Total Excluding Licensees
Balance at end of 2002	2,333	2,144	7,061	11,538
New Builds	312	173	623	1,108
Acquisitions	283	(736)	453	—
Refranchising	(78)	(1)	79	—
Closures	(90)	(74)	(305)	(469)
Other[(a)]	—	—	(6)	(6)
Balance at end of 2003	2,760	1,506	7,905	12,171
New Builds	311	178	588	1,077
Acquisitions	11	11	(22)	—
Refranchising	(204)	—	204	—
Closures	(120)	(25)	(286)	(431)
Other[(a)]	(4)	(8)	(13)	(25)
Balance at end of 2004	**2,754**	**1,662**	**8,376**	**12,792**
% of Total	**22%**	**13%**	**65%**	**100%**

(a) Represents an adjustment of previously reported amounts.

The above totals exclude 206 licensed units at both the end of 2004 and 2003.

Included in the above totals are multibrand restaurants. Multibrand conversions increase the sales and points of distribution for the second brand added to a restaurant but do not result in an additional unit count. Similarly, a new multibrand restaurant, while increasing sales and points of distribution for two brands, results in just one additional unit count. Franchise unit counts include both franchisee and unconsolidated affiliate multibrand units. Multibrand restaurant totals were as follows:

2004	**Company**	**Franchise**	**Total**
United States	**1,391**	**1,250**	**2,641**
International	**28**	**155**	**183**
Worldwide	**1,419**	**1,405**	**2,824**

2003	Company	Franchise	Total
United States	1,032	1,116	2,148
International	52	127	179
Worldwide	1,084	1,243	2,327

For 2004 and 2003, Company multibrand unit gross additions were 384 and 235, respectively. For 2004 and 2003, franchise multibrand unit gross additions were 169 and 194, respectively.

SYSTEM SALES GROWTH

	Increase		Increase excluding currency translation	
	2004	2003	**2004**	2003
United States	**3%**	3%	**N/A**	N/A
International	**15%**	14%	**9%**	7%
Worldwide	**8%**	7%	**5%**	5%

System sales growth includes the results of all restaurants regardless of ownership, including Company-owned, franchise, unconsolidated affiliate and license restaurants. Sales of franchise, unconsolidated affiliate and license restaurants generate franchise and license fees for the Company (typically at a rate of 4% to 6% of sales). Franchise, unconsolidated affiliate and license restaurants sales are not included in Company sales on the 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 all of our revenue drivers, Company and franchise same store sales as well as net unit development.

In 2004, the increase in Worldwide system sales was driven by new unit development and same store sales growth, partially offset by store closures. Excluding the favorable impact from both foreign currency translation and the YGR acquisition, Worldwide system sales increased 3% in 2003. The increase was driven by new unit development, partially offset by store closures.

In 2004, the increase in U.S. system sales was driven by new unit development and same store sales growth, partially offset by store closures. Excluding the favorable impact of the YGR acquisition, U.S. system sales increased 1% in 2003. The increase was driven by new unit development, partially offset by store closures.

In 2004, the increase in International system sales was driven by new unit development and same store sales growth, partially offset by store closures. In 2003, the increase in International system sales was driven by new unit development, partially offset by store closures.

REVENUES

	Amount		% Increase		% Increase excluding currency translation	
	2004	2003	**2004**	2003	**2004**	2003
Company sales						
United States	**$ 5,163**	$ 5,081	**2**	6	**N/A**	N/A
International	**2,829**	2,360	**20**	12	**16**	8
Worldwide	**7,992**	7,441	**7**	8	**6**	7
Franchise and license fees						
United States	**600**	574	**4**	1	**N/A**	N/A
International	**419**	365	**15**	23	**8**	14
Worldwide	**1,019**	939	**8**	9	**6**	6
Total revenues						
United States	**5,763**	5,655	**2**	6	**N/A**	N/A
International	**3,248**	2,725	**19**	13	**15**	8
Worldwide	**$ 9,011**	$ 8,380	**8**	8	**6**	7

In 2004, the increase in Worldwide Company sales was driven by new unit development, acquisitions of franchisee restaurants (primarily certain units in Canada which we now operate), and same store sales growth, partially offset by refranchising and store closures. Excluding the favorable impact of both foreign currency translation and the YGR acquisition, Worldwide Company sales increased 4% in 2003. The increase was driven by new unit development, partially offset by store closures and refranchising.

In 2004, the increase in Worldwide franchise and license fees was driven by new unit development, same store sales growth, and refranchising, partially offset by store closures and acquisitions of franchisee restaurants (primarily certain units in Canada which we now operate). Excluding the favorable impact of both foreign currency translation and the YGR acquisition, Worldwide franchise and license fees increased 5% in 2003. The increase was driven by new unit development, royalty rate increases and same store sales growth, partially offset by store closures.

In 2004, the increase in U.S. Company sales was driven by new unit development and same store sales growth, partially offset by refranchising and store closures. Excluding the favorable impact of the YGR acquisition, U.S. Company sales increased 2% in 2003. The increase was driven by new unit development, partially offset by store closures and refranchising.

U.S same store sales includes only Company restaurants that have been open one year or more. U.S. blended same store sales include KFC, Pizza Hut and Taco Bell Company-owned restaurants only. U.S. same store sales for Long John Silver's and A&W restaurants are not included. Following are the same store sales growth results by brand:

2004	**Same Store Sales**	**Transactions**	**Average Guest Check**
KFC	**(2)%**	**(4)%**	**2%**
Pizza Hut	**5%**	**2%**	**3%**
Taco Bell	**5%**	**3%**	**2%**

2003	Same Store Sales	Transactions	Average Guest Check
KFC	(2)%	(4)%	2%
Pizza Hut	(1)%	(4)%	3%
Taco Bell	2%	1%	1%

In 2004, blended Company same store sales increased 3% due to increases in average guest check and transactions. In 2003, blended Company same store sales were flat due to a decrease in transactions offset by an increase in average guest check.

In 2004, the increase in U.S. franchise and license fees was driven by same store sales growth, new unit development and refranchising, partially offset by store closures. Excluding the favorable impact of the YGR acquisition, U.S. franchise and license fees remained essentially flat in 2003 as a decrease primarily driven by store closures was largely offset by new unit development.

In 2004, the increase in International Company sales was driven by new unit development, acquisitions of franchisee restaurants (primarily certain units in Canada which we now operate), and same store sales growth, partially offset by refranchising and store closures. In 2003, the increase in International Company sales was driven by new unit development, partially offset by refranchising, same store sales declines and store closures.

In 2004, the increase in International franchise and license fees was driven by new unit development, same store sales growth and refranchising, partially offset by store closures and our acquisitions of franchisee restaurants (primarily certain units in Canada which we now operate). In 2003, the increase in International franchise and license fees was driven by new unit development, royalty rate increases and same store sales growth, partially offset by store closures.

COMPANY RESTAURANT MARGINS

2004	United States	International	Worldwide
Company sales	**100.0%**	**100.0%**	**100.0%**
Food and paper	**29.9**	**35.1**	**31.8**
Payroll and employee benefits	**30.5**	**19.1**	**26.4**
Occupancy and other operating expenses	**25.8**	**30.0**	**27.3**
Company restaurant margin	**13.8%**	**15.8%**	**14.5%**

2003	United States	International	Worldwide
Company sales	100.0%	100.0%	100.0%
Food and paper	28.8	35.5	30.9
Payroll and employee benefits	31.0	19.0	27.2
Occupancy and other operating expenses	25.6	30.0	27.1
Company restaurant margin	14.6%	15.5%	14.8%

2002	United States	International	Worldwide
Company sales	100.0%	100.0%	100.0%
Food and paper	28.2	36.1	30.6
Payroll and employee benefits	30.9	18.7	27.2
Occupancy and other operating expenses	24.9	29.2	26.2
Company restaurant margin	16.0%	16.0%	16.0%

In 2004, the decrease in U.S. restaurant margins as a percentage of sales was driven by higher food and paper costs and higher occupancy and other costs, partially offset by the impact of same store sales increases on restaurant margin. Higher food and paper costs were primarily driven by increased commodity costs (principally cheese and meats) and higher occupancy and other costs were primarily driven by increased expense resulting from the adjustment related to our accounting for leases and the depreciation of leasehold improvements. In 2003, the decrease in U.S. restaurant margin as a percentage of sales was primarily driven by the increased occupancy expenses due to higher rent, primarily due to additional rent expense associated with the amended YGR sale-leaseback agreements, and utilities. The higher food and paper costs were primarily due to the impact of unfavorable discounting and product mix. Also contributing to the decrease were higher labor costs, primarily driven by low single-digit increases in wage rates.

In 2004, the increase in International restaurant margins as a percentage of sales was driven by the impact of same store sales increases on restaurant margin and lower food and paper costs (principally due to supply chain savings). The increase was partially offset by a 60 basis point unfavorable impact of operating certain restaurants in Canada, which is a market with below average margins, that were previously operated by our unconsolidated affiliate, increased labor costs in certain markets and a 10 basis point unfavorable impact from foreign currency translation. In 2003, the decrease in International restaurant margins as a percentage of sales was driven by the impact on margin of same store sales declines and a 20 basis point unfavorable impact from foreign currency translation. The decrease was partially offset by the impact of supply chain savings on the cost of food and paper (principally in China), and the cessation of depreciation expense of approximately $9 million for the Puerto Rico business while it was held for sale.

The impact from foreign currency translation on margins as a percentage of sales is a result of the portfolio of markets effect. International margin percentages in total are impacted unfavorably when currencies strengthen in markets with below average margins. Those markets contributing to the unfavorable impacts of foreign currency translation on margin have below average margins largely due to their higher labor costs.

WORLDWIDE GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses increased $111 million or 12% in 2004, including a 2% unfavorable impact from foreign currency translation. The increase was driven by higher compensation related costs, including incentive compensation, amounts associated with investments in strategic initiatives in China and other international growth markets and pension costs. Also contributing to the increase were higher professional fees and increased reserves related to potential development sites and surplus facilities. The increase was also partially attributable to expenses of $11 million associated with operating the restaurants we now own in Canada that were previously operated by our unconsolidated affiliate. These increases were partially offset by decreases in expenses due to the favorable impact of refranchising certain restaurants.

General and administrative expenses increased $32 million or 3% in 2003, including a 1% unfavorable impact from foreign currency translation. Excluding the unfavorable impact from both foreign currency translation and the YGR acquisition, general and administrative expenses were flat for 2003. Lower management incentive compensation costs were offset by increases in expenses associated with international restaurant expansion and pension expense.

WORLDWIDE FRANCHISE AND LICENSE EXPENSES

Franchise and license expenses decreased $2 million or 8% in 2004. The decrease was primarily driven by the favorable impact of lapping the biennial International franchise convention held in 2003.

Franchise and license expenses decreased $21 million or 42% in 2003. The decrease was primarily attributable to lower allowances for doubtful franchise and license fee receivables, principally at Taco Bell.

WORLDWIDE OTHER (INCOME) EXPENSE

	2004	2003	2002
Equity income from investments in unconsolidated affiliates	**$ (54)**	$ (39)	$ (29)
Foreign exchange net (gain) loss	**(1)**	(2)	(1)
Other (income) expense	**$ (55)**	$ (41)	$ (30)

Other income increased $14 million or 34% in 2004, including a 7% favorable impact from foreign currency translation. The increase was driven by an increase in equity income from our unconsolidated affiliates, principally in China, and the dissolution of our unconsolidated affiliate in Canada which recorded a loss for the year ended December 27, 2003.

Other income increased $11 million or 39% in 2003, including a 6% favorable impact from foreign currency translation. The increase was primarily driven by an increase in equity income from our unconsolidated affiliates, particularly in China.

WORLDWIDE FACILITY ACTIONS

We recorded a net loss from facility actions of $26 million, $36 million and $32 million in 2004, 2003 and 2002, respectively. See the Store Portfolio Strategy section for more detail of our refranchising and closure activities and Note 7 for a summary of the components of facility actions by reportable operating segment.

OPERATING PROFIT

	2004	2003	% Increase/ (decrease) 2004	2003
United States	**$ 777**	$ 812	**(4)**	1
International	**542**	441	**23**	22
Unallocated and corporate expenses	**(204)**	(179)	**(14)**	—
Unallocated other income (expense)	**(2)**	(3)	**NM**	NM
Unallocated facility actions	**12**	4	**NM**	NM
Wrench litigation income (expense)	**14**	(42)	**NM**	NM
AmeriServe and other (charges) credits	**16**	26	**NM**	NM
Operating profit	**$ 1,155**	$ 1,059	**9**	3

In 2004, the decrease in U.S. operating profit was driven by the impact on restaurant profit of higher commodity costs (primarily cheese and meat) and the adjustment recorded related to our accounting for leases and the depreciation of leasehold improvements, as well as higher general and administrative expenses. The decrease was partially offset by the impact of same store sales increases on restaurant profit and franchise and license fees. Excluding the favorable impact of the YGR acquisition, U.S. operating profit in 2003 was flat compared to 2002. Decreases driven by lower restaurant profit as a result of increased occupancy expenses and the impact of unfavorable discounting and product mix shift on food and paper costs were offset by lower franchise and license and general and administrative expenses.

Excluding the favorable impact from foreign currency translation, International operating profit increased 17% in 2004. The increase was driven by new unit development, the impact of same store sales increases on restaurant profit and franchise and license fees and higher income from our investments in unconsolidated affiliates, partially offset by higher general and administrative costs. Excluding the favorable impact from foreign currency translation, International operating profit increased 15% in 2003. The increase was driven by new unit development and the impact of supply chain savings initiatives on the cost of food and paper, partially offset by the impact of same store sales declines on restaurant profit and higher general and administrative expenses.

Unallocated and corporate expenses comprise general and administrative expenses and unallocated facility actions comprise refranchising gains (losses), neither of which are allocated to the U.S. or International segments for performance reporting purposes.

INTEREST EXPENSE, NET

	2004	2003	2002
Interest expense	**$ 145**	$ 185	$ 180
Interest income	**(16)**	(12)	(8)
Interest expense, net	**$ 129**	$ 173	$ 172

Interest expense decreased $40 million or 22% in 2004. The decrease was primarily driven by a decrease in our average interest rates primarily attributable to pay-variable interest rate swaps entered into during 2004. Also contributing to the decrease was a reduction in our average debt outstanding primarily as a result of the amended YGR sale-leaseback agreement and lower International short-term borrowings.

Interest expense increased $5 million or 3% in 2003. Excluding the impact of the YGR acquisition, interest expense decreased 6%. The decrease was primarily due to a decrease in our average debt outstanding.

INCOME TAXES

	2004	2003	2002
Reported			
Income taxes	**$ 286**	$ 268	$ 275
Effective tax rate	**27.9%**	30.2%	32.1%

The reconciliation of income taxes calculated at the U.S. federal tax statutory rate to our effective tax rate is set forth below:

	2004	2003	2002
U.S. federal statutory tax rate	**35.0%**	35.0%	35.0%
State income tax, net of federal tax benefit	**1.3**	1.8	2.0
Foreign and U.S. tax effects attributable to foreign operations	**(5.8)**	(3.6)	(2.8)
Adjustments to reserves and prior years	**(6.7)**	(1.7)	(1.8)
Foreign tax credit amended return benefit	**—**	(4.1)	—
Valuation allowance additions (reversals)	**4.2**	2.8	—
Other, net	**(0.1)**	—	(0.3)
Effective tax rate	**27.9%**	30.2%	32.1%

Income taxes and the effective tax rate as shown above reflect tax on all amounts included in our results of operations except for the income tax benefit of approximately $1 million on the $2 million cumulative effect adjustment recorded in the year ended December 27, 2003 due to the adoption of SFAS 143.

The 2004 effective tax rate decreased 2.3 percentage points to 27.9%. The decrease in the effective tax rate was driven by a number of factors, including the reversal of reserves in the current year associated with audits that were settled as well as the effects of certain international tax planning strategies implemented in 2004. The decrease was partially offset by the impact of lapping the benefit in 2003 of amending certain prior U.S. income tax returns to claim credit for foreign taxes paid in prior years as well as the recognition in 2004 of valuation allowances for certain deferred tax assets whose realization is no longer considered more likely than not.

The 2003 effective tax rate decreased 1.9 percentage points to 30.2%. The decrease in the effective tax rate was primarily due to a 4.1 percentage point benefit of amending certain prior U.S. income tax returns to claim credit for foreign taxes paid in prior years. The returns were amended upon our determination that it was more beneficial to claim credit for such taxes than to deduct such taxes, as had been done when the returns were originally filed. In future years, we anticipate continuing to claim credit for foreign taxes paid in the then current year, as we have done in 2004, 2003 and 2002. However, the amended return benefit recognized in 2003 was non-recurring. The decrease in the 2003 effective tax rate was partially offset by the recognition of valuation allowances for certain deferred tax assets whose realization is no longer considered more likely than not. See Note 22 for a discussion of valuation allowances.

Adjustments to reserves and prior years include the effects of the reconciliation of income tax amounts recorded in our Consolidated Statements of Income to amounts reflected on our tax returns, including any adjustments to the Consolidated Balance Sheets. Adjustments to reserves and prior years also includes changes in tax reserves established for potential exposure we may incur if a taxing authority takes a position on a matter contrary to our position. We evaluate these reserves, including interest thereon, on a quarterly basis to insure that they have been appropriately adjusted for events, including audit settlements, that we believe may impact our exposure.

CONSOLIDATED CASH FLOWS

Net cash provided by operating activities was $1,131 million compared to $1,053 million in 2003. The increase was primarily driven by an increase in net income and a decrease in the amount of voluntary contributions to our funded pension plan compared to 2003, partially offset by higher income tax payments in 2004.

In 2003, net cash provided by operating activities was $1,053 million compared to $1,088 million in 2002. The decrease was primarily driven by $130 million in voluntary contributions to our funded pension plan in 2003, partially offset by higher net income.

Net cash used in investing activities was $486 million versus $519 million in 2003. The decrease was primarily driven by higher proceeds from refranchising of restaurants and lower capital spending compared to 2003, partially offset by the impact of the timing of purchases and sales of short-term investments.

In 2003, net cash used in investing activities was $519 million versus $885 million in 2002. The decrease in cash used was primarily driven by the $275 million acquisition of YGR in 2002 and lower capital spending in 2003.

Net cash used in financing activities was $779 million versus $475 million in 2003. The increase in 2004 was primarily driven by higher share repurchases, higher net debt repayments and the payment of two quarterly dividends, partially offset by higher proceeds from stock option exercises.

In 2003, net cash used in financing activities was $475 million versus $187 million in 2002. The increase was primarily driven by higher net debt repayments and higher shares repurchased in 2003.

CONSOLIDATED FINANCIAL CONDITION

Assets increased $76 million or 1% to $5.7 billion primarily due to an increase in property, plant and equipment driven by capital expenditures in excess of depreciation. The increase was also partially driven by the existence of a federal income tax receivable at December 25, 2004 recorded in prepaid expenses and other current assets and the timing of the collection of certain accounts receivable. The increase was partially offset by the impact of higher spending for financing activities compared to 2003, as described above, and a decrease in other assets as a result of the utilization of deferred income tax assets in 2004.

Liabilities decreased $399 million or 9% to $4.1 billion primarily due to lower long-term debt as a result of the early redemption of our 2005 Senior Unsecured Notes of $350 million in 2004 and lower income taxes payable due to the excess of current year tax payments made over the current year provision.

LIQUIDITY AND CAPITAL RESOURCES

Operating in the QSR industry allows us to generate substantial cash flows from the operations of our company stores and from our franchise operations, which require a limited YUM investment. In each of the last three fiscal years, net cash provided by operating activities has exceeded $1 billion. These cash flows have allowed us to fund our discretionary spending, while at the same time reducing our long-term debt balances. We expect these levels of net cash provided by operating activities to continue in the foreseeable future. Our discretionary spending includes capital spending for new restaurants, acquisitions of restaurants from franchisees, repurchases of shares of our common stock and dividends paid to our shareholders. Though a decline in revenues could adversely impact our cash flows from operations, we believe our operating cash flows, our ability to reduce discretionary spending, and our borrowing capacity will allow us to meet our cash requirements in 2005 and beyond.

We initiated the payment of quarterly dividends in 2004 with two quarterly dividends paid totaling $58 million. Additionally, on November 12, 2004 our Board of Directors approved a cash dividend of $0.10 per share of common stock to be distributed on February 4, 2005 to shareholders of record at the close of business on January 14, 2005. On an annual basis, the Company is targeting a payout ratio of 15% to 20% of net income.

On September 7, 2004, the Company executed an amended and restated five-year senior unsecured Revolving Credit Facility (the "Credit Facility") totaling $1.0 billion which replaced a $1.0 billion senior unsecured Revolving Credit Facility (the "Old Facility") with a maturity date of June 25, 2005. Under the terms of the Credit Facility, the Company may borrow up to the maximum borrowing limit less outstanding letters of credit. At December 25, 2004, our unused Credit Facility totaled $776 million, net of outstanding letters of credit of $205 million. There were borrowings of $19 million outstanding under the Credit Facility at December 25, 2004. The interest rate for borrowings under the Credit Facility ranges from 0.35% to 1.625% over the London Interbank Offered Rate ("LIBOR") or 0.00% to 0.20% over an Alternate Base Rate, which is the greater of the Prime Rate or the Federal Funds Effective Rate plus 0.50%. The exact spread over LIBOR or the Alternate Base Rate, as applicable, will depend upon our performance under specified financial criteria. Interest on any outstanding borrowings under the Credit Facility is payable at least quarterly.

The Credit Facility is unconditionally guaranteed by our principal domestic subsidiaries and contains financial covenants relating to maintenance of leverage and fixed charge coverage ratios. The Credit Facility also contains affirmative and negative covenants including, among other things, limitations on certain additional indebtedness, guarantees of indebtedness, level of cash dividends, aggregate non-U.S. investment and certain other transactions as defined in the agreement. These covenants are substantially similar to those contained in the Old Facility. We were in compliance with all covenants at December 25, 2004, and do not anticipate that the covenants will impact our ability to borrow under our Credit Facility for its remaining term.

The remainder of our long-term debt primarily comprises Senior Unsecured Notes. Amounts outstanding under Senior Unsecured Notes were $1.5 billion at December 25, 2004. On November 15, 2004, we voluntarily redeemed all of our 7.45% Senior Unsecured Notes due in May 2005 (the "2005 Notes") in accordance with their original terms. The 2005 Notes, which had a face value of $350 million, were redeemed for an amount of approximately $358 million using primarily cash on hand as well as some borrowings under our Credit Facility. The redemption amount approximated the carrying value of the 2005 Notes resulting in no significant impact on net income.

We estimate that in 2005 capital spending, including acquisitions of our restaurants from franchisees, will be approximately $780 million. We also estimate that in 2005 refranchising proceeds, prior to taxes, will be approximately $100 million, employee stock options proceeds, prior to taxes, will be approximately $150 million and sales of property, plant and equipment will be approximately $80 million. A share repurchase program authorized by our Board of Directors in May 2004 is expected to be completed during the first half of 2005. At December 25, 2004, we had remaining capacity to repurchase, through November 2005, up to approximately $25 million of our outstanding Common Stock (excluding applicable transaction fees) under this program. In January 2005, the Board of Directors authorized a new share repurchase program for up to $500 million of the Company's outstanding common stock to be purchased through January 2006.

In addition to any discretionary spending we may choose to make, significant contractual obligations and payments as of December 25, 2004 included:

	Total	Less than 1 Year	1–3 Years	3–5 Years	More than 5 Years
Long-term debt[(a)]	$ 1,598	$ 1	$ 204	$ 275	$ 1,118
Capital leases[(b)]	184	18	32	28	106
Operating leases[(b)]	2,511	342	564	442	1,163
Purchase obligations[(c)]	233	138	39	30	26
Other long-term liabilities reflected on our Consolidated Balance Sheet under GAAP	30	—	18	4	8
Total contractual obligations	$ 4,556	$ 499	$ 857	$ 779	$ 2,421

(a) Excludes a fair value adjustment of $21 million included in debt related to interest rate swaps that hedge the fair value of a portion of our debt. See Note 14.

(b) These obligations, which are shown on a nominal basis, relate to approximately 5,500 restaurants. See Note 15.

(c) Purchase obligations include agreements to purchase goods or services that are enforceable and legally binding on us and that specify all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction. We have excluded agreements that are cancelable without penalty. Purchase obligations relate primarily to information technology and commodity agreements, purchases of property, plant and equipment as well as marketing, maintenance, consulting and other agreements.

We have not included obligations under our pension and postretirement medical benefit plans in the contractual obligations table. Our funding policy regarding our funded pension plan is to contribute amounts necessary to satisfy minimum pension funding requirements plus such additional amounts from time to time as are determined to be appropriate to improve the plan's funded status. The pension plan's funded status is affected by many factors including discount rates and the performance of plan assets. We are not required to make minimum pension funding payments in 2005, but we may make discretionary contributions during the year based on our estimate of the plan's expected September 30, 2005 funded status. During 2004, we made a $50 million discretionary contribution to our funded plan, none of which represented minimum funding requirements. Our postretirement plan is not required to be funded in advance, but is pay as you go. We made postretirement benefit payments of $4 million in 2004.

Also excluded from the contractual obligations table are payments we may make for workers' compensation, employment practices liability, general liability, automobile liability and property losses (collectively "property and casualty losses") as well as employee healthcare claims for which we are self-insured. The majority of our recorded liability for self-insured employee health and property and casualty losses represents estimated reserves for incurred claims that have yet to be filed or settled.

OFF-BALANCE SHEET ARRANGEMENTS

We had provided approximately $16 million of partial guarantees of two franchisee loan pools related primarily to the Company's historical refranchising programs and, to a lesser extent, franchisee development of new restaurants, at December 25, 2004. In support of these guarantees, we posted $4 million of letters of credit at December 25, 2004. We also provided a standby letter of credit of $18 million at December 25, 2004, under which we could potentially be required to fund a portion of one of the franchisee loan pools. The total loans outstanding under these loan pools were approximately $90 million at December 25, 2004.

Any funding under the guarantees or letters of credit would be secured by the franchisee loans and any related collateral. We believe that we have appropriately provided for our estimated probable exposures under these contingent liabilities. These provisions were primarily charged to net refranchising loss (gain). New loans are not currently being added to either loan pool.

We have guaranteed certain lines of credit and loans of unconsolidated affiliates totaling $34 million at December 25, 2004. Our unconsolidated affiliates had total revenues of over $1.7 billion for the year ended December 25, 2004 and assets and debt of approximately $884 million and $49 million, respectively, at December 25, 2004.

OTHER SIGNIFICANT KNOWN EVENTS, TRENDS OR UNCERTAINTIES EXPECTED TO IMPACT 2005 OPERATING PROFIT COMPARISONS WITH 2004

New Accounting Pronouncements Not Yet Adopted Upon the adoption of Statement of Financial Accounting Standards No. 123 (Revised 2004), "Share-Based Payment" ("SFAS 123R") in 2005, we will be required to recognize compensation cost in the financial statements for all share-based payments to our employees, including grants of stock options, based on the fair value of the share-based awards on the date of grant. The fair value of the share-based awards will be determined using option pricing models and assumptions that appropriately reflect the specific circumstances of the awards. Compensation cost will be recognized over the vesting period based on the fair value of awards that actually vest.

SFAS 123R is effective at the beginning of the first interim or annual period beginning after June 15, 2005 (the quarter ending December 31, 2005 for the Company) and early adoption is encouraged. We are in the process of evaluating the use of certain option-pricing models as well as the assumptions to be used in such models. When such evaluation is complete, we will determine the transition method to use and the timing of adoption. We currently do not anticipate that the impact on net income on a full year basis of the adoption of SFAS 123R will be significantly different from the historical pro forma impacts as previously disclosed.

See Note 2.

Sale of Puerto Rico Business As a result of the sale of our Puerto Rico business on October 4, 2004, Company sales, restaurant profit and general and administrative expenses will decrease by $159 million, $29 million and $8 million, respectively, and we estimate franchise fees will increase by $10 million for the year ended December 31, 2005 compared to the year ended December 25, 2004.

Extra Week in 2005 Our fiscal calendar results in a fifty-third week every five or six years. Fiscal year 2005 will include a fifty-third week in the fourth quarter for the majority of our U.S. businesses as well as our international businesses that report on a period, as opposed to a monthly, basis. In the U.S., we anticipate permanently accelerating the timing of the KFC business closing by one week in December 2005, and thus, there will be no fifty-third week benefit for this business in 2005. We estimate the fifty-third week will increase revenues and operating profit in 2005 by approximately $80 million and $15 million, respectively. While the impact of the fifty-third week adds a potential incremental benefit of $0.04 to diluted earnings per share, we believe this benefit will be offset by expense associated with strategic asset actions and refranchising KFC restaurants in the U.S.

International Reporting Changes In the first quarter of 2005 we will begin reporting information for our international businesses in two separate operating segments as a result of changes to our management reporting structure. The China Division will include Mainland China ("China"), Thailand and KFC Taiwan, and the International Division will include the remainder of our international operations. This reporting change will not impact our consolidated results.

In the first quarter of 2005 we will also change the China business reporting calendar to more closely align the timing of the reporting of its results of operations with our U.S. business. Previously our China business, like the rest of our international businesses, closed one month (or one period for certain of our international businesses) earlier than YUM's period end date to facilitate consolidated reporting. As a result, the operations of the China business for the one month period ending December 31, 2004 will be recognized as an adjustment to consolidated retained earnings in the first quarter of 2005, as opposed to being recorded in our Consolidated Statement of Income, to maintain comparability of our consolidated results of operations. Our consolidated results of operations for the first quarter of 2005 will thus include the results of operations of the China business for the months of January and February and the months included in each quarterly reporting period thereafter will begin one month later in 2005 than in previous years.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our reported results are impacted by the application of certain accounting policies that require us to make subjective or complex judgments. These judgments involve estimations of the effect of matters that are inherently uncertain and may significantly impact our quarterly or annual results of operations or financial condition. Changes in the estimates and judgments could significantly affect our results of operations, financial condition and cash flows in future years. A description of what we consider to be our most significant critical accounting policies follows.

Impairment or Disposal of Long-Lived Assets We evaluate our long-lived assets for impairment at the individual restaurant level except when there is an expectation that we will refranchise restaurants as a group. Restaurants held and used are evaluated for impairment on a semi-annual basis or whenever events or circumstances indicate that the carrying amount of a restaurant may not be recoverable (including a decision to close a restaurant or an offer to refranchise a restaurant or group of restaurants for less than the carrying value). Our semi-annual test includes those restaurants that have experienced two consecutive years of operating losses. These impairment evaluations require an estimation of cash flows over the remaining useful life of the primary asset of the restaurant, which can be for a period of over 20 years, and any terminal value. We limit assumptions about important factors such as sales growth and margin improvement to those that are supportable based upon our plans for the unit and actual results at comparable restaurants.

If the long-lived assets of a restaurant on a held and used basis are not recoverable based upon forecasted, undiscounted cash flows, we write the assets down to their fair value. This fair value is determined by discounting the forecasted cash flows, including terminal value, of the restaurant at an appropriate rate. The discount rate used is our cost of capital, adjusted upward when a higher risk is believed to exist.

When it is probable that we will sell a restaurant within one year, we write down the restaurant to its fair value. We often refranchise restaurants in groups and, therefore, perform such impairment evaluations at the group level. Fair value is based on the expected sales proceeds less applicable transaction costs. Estimated sales proceeds are based on the most relevant of historical sales multiples or bids from buyers, and have historically been reasonably accurate estimations of the proceeds ultimately received.

See Note 2 for a further discussion of our policy regarding the impairment or disposal of long-lived assets.

Impairment of Investments in Unconsolidated Affiliates We record impairment charges related to an investment in an unconsolidated affiliate whenever events or circumstances indicate that a decrease in the value of an investment has occurred which is other than temporary. In addition, we evaluate our investments in unconsolidated affiliates for impairment when they have experienced two consecutive years of operating losses. Our impairment measurement test for an investment in an unconsolidated affiliate is similar to that for our restaurants except that we use discounted cash flows after interest and taxes instead of discounted cash flows before interest and taxes as used for our restaurants. The fair values of our investments in unconsolidated affiliates are generally significantly in excess of their carrying value.

See Note 2 for a further discussion of our policy regarding the impairment of investments in unconsolidated affiliates.

Impairment of Goodwill and Indefinite-Lived Intangible Assets We evaluate goodwill and indefinite-lived intangible assets for impairment on an annual basis or more often if an event occurs or circumstances change that indicates impairment might exist. Goodwill is evaluated for impairment through the comparison of fair value of our reporting units to their carrying values. Our reporting units are our operating segments in the U.S. and our business management units internationally (typically individual countries). Fair value is the price a willing buyer would pay for the reporting unit, and is generally estimated by discounting expected future cash flows from the reporting unit over twenty years plus an expected terminal value. We limit assumptions about important factors such as sales growth and margin improvement to those that are supportable based upon our plans for the reporting unit. For 2004, there was no impairment of goodwill identified during our annual impairment testing.

Our impairment test for indefinite-lived intangible assets consists of a comparison of the fair value of the asset with its carrying amount. Our indefinite-lived intangible assets consist of values assigned to certain trademarks/brands of which we have acquired ownership. We believe the value of these trademarks/brands is derived from the royalty we avoid, in the case of Company stores, or receive, in the case of franchise stores, due to our ownership of the trademarks/brands. Thus, anticipated sales are the most important assumption in valuing trademarks/brands. We limit assumptions about sales growth, as well as other factors impacting the fair value calculation, to those that are supportable based on our plans for the applicable Concept.

The most significant indefinite-lived trademark/brand asset we have recorded is the LJS trademark/brand in the amount of $140 million. The fair value of this trademark/brand is currently in excess of its carrying value as are the fair values of all other recorded trademarks/brands with an indefinite life. While we believe the sales assumptions used in our determinations of fair value for our trademarks/brands are consistent with our operating plans and forecasts, fluctuations in the assumptions would have impacted our impairment calculation. If the long-term rate of sales growth used in each of our fair value determinations for our trademarks/brands had been one percentage point lower, such fair values would have continued to exceed carrying value in all instances.

See Note 2 for a further discussion of our policies regarding goodwill and indefinite-lived intangible assets.

Allowances for Franchise and License Receivables and Contingent Liabilities We reserve a franchisee's or licensee's entire receivable balance based upon pre-defined aging criteria and upon the occurrence of other events that indicate that we may not collect the balance due. As a result of reserving using this methodology, we have an immaterial amount of receivables that are past due that have not been reserved for at December 25, 2004.

See Note 2 for a further discussion of our policies regarding franchise and license operations.

Primarily as a result of our refranchising efforts, we remain liable for certain lease assignments and guarantees. We record a liability for our exposure under these lease assignments and guarantees when such exposure is probable and estimable. At December 25, 2004, we have recorded an immaterial liability for our exposure which we consider to be probable and estimable. The potential total exposure under such leases is significant, with $306 million representing the present value, discounted at our pre-tax cost of debt, of the minimum payments of the assigned leases at December 25, 2004. Current 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 agreement in the event of non-payment under the lease. We believe these cross-default provisions significantly reduce the risk that we will be required to make payments under these leases and, historically, we have not been required to make such payments in significant amounts.

See Note 24 for a further discussion of our lease guarantees.

Self-Insured Property and Casualty Losses We record our best estimate of the remaining cost to settle incurred self-insured property and casualty claims. The estimate is based on the results of an independent actuarial study and considers historical claim frequency and severity as well as changes in factors such as our business environment, benefit levels, medical costs and the regulatory environment that could impact overall self-insurance costs. Additionally, a risk margin to cover unforeseen events that may occur over the several years it takes for claims to settle is included in our reserve, increasing our confidence level that the recorded reserve is adequate.

See Note 24 for a further discussion of our insurance programs.

Pension Plans Certain of our employees are covered under noncontributory defined benefit pension plans. The most significant of these plans was amended in 2001 such that employees hired after September 30, 2001 are not eligible to participate. As of our September 30, 2004 measurement date, these plans had a projected benefit obligation ("PBO") of $700 million, an accumulated benefit obligation ("ABO") of $629 million and a fair value of plan assets of $518 million. As a result of the $111 million underfunded status of the plans relative to the ABO at September 30, 2004, we have recorded a cumulative $95 million charge to accumulated other comprehensive loss (net of tax of $58 million) as of December 25, 2004.

The PBO and ABO reflect the actuarial present value of all benefits earned to date by employees. The PBO incorporates assumptions as to future compensation levels while the ABO reflects only current compensation levels. Due to the relatively long time frame over which benefits earned to date are expected to be paid, our PBO and ABO are highly sensitive to changes in discount rates. We measured our PBO and ABO using a discount rate of 6.15% at September 30, 2004. This discount rate was determined using a hypothetical portfolio of high-quality debt instruments with maturities that mirror our expected benefit obligations under the plans. A 50 basis point increase in this discount rate would have decreased our PBO by approximately $63 million at September 30, 2004. Conversely, a 50 basis point decrease in this discount rate would have increased our PBO by approximately $65 million at September 30, 2004.

The pension expense we will record in 2005 is also impacted by the discount rate we selected at September 30, 2004. In total, we expect pension expense to increase approximately $3 million to $56 million in 2005. The increase is primarily driven by an increase in interest cost because of the higher PBO. Service cost will also increase as a result of the lower discount rate, though, as previously mentioned, the plans are closed to new participants. A 50 basis point change in our discount rate assumption of 6.15% at September 30, 2004 would impact our 2005 pension expense by approximately $12 million.

The assumption we make regarding our expected long-term rate of return on plan assets also impacts our pension expense. Our expected long-term rate of return on plan assets at both September 30, 2004 and September 30, 2003 was 8.5%. We believe that this assumption is appropriate given the composition of our plan assets and historical market returns thereon. Given no change to the market-related value of our plan assets as of September 30, 2004, a one percentage point increase or decrease in our expected rate of return on plan assets assumption would decrease or increase, respectively, our 2005 pension plan expense by approximately $5 million.

The losses our plan assets have experienced, along with the decrease in discount rates, have largely contributed to an unrecognized actuarial loss of $225 million in our plans as of September 30, 2004. For purposes of determining 2004 expense, our funded status was such that we recognized $19 million of unrecognized actuarial loss in 2004. We will recognize approximately $22 million of unrecognized actuarial loss in 2005. Given no change to the assumptions at our September 30, 2004 measurement date, actuarial loss recognition will remain at an amount near that to be recognized in 2005 over the next few years before it begins to gradually decline.

Income Tax Valuation Allowances and Tax Reserves At December 25, 2004, we have a valuation allowance of $351 million primarily to reduce our net operating loss and tax credit carryforwards of $231 million and our other deferred tax assets to amounts that will more likely than not be realized. The net operating loss and tax credit carryforwards exist in many state and foreign jurisdictions and have varying carryforward periods and restrictions on usage. The estimation of future taxable income in these state and foreign jurisdictions and our resulting ability to utilize net operating loss and tax credit carryforwards can significantly change based on future events, including our determinations as to the feasibility of certain tax planning strategies. Thus, recorded valuation allowances may be subject to material future changes.

As a matter of course, we are regularly audited by federal, state and foreign tax authorities. We provide reserves for potential exposures when we consider it probable that a taxing authority may take a sustainable position on a matter contrary to our position. We evaluate these reserves, including interest thereon, on a quarterly basis to insure that they have been appropriately adjusted for events, including audit settlements, that may impact our ultimate payment for such exposures.

See Note 22 for a further discussion of our income taxes.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to financial market risks associated with interest rates, foreign currency exchange rates and commodity prices. In the normal course of business and in accordance with our policies, we manage these risks through a variety of strategies, which may include the use of derivative financial and commodity instruments to hedge our underlying exposures. Our policies prohibit the use of derivative instruments for trading purposes, and we have procedures in place to monitor and control their use.

Interest Rate Risk We have a market risk exposure to changes in interest rates, principally in the United States. We attempt to minimize this risk and lower our overall borrowing costs through the utilization of derivative financial instruments, primarily interest rate swaps. These swaps are entered into with financial institutions and have reset dates and critical terms that match those of the underlying debt. Accordingly, any change in market value associated with interest rate swaps is offset by the opposite market impact on the related debt.

At December 25, 2004 and December 27, 2003, a hypothetical 100 basis point increase in short-term interest rates would result, over the following twelve-month period, in a reduction of approximately $6 million and $3 million, respectively, in income before income taxes. The estimated reductions are based upon the level of variable rate debt and assume no changes in the volume or composition of debt. In addition, the fair value of our derivative financial instruments at December 25, 2004 and December 27, 2003 would decrease approximately $51 million and $5 million, respectively. The fair value of our Senior Unsecured Notes at December 25, 2004 and December 27, 2003 would decrease approximately $76 million and $87 million, respectively. Fair value was determined by discounting the projected cash flows.

Foreign Currency Exchange Rate Risk International operating profit constitutes approximately 41% of our operating profit in 2004, excluding unallocated income (expenses). In addition, the Company's net asset exposure (defined as foreign currency assets less foreign currency liabilities) totaled approximately $1.5 billion as of December 25, 2004. Operating in international markets exposes the Company to movements in foreign currency exchange rates. The Company's primary exposures result from our operations in Asia-Pacific, the Americas and Europe. Changes in foreign currency exchange rates would impact the translation of our investments in foreign operations, the fair value of our foreign currency denominated financial instruments and our reported foreign currency denominated earnings and cash flows. For the fiscal year ended December 25, 2004, operating profit would have decreased $59 million if all foreign currencies had uniformly weakened 10% relative to the U.S. dollar. The estimated reduction assumes no changes in sales volumes or local currency sales or input prices.

We attempt to minimize the exposure related to our investments in foreign operations by financing those investments with local currency debt when practical and holding cash in local currencies when possible. In addition, we attempt to minimize the exposure related to foreign currency denominated financial instruments by purchasing goods and services from third parties in local currencies when practical. Consequently, foreign currency denominated financial instruments consist primarily of intercompany short-term receivables and payables. At times, we utilize forward contracts to reduce our exposure related to these intercompany short-term receivables and payables. The notional amount and maturity dates of these contracts match those of the underlying receivables or payables such that our foreign currency exchange risk related to these instruments is eliminated.

Commodity Price Risk We are subject to volatility in food costs as a result of market risk associated with commodity prices. Our ability to recover increased costs through higher pricing is, at times, limited by the competitive environment in which we operate. We manage our exposure to this risk primarily through pricing agreements as well as, on a limited basis, commodity future and option contracts. Commodity future and option contracts entered into for the fiscal years ended December 25, 2004, and December 27, 2003, did not significantly impact our financial position, results of operations or cash flows.

CAUTIONARY STATEMENTS

From time to time, in both written reports and oral statements, we present "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The statements include those identified by such words as "may," "will," "expect," "project," "anticipate," "believe," "plan" and other similar terminology. These "forward-looking statements" reflect our current expectations regarding future events and operating and financial performance and are based upon data available at the time of the statements. Actual results involve risks and uncertainties, including both those specific to the Company and those specific to the industry, and could differ materially from expectations.

Company risks and uncertainties include, but are not limited to, potentially substantial tax contingencies related to the Spin-off, which, if they occur, require us to indemnify PepsiCo, Inc.; changes in effective tax rates; our debt leverage and the attendant potential restriction on our ability to borrow in the future; potential unfavorable variances between estimated and actual liabilities; our ability to secure distribution of products and equipment to our restaurants on favorable economic terms and our ability to ensure adequate supply of restaurant products and equipment in our stores; effects and outcomes of legal claims involving the Company; the effectiveness of operating initiatives and advertising and promotional efforts; the ongoing financial viability of our franchisees and licensees; the success of our refranchising strategy; volatility of actuarially determined losses and loss estimates; and adoption of new or changes in accounting policies and practices including pronouncements promulgated by standard setting bodies.

Industry risks and uncertainties include, but are not limited to, economic and political conditions in the countries and territories where we operate, including effects of war and terrorist activities; changes in legislation and governmental regulation; new product and concept development by us and/or our food industry competitors; changes in commodity, labor, and other operating costs; changes in competition in the food industry; publicity which may impact our business and/or industry; severe weather conditions; volatility of commodity costs; increases in minimum wage and other operating costs; availability and cost of land and construction; consumer preferences or perceptions concerning the products of the Company and/or our competitors, spending patterns and demographic trends; political or economic instability in local markets and changes in currency exchange and interest rates; and the impact that any widespread illness or general health concern may have on our business and/or the economy of the countries in which we operate.

Consolidated Statements of Income

Fiscal years ended December 25, 2004, December 27, 2003 and December 28, 2002

(in millions, except per share data)	**2004**	2003	2002
REVENUES			
Company sales	**$ 7,992**	$ 7,441	$ 6,891
Franchise and license fees	**1,019**	939	866
	9,011	8,380	7,757
COSTS AND EXPENSES, NET			
Company restaurants			
Food and paper	**2,538**	2,300	2,109
Payroll and employee benefits	**2,112**	2,024	1,875
Occupancy and other operating expenses	**2,183**	2,013	1,806
	6,833	6,337	5,790
General and administrative expenses	**1,056**	945	913
Franchise and license expenses	**26**	28	49
Facility actions	**26**	36	32
Other (income) expense	**(55)**	(41)	(30)
Wrench litigation (income) expense	**(14)**	42	—
AmeriServe and other charges (credits)	**(16)**	(26)	(27)
Total costs and expenses, net	**7,856**	7,321	6,727
OPERATING PROFIT	**1,155**	1,059	1,030
Interest expense, net	**129**	173	172
INCOME BEFORE INCOME TAXES AND CUMULATIVE EFFECT OF ACCOUNTING CHANGE	**1,026**	886	858
Income tax provision	**286**	268	275
INCOME BEFORE CUMULATIVE EFFECT OF ACCOUNTING CHANGE	**740**	618	583
Cumulative effect of accounting change, net of tax	**—**	(1)	—
NET INCOME	**$ 740**	$ 617	$ 583
BASIC EARNINGS PER COMMON SHARE	**$ 2.54**	$ 2.10	$ 1.97
DILUTED EARNINGS PER COMMON SHARE	**$ 2.42**	$ 2.02	$ 1.88
DIVIDENDS DECLARED PER COMMON SHARE	**$ 0.30**	$ —	$ —

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Cash Flows

Fiscal years ended December 25, 2004, December 27, 2003 and December 28, 2002

(in millions)	2004	2003	2002
CASH FLOWS—OPERATING ACTIVITIES			
Net income	**$ 740**	$ 617	$ 583
Adjustments to reconcile net income to net cash provided by operating activities:			
Cumulative effect of accounting change, net of tax	**—**	1	—
Depreciation and amortization	**448**	401	370
Facility actions	**26**	36	32
Wrench litigation (income) expense	**(14)**	42	—
AmeriServe and other charges (credits)	**—**	(3)	—
Contributions to defined benefit pension plans	**(55)**	(132)	(26)
Other liabilities and deferred credits	**21**	17	(12)
Deferred income taxes	**142**	(23)	21
Other non-cash charges and credits, net	**25**	32	36
Changes in operating working capital, excluding effects of acquisitions and dispositions:			
Accounts and notes receivable	**(39)**	2	32
Inventories	**(7)**	(1)	11
Prepaid expenses and other current assets	**(5)**	—	19
Accounts payable and other current liabilities	**(20)**	(32)	(37)
Income taxes payable	**(131)**	96	59
Net change in operating working capital	**(202)**	65	84
NET CASH PROVIDED BY OPERATING ACTIVITIES	**1,131**	1,053	1,088
CASH FLOWS—INVESTING ACTIVITIES			
Capital spending	**(645)**	(663)	(760)
Proceeds from refranchising of restaurants	**140**	92	81
Acquisition of Yorkshire Global Restaurants, Inc.	**—**	—	(275)
Acquisition of restaurants from franchisees	**(38)**	(41)	(13)
Short-term investments	**(36)**	13	9
Sales of property, plant and equipment	**52**	46	58
Other, net	**41**	34	15
NET CASH USED IN INVESTING ACTIVITIES	**(486)**	(519)	(885)
CASH FLOWS—FINANCING ACTIVITIES			
Proceeds from Senior Unsecured Notes	**—**	—	398
Revolving Credit Facility activity, by original maturity			
Three months or less, net	**19**	(153)	59
Repayments of long-term debt	**(371)**	(17)	(511)
Short-term borrowings-three months or less, net	**—**	(137)	(15)
Repurchase shares of common stock	**(569)**	(278)	(228)
Employee stock option proceeds	**200**	110	125
Dividends paid on common shares	**(58)**	—	—
Other, net	**—**	—	(15)
NET CASH USED IN FINANCING ACTIVITIES	**(779)**	(475)	(187)
EFFECT OF EXCHANGE RATE ON CASH AND CASH EQUIVALENTS	**4**	3	4
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	**(130)**	62	20
CASH AND CASH EQUIVALENTS—BEGINNING OF YEAR	**192**	130	110
CASH AND CASH EQUIVALENTS—END OF YEAR	**$ 62**	$ 192	$ 130

See accompanying Notes to Consolidated Financial Statements.

Consolidated Balance Sheets

December 25, 2004 and December 27, 2003

(in millions)	**2004**	2003
ASSETS		
Current Assets		
Cash and cash equivalents	**$ 62**	$ 192
Short-term investments, at cost	**54**	15
Accounts and notes receivable, less allowance: $22 in 2004 and $25 in 2003	**192**	150
Inventories	**76**	67
Assets classified as held for sale	**7**	96
Prepaid expenses and other current assets	**135**	65
Deferred income taxes	**156**	165
Advertising cooperative assets, restricted	**65**	56
Total Current Assets	**747**	806
Property, plant and equipment, net	**3,439**	3,280
Goodwill	**553**	521
Intangible assets, net	**347**	357
Investments in unconsolidated affiliates	**194**	184
Other assets	**416**	472
Total Assets	**$ 5,696**	$ 5,620
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Accounts payable and other current liabilities	**$ 1,160**	$ 1,157
Dividends payable	**29**	—
Income taxes payable	**111**	238
Short-term borrowings	**11**	10
Advertising cooperative liabilities	**65**	56
Total Current Liabilities	**1,376**	1,461
Long-term debt	**1,731**	2,056
Other liabilities and deferred credits	**994**	983
Total Liabilities	**4,101**	4,500
Shareholders' Equity		
Preferred stock, no par value, 250 shares authorized; no shares issued	**—**	—
Common stock, no par value, 750 shares authorized; 290 shares and 292 shares issued in 2004 and 2003, respectively	**659**	916
Retained earnings	**1,067**	414
Accumulated other comprehensive income (loss)	**(131)**	(210)
Total Shareholders' Equity	**1,595**	1,120
Total Liabilities and Shareholders' Equity	**$ 5,696**	$ 5,620

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Shareholders' Equity and Comprehensive Income

Fiscal years ended December 25, 2004, December 27, 2003 and December 28, 2002

(in millions)	Issued Common Stock Shares	Issued Common Stock Amount	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss)	Total
Balance at December 29, 2001	293	$ 1,097	$ (786)	$ (207)	$ 104
Net income			583		583
Foreign currency translation adjustment arising during the period				6	6
Net unrealized loss on derivative instruments (net of tax impact of $1 million)				(1)	(1)
Minimum pension liability adjustment (net of tax impact of $29 million)				(47)	(47)
Comprehensive Income					541
Repurchase of shares of common stock	(8)	(228)			(228)
Employee stock option exercises (includes tax impact of $49 million)	9	174			174
Compensation-related events		3			3
Balance at December 28, 2002	294	$ 1,046	$ (203)	$ (249)	$ 594
Net income			617		617
Foreign currency translation adjustment arising during the period				67	67
Foreign currency translation adjustment included in net income				2	2
Minimum pension liability adjustment (net of tax impact of $18 million)				(30)	(30)
Comprehensive Income					656
Repurchase of shares of common stock	(9)	(278)			(278)
Employee stock option exercises (includes tax impact of $26 million)	7	136			136
Compensation-related events		12			12
Balance at December 27, 2003	292	$ 916	$ 414	$ (210)	$ 1,120
Net income			**740**		**740**
Foreign currency translation adjustment arising during the period				**73**	**73**
Minimum pension liability adjustment (net of tax impact of $3 million)				**6**	**6**
Comprehensive Income					**819**
Dividends declared on common shares ($0.30 per common share)			**(87)**		**(87)**
Repurchase of shares of common stock	**(14)**	**(569)**			**(569)**
Employee stock option exercises (includes tax impact of $102 million)	**12**	**302**			**302**
Compensation-related events		**10**			**10**
Balance at December 25, 2004	**290**	**$ 659**	**$ 1,067**	**$ (131)**	**$ 1,595**

See accompanying Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements

(Tabular amounts in millions, except share data)

DESCRIPTION OF BUSINESS

NOTE 1

YUM! Brands, Inc. and Subsidiaries (collectively referred to as "YUM" or the "Company") comprises the worldwide operations of KFC, Pizza Hut, Taco Bell and since May 7, 2002, Long John Silver's ("LJS") and A&W All-American Food Restaurants ("A&W") (collectively the "Concepts"), which were added when we acquired Yorkshire Global Restaurants, Inc. ("YGR"). YUM is the world's largest quick service restaurant company based on the number of system units, with over 33,000 units of which approximately 39% are located outside the U.S. in more than 100 countries and territories. YUM was created as an independent, publicly-owned company on October 6, 1997 (the "Spin-off Date") via a tax-free distribution by our former parent, PepsiCo, Inc. ("PepsiCo"), of our Common Stock (the "Distribution" or "Spin-off") to its shareholders. References to YUM throughout these Consolidated Financial Statements are made using the first person notations of "we," "us " or "our."

Through our widely-recognized Concepts, we develop, operate, franchise and license a system of both traditional and non-traditional quick service restaurants. Each Concept has proprietary menu items and emphasizes the preparation of food with high quality ingredients as well as unique recipes and special seasonings to provide appealing, tasty and attractive food at competitive prices. Our traditional restaurants feature dine-in, carryout and, in some instances, drive-thru or delivery service. Non-traditional units, which are principally licensed outlets, include express units and kiosks which have a more limited menu and operate in non-traditional locations like airports, gasoline service stations, convenience stores, stadiums, amusement parks and colleges, where a full-scale traditional outlet would not be practical or efficient. We are actively pursuing the strategy of multibranding, where two or more of our Concepts are operated in a single unit. In addition, we are pursuing the multibrand combination of Pizza Hut and WingStreet, a flavored chicken wings concept we have developed. We are also testing multibranding options involving one of our Concepts and either a concept in development, such as Pasta Bravo, or a concept not owned or affiliated with YUM.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

NOTE 2

Our preparation of the accompanying Consolidated Financial Statements in conformity with accounting principles generally accepted in the United States of America 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.

Principles of Consolidation and Basis of Preparation Intercompany accounts and transactions have been eliminated. Certain investments in businesses that operate our Concepts are accounted for by the equity method. Generally, we possess 50% ownership of and 50% voting rights over these affiliates. Our lack of majority voting rights precludes us from controlling these affiliates, and thus we do not consolidate these affiliates. Our share of the net income or loss of those unconsolidated affiliates is included in other (income) expense.

We participate in various advertising cooperatives with our franchisees and licensees. In certain of these cooperatives we possess majority voting rights, and thus control the cooperatives. At December 27, 2003, we reported the related assets and liabilities of those advertising cooperatives we control in accounts and notes receivable, prepaid expenses and other current assets and accounts payable and other current liabilities, as appropriate. We have now summed all assets and liabilities of these advertising cooperatives and reported the amounts as advertising cooperative assets, restricted and advertising cooperative liabilities in the Consolidated Balance Sheet as of December 25, 2004. We have reclassified those amounts in the Consolidated Balance Sheet as of December 27, 2003 for comparative purposes. As the contributions to these cooperatives are designated and segregated for advertising, we act as an agent for the franchisees and licensees with regard to these contributions. Thus, in accordance with Statement of Financial Accounting Standards ("SFAS") No. 45, "Accounting for Franchise Fee Revenue," we do not reflect, and have not reflected in the past, franchisee and licensee contributions to these cooperatives in our Consolidated Statements of Income.

In 2004, we adopted Financial Accounting Standards Board ("FASB") Interpretation No. 46 (revised December 2003), "Consolidation of Variable Interest Entities, an interpretation of ARB No. 51" ("FIN 46R"). FIN 46R addresses the consolidation of an entity whose equity holders either (a) have not provided sufficient equity at risk to allow the entity to finance its own activities or (b) do not possess certain characteristics of a controlling financial interest. FIN 46R requires the consolidation of such an entity, known as a variable interest entity ("VIE"), by the primary beneficiary of the entity. The primary beneficiary is the entity, if any, that is obligated to absorb a majority of the risk of loss from the VIE's activities, entitled to receive a majority of the VIE's residual returns, or both. FIN 46R excludes from its scope businesses (as defined by FIN 46R) unless certain conditions exist.

The principal entities in which we possess a variable interest include franchise entities, including our unconsolidated affiliates described above. We do not possess any ownership interests in franchise entities except for our investments in various unconsolidated affiliates accounted for under the equity method. Additionally, we generally do not provide financial support to franchise entities in a typical franchise relationship.

We also possess variable interests in certain purchasing cooperatives we have formed along with representatives of the franchisee groups of each of our Concepts. These purchasing cooperatives were formed for the purpose of purchasing certain restaurant products and equipment in the

U.S. Our equity ownership in each cooperative is generally proportional to our percentage ownership of the U.S. system units for the Concept. We account for our investments in these purchasing cooperatives using the cost method, under which our recorded balances were not significant at December 25, 2004 or December 27, 2003.

As a result of the adoption of FIN 46R, we have not consolidated any franchise entities, purchasing cooperatives or other entities.

Fiscal Year Our fiscal year ends on the last Saturday in December and, as a result, a fifty-third week is added every five or six years. Fiscal year 2000 included 53 weeks. The Company's next fiscal year with 53 weeks will be 2005. The first three quarters of each fiscal year consist of 12 weeks and the fourth quarter consists of 16 weeks in fiscal years with 52 weeks and 17 weeks in fiscal years with 53 weeks. Our subsidiaries operate on similar fiscal calendars with period or month end dates suited to their businesses. The subsidiaries' period end dates are within one week of YUM's period end date with the exception of our international businesses, which close one period or one month earlier to facilitate consolidated reporting.

Reclassifications We have reclassified certain items in the accompanying Consolidated Financial Statements and Notes thereto for prior periods to be comparable with the classification for the fiscal year ended December 25, 2004. These reclassifications had no effect on previously reported net income.

Franchise and License Operations We execute franchise or license agreements for each unit which set out the terms of our arrangement with the franchisee or licensee. Our franchise and license agreements typically require the franchisee or licensee to pay an initial, non-refundable fee and continuing fees based upon a percentage of sales. Subject to our approval and their payment of a renewal fee, a franchisee may generally renew the franchise agreement upon its expiration.

We incur expenses that benefit both our franchise and license communities and their representative organizations and our Company operated restaurants. These expenses, along with other costs of servicing of franchise and license agreements are charged to general and administrative ("G&A") expenses as incurred. Certain direct costs of our franchise and license operations are charged to franchise and license expenses. These costs include provisions for estimated uncollectible fees, franchise and license marketing funding, amortization expense for franchise related intangible assets and certain other direct incremental franchise and license support costs. Franchise and license expenses also include occupancy costs associated with restaurants we sublease to franchisees, net of any rental income we receive.

We monitor the financial condition of our franchisees and licensees and record provisions for estimated losses on receivables when we believe that our franchisees or licensees are unable to make their required payments. While we use the best information available in making our determination, the ultimate recovery of recorded receivables is also dependent upon future economic events and other conditions that may be beyond our control. Net provisions for uncollectible franchise and license receivables of $1 million and $15 million were included in franchise and license expense in 2004 and 2002, respectively. Included in franchise and license expense in 2003 was a net benefit for uncollectible franchise and license receivables of $3 million, as we were able to recover previously reserved receivables in excess of current provisions.

Revenue Recognition The Company's revenues consist of sales by Company operated restaurants and fees from our franchisees and licensees. Revenues from Company operated restaurants are recognized when payment is tendered at the time of sale. We recognize initial fees received from a franchisee or licensee as revenue when we have performed substantially all initial services required by the franchise or license agreement, which is generally upon the opening of a store. We recognize continuing fees based upon a percentage of franchisee and licensee sales as earned. We recognize renewal fees when a renewal agreement with a franchisee or licensee becomes effective. We include initial fees collected upon the sale of a restaurant to a franchisee in refranchising gains (losses).

Direct Marketing Costs We report substantially all of our direct marketing costs in occupancy and other operating expenses. We charge direct marketing costs to expense ratably in relation to revenues over the year in which incurred and, in the case of advertising production costs, in the year the advertisement is first shown. Deferred direct marketing costs, which are classified as prepaid expenses, consist of media and related advertising production costs which will generally be used for the first time in the next fiscal year and have historically not been significant. To the extent we participate in advertising cooperatives, we expense our contributions as incurred. Our advertising expenses were $458 million, $419 million and $384 million in 2004, 2003 and 2002, respectively.

Research and Development Expenses Research and development expenses, which we expense as incurred, are reported in G&A expenses. Research and development expenses were $26 million in both 2004 and 2003 and $23 million in 2002.

Impairment or Disposal of Long-Lived Assets In accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"), we review our long-lived assets related to each restaurant to be held and used in the business, including any allocated intangible assets subject to amortization, semi-annually for impairment, or whenever events or changes in circumstances indicate that the carrying amount of a restaurant may not be recoverable. We evaluate restaurants using a "two-year history of operating losses" as our primary indicator of potential impairment. Based on the best information available, we write down an impaired restaurant to its estimated fair market value, which becomes its new cost basis. We generally measure estimated fair market value by discounting estimated future cash flows. In addition, when we decide to close a restaurant it is reviewed for impairment and depreciable lives are adjusted based on the expected disposal date. The impairment evaluation is based on the estimated cash flows from continuing use through the expected disposal date plus the expected terminal value.

The Company has adopted SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" ("SFAS 146"), effective for exit or disposal activities that were initiated after December 31, 2002. Costs addressed by SFAS 146 include costs to terminate a contract that is not a capital lease, costs of involuntary employee termination benefits pursuant to a one-time benefit arrangement, costs to consolidate facilities and costs to relocate employees. SFAS 146 changes the timing of expense recognition for certain costs we incur while closing restaurants or undertaking other exit or disposal activities; however, the timing difference is not typically significant in length. Adoption of SFAS 146 did not have a material impact on our Consolidated Financial Statements for the years ended December 25, 2004 or December 27, 2003.

Store closure costs include costs of disposing of the assets as well as other facility-related expenses from previously closed stores. These store closure costs are generally expensed as incurred. Additionally, at the date we cease using a property under an operating lease, we record a liability for the net present value of any remaining lease obligations, net of estimated sublease income, if any. To the extent we sell assets, primarily land, associated with a closed store, any gain or loss upon that sale is recorded in store closure costs.

Refranchising gains (losses) includes the gains or losses from the sales of our restaurants to new and existing franchisees and the related initial franchise fees, reduced by transaction costs. In executing our refranchising initiatives, we most often offer groups of restaurants. We classify restaurants as held for sale and suspend depreciation and amortization when (a) we make a decision to refranchise; (b) the stores can be immediately removed from operations; (c) we have begun an active program to locate a buyer; (d) significant changes to the plan of sale are not likely; and (e) the sale is probable within one year. We recognize estimated losses on refranchisings when the restaurants are classified as held for sale. We also recognize as refranchising losses impairment associated with stores we have offered to refranchise for a price less than their carrying value, but do not believe have met the criteria to be classified as held for sale. We recognize gains on restaurant refranchisings when the sale transaction closes, the franchisee has a minimum amount of the purchase price in at-risk equity, and we are satisfied that the franchisee can meet its financial obligations. If the criteria for gain recognition are not met, we defer the gain to the extent we have a remaining financial exposure in connection with the sales transaction. Deferred gains are recognized when the gain recognition criteria are met or as our financial exposure is reduced. When we make a decision to retain a store previously held for sale, we revalue the store at the lower of its (a) net book value at our original sale decision date less normal depreciation and amortization that would have been recorded during the period held for sale or (b) its current fair market value. This value becomes the store's new cost basis. We record any difference between the store's carrying amount and its new cost basis to refranchising gains (losses). When we make a decision to close a store previously held for sale, we reverse any previously recognized refranchising loss and then record impairment and store closure costs as described above. Refranchising gains (losses) also include charges for estimated exposures related to those partial guarantees of franchisee loan pools and contingent lease liabilities which arose from refranchising activities. These exposures are more fully discussed in Note 24.

Considerable management judgment is necessary to estimate future cash flows, including cash flows from continuing use, terminal value, closure costs, sublease income and refranchising proceeds. Accordingly, actual results could vary significantly from our estimates.

Impairment of Investments in Unconsolidated Affiliates We record impairment charges related to an investment in an unconsolidated affiliate whenever events or circumstances indicate that a decrease in the value of an investment has occurred which is other than temporary. In addition, we evaluate our investments in unconsolidated affiliates for impairment when they have experienced two consecutive years of operating losses. Our impairment measurement test for an investment in an unconsolidated affiliate is similar to that for our restaurants except that we use discounted cash flows after interest and taxes instead of discounted cash flows before interest and taxes as used for our restaurants.

Considerable management judgment is necessary to estimate future cash flows. Accordingly, actual results could vary significantly from our estimates.

Asset Retirement Obligations Effective December 29, 2002, the Company adopted SFAS No. 143, "Accounting for Asset Retirement Obligations" ("SFAS 143"). SFAS 143 addresses the financial accounting and reporting for legal obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. As a result of obligations under certain leases that are within the scope of SFAS 143, the Company recorded a cumulative effect adjustment of $2 million ($1 million after tax) which did not have a material effect on diluted earnings per common share. The adoption of SFAS 143 also did not have a material impact on our Consolidated Financial Statements for the years ended December 25, 2004 or December 27, 2003. If SFAS 143 had been adopted as of the beginning of 2002, the cumulative effect adjustment would not have been materially different from that recorded on December 29, 2002.

Guarantees The Company has adopted FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others, an interpretation of FASB Statements No. 5, 57 and 107 and a rescission of FASB Interpretation No. 34" ("FIN 45"). FIN 45 elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees issued. FIN 45 also clarifies that a guarantor is required to recognize, at inception of a guarantee, a liability for the fair value of certain obligations undertaken. The initial recognition and measurement provisions were applicable to certain guarantees issued or modified after December 31, 2002. While the nature of our business results in the issuance of certain guarantees from time to time, the adoption of FIN 45 did not have a material impact on our Consolidated Financial Statements for the years ended December 25, 2004 or December 27, 2003.

We have also issued guarantees as a result of assigning our interest in obligations under operating leases as a condition to the refranchising of certain Company restaurants. Such guarantees are subject to the requirements of SFAS No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections" ("SFAS 145"). We recognize a liability for the fair value of such lease guarantees under SFAS 145 at their inception, with the related expense being included in refranchising gains (losses).

Cash and Cash Equivalents Cash equivalents represent funds we have temporarily invested (with original maturities not exceeding three months) as part of managing our day-to-day operating cash receipts and disbursements.

Inventories We value our inventories at the lower of cost (computed on the first-in, first-out method) or net realizable value.

Property, Plant and Equipment We state property, plant and equipment at cost less accumulated depreciation and amortization, impairment writedowns and valuation allowances. We calculate depreciation and amortization on a straight-line basis over the estimated useful lives of the assets as follows: 5 to 25 years for buildings and improvements, 3 to 20 years for machinery and equipment and 3 to 7 years for capitalized software costs. As discussed above, we suspend depreciation and amortization on assets related to restaurants that are held for sale.

Leases and Leasehold Improvements We account for our leases in accordance with SFAS No. 13, "Accounting for Leases" ("SFAS 13"), and other related authoritative guidance. When determining the lease term, we often include option periods for which failure to renew the lease imposes a penalty on the Company in such an amount that a renewal appears, at the inception of the lease, to be reasonably assured. The primary penalty to which we are subject is the economic detriment associated with the existence of leasehold improvements which might be impaired if we choose not to continue the use of the leased property.

In 2004, we recorded an adjustment, similar to that recorded by many other companies within our industry, such that all of our leasehold improvements are now being depreciated over the shorter of their useful lives or the underlying lease term. The cumulative adjustment necessary, primarily through increased U.S. depreciation expense, totaled $11.5 million ($7 million after tax). The portion of this adjustment that related to the current year was approximately $3 million. As the portion of the adjustment recorded that was a correction of errors in our prior period financial statements was not material to any of those prior period financial statements, we recorded the entire adjustment in our 2004 Consolidated Financial Statements as increased occupancy and other operating expenses.

We record rent expense for leases that contain scheduled rent increases on a straight-line basis over the lease term, including any option periods considered in the determination of that lease term. Contingent rentals are generally based on sales levels in excess of stipulated amounts, and thus are not considered minimum lease payments and are included in rent expense as they accrue. We capitalize rent associated with land that we are leasing while we are constructing a restaurant. Such capitalized rent is then expensed on a straight-line basis over the remaining term of the lease upon opening of the restaurant. We generally do not receive rent holidays, rent concessions or leasehold improvement incentives upon opening a store that is subject to a lease.

Internal Development Costs and Abandoned Site Costs We capitalize direct costs associated with the site acquisition and construction of a Company unit on that site, including direct internal payroll and payroll-related costs. Only those site-specific costs incurred subsequent to the time that the site acquisition is considered probable are capitalized. If we subsequently make a determination that a site for which internal development costs have been capitalized will not be acquired or developed, any previously capitalized internal development costs are expensed and included in G&A expenses.

Goodwill and Intangible Assets The Company accounts for acquisitions of restaurants from franchisees and other acquisitions of business that may occur from time to time in accordance with SFAS No. 141, "Business Combinations" ("SFAS 141"). Goodwill in such acquisitions represents the excess of the cost of a business acquired over the net of the amounts assigned to assets acquired, including identifiable intangible assets, and liabilities assumed. SFAS 141 specifies criteria to be used in determining whether intangible assets acquired in a business combination must be recognized and reported separately from goodwill. We base amounts assigned to goodwill and other identifiable intangible assets on independent appraisals or internal estimates.

The Company accounts for recorded goodwill and other intangible assets in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"). In accordance with SFAS 142, we do not amortize goodwill and indefinite-lived intangible assets. We evaluate the remaining useful life of an intangible asset that is not being amortized each reporting period to determine whether events and circumstances continue to support an indefinite useful life. If an intangible asset that is not being amortized is subsequently determined to have a finite useful life, we amortize the intangible asset prospectively over its estimated remaining useful life. Amortizable intangible assets are amortized on a straight-line basis over 3 to 40 years. As discussed above, we suspend amortization on those intangible assets with a defined life that are allocated to restaurants that are held for sale.

In accordance with the requirements of SFAS 142, goodwill has been assigned to reporting units for purposes of impairment testing. Our reporting units are our operating segments in the U.S. (see Note 23) and our business management units internationally (typically individual countries). Goodwill impairment tests consist of a comparison of each reporting unit's fair value with its carrying value. The fair value of a reporting unit is an estimate of the amount for which the unit as a whole could be sold in a current transaction between willing parties. We generally estimate fair value based on discounted cash flows. If the carrying value of a reporting unit exceeds its fair value, goodwill is written down to its implied fair value. We have selected the beginning of our fourth quarter as the date on which to perform our ongoing annual impairment test for goodwill. For 2004 and 2003, there was no impairment of goodwill identified during our annual impairment testing. For 2002, goodwill assigned to the Pizza Hut France reporting unit was deemed impaired and written off. The charge of $5 million was recorded in facility actions.

For indefinite-lived intangible assets, our impairment test consists of a comparison of the fair value of an intangible asset with its carrying amount. Fair value is an estimate of the price a willing buyer would pay for the intangible asset and is generally estimated by discounting the expected future cash flows associated with the intangible asset. We also perform our annual test for impairment of our indefinite-lived intangible assets at the beginning of our fourth quarter. Our indefinite-lived intangible assets consist of values assigned to certain trademarks/brands we have acquired. When determining the fair value, we limit assumptions about important factors such as sales growth to those that are supportable based on our plans for the trademark/brand. As discussed in Note 12, we recorded a $5 million charge in 2003 as a result of the impairment of an indefinite-lived intangible asset. This charge was recorded in facility actions. No impairment of indefinite-lived intangibles was recorded in 2004 or 2002.

Stock-Based Employee Compensation At December 25, 2004, the Company had four stock-based employee compensation plans in effect, which are described more fully in Note 18. The Company accounts for those plans under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"), and related Interpretations. No stock-based employee compensation cost is reflected in net income for options granted under these plans, as all such options had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"), to stock-based employee compensation.

	2004	2003	2002
Net Income, as reported	**$ 740**	$ 617	$ 583
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	**(34)**	(36)	(39)
Net income, pro forma	**706**	581	544
Basic Earnings per Common Share			
As reported	**$ 2.54**	$ 2.10	$ 1.97
Pro forma	**2.42**	1.98	1.84
Diluted Earnings per Common Share			
As reported	**$ 2.42**	$ 2.02	$ 1.88
Pro forma	**2.31**	1.91	1.76

Derivative Financial Instruments We do not use derivative instruments for trading purposes and we have procedures in place to monitor and control their use. Our use of derivative instruments has included interest rate swaps and collars, treasury locks and foreign currency forward contracts. In addition, on a limited basis we utilize commodity futures and options contracts. Our interest rate and foreign currency derivative contracts are entered into with financial institutions while our commodity derivative contracts are exchange traded.

We account for these derivative financial instruments in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133") as amended by SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" ("SFAS 149"). SFAS 133 requires that all derivative instruments be recorded on the Consolidated Balance Sheet at fair value. The accounting for changes in the fair value (i.e., gains or losses) of a derivative instrument is dependent upon whether the derivative has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. For derivative instruments that are designated and qualify as a fair value hedge, the gain or loss on the derivative instrument as well as the offsetting gain or loss on the hedged item attributable to the hedged risk are recognized in the results of operations. For derivative instruments that are designated and qualify as a cash flow hedge, the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income (loss) and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Any ineffective portion of the gain or loss on the derivative instrument is recorded in the results of operations immediately. For derivative instruments not designated as hedging instruments, the gain or loss is recognized in the results of operations immediately. See Note 16 for a discussion of our use of derivative instruments, management of credit risk inherent in derivative instruments and fair value information.

New Accounting Pronouncements Not Yet Adopted In October 2004, the FASB ratified the consensus reached by the Emerging Issues Task Force ("EITF") on Issue 04-1 "Accounting for Preexisting Relationships between the Parties to a Business Combination" ("EITF 04-1"). EITF 04-1 requires that a business combination between two parties that have a preexisting relationship be evaluated to determine if a settlement of a preexisting relationship exists. EITF 04-1 also requires that certain reacquired rights (including the rights to the acquirer's trade name under a franchise agreement) be recognized as intangible assets apart from goodwill. However, if a contract giving rise to the reacquired rights includes terms that are favorable or unfavorable when compared to pricing for current market transactions for the same or similar items, EITF 04-1 requires that a settlement gain or loss should be measured as the lesser of a) the amount by which the contract is favorable or unfavorable to market terms from the perspective of the acquirer or b) the stated settlement provisions of the contract available to the counterparty to which the contract is unfavorable.

EITF 04-1 is effective prospectively for business combinations consummated in reporting periods beginning after October 13, 2004 (the fiscal year beginning December 26, 2004 for the Company). When effective, EITF 04-01 will apply to acquisitions of restaurants we may make from our franchisees or licensees. We currently attempt to have our franchisees or licensees enter into standard franchise or license agreements for the applicable Concept and/or market when renewing or entering into a new agreement. However, in certain instances franchisees or licensees have existing agreements that possess terms, including royalty rates, that differ from our current standard agreements for the applicable Concept and/or market. If in the future we were to acquire a franchisee or licensee with such an existing agreement, we would be required to record a settlement gain or loss at the date of acquisition. The amount and timing of any such gains or losses we might record is dependent upon which franchisees or licensees we might acquire and when they are acquired. Accordingly, any impact cannot be currently determined.

In December 2004, the FASB issued SFAS No. 123 (Revised 2004), "Share-Based Payment" ("SFAS 123R"), which replaces SFAS 123, supersedes APB 25 and related interpretations and amends SFAS No. 95, "Statement of Cash Flows." The provisions of SFAS 123R are similar to those of SFAS 123, however, SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements as compensation cost based on their fair value on the date of grant. Fair value of share-based awards will be determined using option-pricing models (e.g. Black-Scholes or binomial models) and assumptions that appropriately reflect the specific circumstances of the awards. Compensation cost will be recognized over the vesting period based on the fair value of awards that actually vest.

We will be required to choose between the modified-prospective and modified-retrospective transition alternatives in adopting SFAS 123R. Under the modified-prospective-transition method, compensation cost will be recognized in financial statements issued subsequent to the date of adoption for all shared-based payments granted, modified or settled after the date of adoption, as well as for any unvested awards that were granted prior to the date of adoption. As we previously adopted only the pro forma disclosure provisions of SFAS 123, we will recognize compensation cost relating to the unvested portion of awards granted prior to the date of adoption using the same estimate of the grant-date fair value and the same attribution method used to determine the pro forma disclosures under SFAS 123. Under the modified-retrospective-transition method compensation cost will be recognized in a manner consistent with the modified-prospective-transition method, however, prior period financial statements will also be restated by recognizing compensation cost as previously reported in the pro forma disclosures under SFAS 123. The restatement provisions can be applied to either a) all periods presented or b) to the beginning of the fiscal year in which SFAS 123R is adopted.

SFAS 123R is effective at the beginning of the first interim or annual period beginning after June 15, 2005 (the quarter ending December 31, 2005 for the Company) and early adoption is encouraged. The Company is in the process of evaluating the use of certain option-pricing models as well as the assumptions to be used in such models. When such evaluation is complete, we will determine the transition method to use and the timing of adoption. We do not currently anticipate that the impact on net income on a full year basis of the adoption of SFAS 123R will be significantly different from the historical pro forma impacts as disclosed in accordance with SFAS 123.

TWO-FOR-ONE COMMON STOCK SPLIT

NOTE 3

On May 7, 2002, the Company announced that its Board of Directors approved a two-for-one split of the Company's outstanding shares of Common Stock. The stock split was effected in the form of a stock dividend and entitled each shareholder of record at the close of business on June 6, 2002 to receive one additional share for every outstanding share of Common Stock held on the record date. The stock dividend was distributed on June 17, 2002, with approximately 149 million shares of common stock distributed. All per share and share amounts in the accompanying Consolidated Financial Statements and Notes to the Financial Statements have been adjusted to reflect the stock split.

YGR ACQUISITION

NOTE 4

On May 7, 2002, YUM completed the acquisition of YGR. The results of operations for YGR have been included in our Consolidated Financial Statements since that date. If the acquisition had been completed as of the beginning of the year ended December 28, 2002, pro forma Company sales and franchise and license fees would have been as follows:

	2002
Company sales	$ 7,139
Franchise and license fees	877

The impact of the acquisition, including interest expense on debt incurred to finance the acquisition, on net income and diluted earnings per share would not have been significant in 2002. The pro forma information is not necessarily indicative of the results of operations had the acquisition actually occurred at the beginning of this period.

As of the date of acquisition, we recorded approximately $49 million of reserves ("exit liabilities") related to our plans to consolidate certain support functions, and exit certain markets through store refranchisings and closures. The consolidation of certain support functions included the termination of approximately 100 employees. The remaining exit liabilities, which totaled approximately $17 million and $27 million at December 25, 2004 and December 27, 2003, respectively, consist of reserves related to the lease of the former YGR headquarters and certain reserves associated with store refranchising and closures. With the exception of these remaining exit liabilities, the vast majority of the other reserves established at the date of acquisition have been extinguished through cash payments.

ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

NOTE 5

Accumulated other comprehensive income (loss) includes:

	2004	2003
Foreign currency translation adjustment	**$ (34)**	$ (107)
Minimum pension liability adjustment, net of tax	**(95)**	(101)
Unrealized losses on derivative instruments, net of tax	**(2)**	(2)
Total accumulated other comprehensive loss	**$(131)**	$ (210)

EARNINGS PER COMMON SHARE ("EPS")

NOTE 6

	2004	2003	2002
Net income	**$ 740**	$ 617	$ 583
Basic EPS:			
Weighted-average common shares outstanding	**291**	293	296
Basic EPS	**$ 2.54**	$ 2.10	$ 1.97
Diluted EPS:			
Weighted-average common shares outstanding	**291**	293	296
Shares assumed issued on exercise of dilutive share equivalents	**47**	52	56
Shares assumed purchased with proceeds of dilutive share equivalents	**(33)**	(39)	(42)
Shares applicable to diluted earnings	**305**	306	310
Diluted EPS	**$ 2.42**	$ 2.02	$ 1.88

Unexercised employee stock options to purchase approximately 0.4 million, 4 million and 1.4 million shares of our Common Stock for the years ended December 25, 2004, December 27, 2003 and December 28, 2002, respectively, were not included in the computation of diluted EPS because their exercise prices were greater than the average market price of our Common Stock during the year.

ITEMS AFFECTING COMPARABILITY OF NET INCOME

NOTE 7

Facility Actions Facility actions consists of the following components:

- Refranchising net (gains) losses;
- Store closure costs;
- Impairment of long-lived assets for stores we intend to close and stores we intend to continue to use in the business;
- Impairment of goodwill and indefinite-lived intangible assets.

	2004	2003	2002
U.S.			
Refranchising net (gains) losses[(a)(b)]	**$ (14)**	$ (20)	$ (4)
Store closure costs[(c)]	**(3)**	1	8
Store impairment charges	**17**	10	15
SFAS 142 impairment charges[(d)]	**—**	5	—
Facility actions	**—**	(4)	19
International			
Refranchising net (gains) losses[(a)(d)]	**2**	16	(15)
Store closure costs	**—**	5	7
Store impairment charges	**24**	19	16
SFAS 142 impairment charges[(e)]	**—**	—	5
Facility actions	**26**	40	13
Worldwide			
Refranchising net (gains) losses[(a)(b)(d)]	**(12)**	(4)	(19)
Store closure costs[(c)]	**(3)**	6	15
Store impairment charges	**41**	29	31
SFAS 142 impairment charges[(e)]	**—**	5	5
Facility actions	**$ 26**	$ 36	$ 32

(a) Includes initial franchise fees in the U.S. of $2 million in 2004, $3 million in 2003 and $1 million in 2002 and in International of $8 million in 2004, $2 million in 2003 and $5 million in 2002. See Note 9.
(b) U.S. includes a $7 million write down in 2004 on restaurants we currently own but have offered to sell at amounts lower than their carrying amounts.
(c) Income in store closure costs results primarily from gains from the sale of properties on which we formerly operated restaurants.
(d) International includes write downs of $6 million and $16 million for the years ended December 25, 2004 and December 27, 2003, respectively, related to our Puerto Rico business, which was sold on October 4, 2004.
(e) In 2003, we recorded a $5 million charge in the U.S. related to the impairment of the A&W trademark/brand (see further discussion at Note 12). In 2002, we recorded a $5 million charge in International related to the impairment of the goodwill of the Pizza Hut France reporting unit.

The following table summarizes the 2004 and 2003 activity related to reserves for remaining lease obligations for stores closed or stores we intend to close.

	Beginning Balance	Amounts Used	New Decisions	Estimate/ Decision Changes	Other [(a)]	Ending Balance
2003 Activity	$41	(13)	6	2	4	$40
2004 Activity	**$40**	**(17)**	**8**	**(1)**	**13**	**$43**

(a) Primarily reserves established upon acquisitions of franchisee restaurants.

The following table summarizes the carrying values of the major classes of assets held for sale at December 25, 2004 and December 27, 2003. U.S. amounts primarily represent land on which we previously operated restaurants and are net of impairment charges of $2 million at both December 25, 2004 and December 27, 2003. International amounts in 2003 relate primarily to our Puerto Rico business. The Puerto Rico business was sold on October 4, 2004 for an amount approximating its then carrying value.

	2004		
	U.S.	**International**	**Worldwide**
Property, plant and equipment, net	**$ 7**	**$ —**	**$ 7**
Goodwill	**—**	**—**	**—**
Other assets	**—**	**—**	**—**
Assets classified as held for sale	**$ 7**	**$ —**	**$ 7**

	2003		
	U.S.	International	Worldwide
Property, plant and equipment, net	$ 9	$ 73	$ 82
Goodwill	—	12	12
Other assets	—	2	2
Assets classified as held for sale	$ 9	$ 87	$ 96

Wrench Litigation Income of $14 million was recorded for 2004 reflecting settlements associated with the Wrench litigation for amounts less than previously accrued as well as related insurance recoveries. Expense of $42 million was recorded as Wrench litigation for 2003 reflecting the amounts awarded to the plaintiff and interest thereon. See Note 24 for a discussion of Wrench litigation.

AmeriServe and Other Charges (Credits) AmeriServe Food Distribution Inc. ("AmeriServe") was the primary distributor of food and paper supplies to our U.S. stores when it filed for protection under Chapter 11 of the U.S. Bankruptcy Code on January 31, 2000. A plan of reorganization for AmeriServe (the "POR") was approved on November 28, 2000, which resulted in, among other things, the assumption of our distribution agreement, subject to certain amendments, by McLane Company, Inc. During the AmeriServe bankruptcy reorganization process, we took a number of actions to ensure continued supply to our system. Those actions resulted in significant expense for the Company, primarily recorded in 2000. Under the POR, we are entitled to proceeds from certain residual assets, preference claims and other legal recoveries of the estate.

We classify expenses and recoveries related to AmeriServe, as well as integration costs related to our acquisition of YGR, costs to defend certain wage and hour litigation and certain other items, as AmeriServe and other charges (credits). These amounts were classified as unusual items in 2002.

Income of $16 million and $26 million was recorded as AmeriServe and other charges (credits) for 2004 and 2003, respectively. These amounts primarily resulted from cash recoveries related to the AmeriServe bankruptcy reorganization process. Income of $27 million was recorded as AmeriServe and other charges (credits) for 2002, primarily resulting from recoveries related to the AmeriServe bankruptcy reorganization process, partially offset by integration costs related to our acquisition of YGR and costs to defend certain wage and hour litigation.

NOTE 8

SUPPLEMENTAL CASH FLOW DATA

	2004	2003	2002
Cash Paid for:			
Interest	**$ 146**	$ 178	$ 153
Income taxes	**276**	196	200
Significant Non-Cash Investing and Financing Activities:			
Assumption of debt and capital leases related to the acquisition of YGR	**$ —**	$ —	$ 227
Assumption of capital leases related to the acquisition of restaurants from franchisees	**8**	—	—
Capital lease obligations incurred to acquire assets	**13**	9	23
Debt reduction due to amendment of sale-leaseback agreements (see Note 14)	**—**	88	—

On November 10, 2003, our unconsolidated affiliate in Canada was dissolved. Upon dissolution, the Company assumed operation of certain units that were previously operated by the unconsolidated affiliate. The Company also assumed ownership of the assets related to the units that it now operates, as well as the real estate associated with certain units previously owned and operated by the unconsolidated affiliate that are now operated by franchisees (either our former partner in the unconsolidated affiliate or a publicly-held Income Trust in Canada). The acquired real estate associated with the units that are not operated by the Company is being leased to the franchisees. The resulting reduction in our investments in unconsolidated affiliates ($56 million at November 10, 2003) was primarily offset by increases in property, plant and equipment, net and capital lease receivables (included in other assets). The Company realized an insignificant gain upon the dissolution of the unconsolidated affiliate. This gain was realized as the fair value of our increased ownership in the assets received was greater than our carrying value in those assets, and was net of expenses associated with the dissolution.

NOTE 9 FRANCHISE AND LICENSE FEES

	2004	2003	2002
Initial fees, including renewal fees	$ 43	$ 36	$ 33
Initial franchise fees included in refranchising gains	(10)	(5)	(6)
	33	31	27
Continuing fees	986	908	839
	$ 1,019	$ 939	$ 866

NOTE 10 OTHER (INCOME) EXPENSE

	2004	2003	2002
Equity income from investments in unconsolidated affiliates	$ (54)	$ (39)	$ (29)
Foreign exchange net (gain) loss	(1)	(2)	(1)
	$ (55)	$ (41)	$ (30)

NOTE 11 PROPERTY, PLANT AND EQUIPMENT, NET

	2004	2003
Land	$ 617	$ 662
Buildings and improvements	2,957	2,861
Capital leases, primarily buildings	146	119
Machinery and equipment	2,337	1,964
	6,057	5,606
Accumulated depreciation and amortization	(2,618)	(2,326)
	$ 3,439	$ 3,280

Depreciation and amortization expense related to property, plant and equipment was $434 million, $388 million and $357 million in 2004, 2003 and 2002, respectively.

NOTE 12 GOODWILL AND INTANGIBLE ASSETS

The changes in the carrying amount of goodwill are as follows:

	U.S.	International	Worldwide
Balance as of December 28, 2002	$ 372	$ 113	$ 485
Acquisitions	21	15	36
Disposals and other, net[(a)]	(7)	7	—
Balance as of December 27, 2003	$ 386	$ 135	$ 521
Acquisitions	19	14	33
Disposals and other, net[(a)]	(10)	9	(1)
Balance as of December 25, 2004	**$ 395**	**$ 158**	**$ 553**

(a) Disposals and other, net for International primarily reflects the impact of foreign currency translation on existing balances.

Intangible assets, net for the years ended 2004 and 2003 are as follows:

	2004		2003	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Amortized intangible assets				
Franchise contract rights	$ 146	$ (55)	$ 141	$ (49)
Trademarks/brands	67	(3)	67	(1)
Favorable operating leases	22	(16)	27	(18)
Pension-related intangible	11	—	14	—
Other	5	(1)	5	—
	$ 251	$ (75)	$ 254	$ (68)
Unamortized intangible assets				
Trademarks/brands	$ 171		$ 171	

The most significant recorded trademark/brand assets resulted when we acquired YGR in 2002. At the date of acquisition, we assigned value to both the LJS and A&W trademark/brand assets and determined both had indefinite lives. The fair value of a trademark/brand is determined based upon the value derived from the royalty we avoid, in the case of Company stores, or receive, in the case of franchise and licensee stores, for the use of the trademark/brand. This fair value determination is thus largely dependent upon our estimation of sales attributable to the trademark/brand.

The fair value of the LJS trademark/brand was determined to be in excess of its carrying value during our 2004 and 2003 annual impairment tests. The estimates of sales attributable to the LJS trademark/brand at the dates of these tests reflect the opportunities we believe exist with regard to increased penetration of LJS, for both stand-alone units and as a multibrand partner.

As a result of the decision in 2003 to focus short-term development largely on increased penetration of LJS and our discretionary capital spending limits, less development of A&W was assumed in the near term than forecasted at the date of acquisition. Additionally, while we continued to view A&W as a viable multibrand partner, subsequent to acquisition we decided to close or refranchise substantially all Company-owned A&W restaurants that we had acquired. These restaurants were low-volume, mall-based units that were inconsistent with the remainder of our Company-owned portfolio. Both the decision to close these Company-owned A&W units and the decision to focus on short-term development opportunities at LJS negatively impacted the fair value of the A&W trademark/brand. Accordingly, we recorded a $5 million charge in 2003 to facility actions to write the value of the A&W trademark/brand down to its fair value.

Historically, we have considered the assets acquired representing trademark/brand to have indefinite useful lives due to our expected use of the asset and the lack of legal, regulatory, contractual, competitive, economic or other factors that may limit their useful lives. As required by SFAS 142, we reconsider the remaining useful life of indefinite-life intangible assets each reporting period. Subsequent to the recording of the impairment of the A&W trademark/brand in 2003, we began amortizing its remaining balance over a period of thirty years. While we continue to incorporate development of the A&W trademark/brand into our multibranding plans, our decision to no longer operate the acquired stand-alone Company-owned A&W restaurants is considered a factor that limits its useful life. Accordingly, we are amortizing the remaining balance of the A&W trademark/brand over a period of thirty years, the typical term of our multibrand franchise agreements including renewals. We continue to believe that all of our other recorded trademark/brand assets, including the LJS trademark/brand, have indefinite lives.

Amortization expense for definite-lived intangible assets was $8 million in 2004, $7 million in 2003 and $6 million in 2002. Amortization expense for definite-lived intangible assets will approximate $8 million in 2005 and 2006 and $7 million in 2007 through 2009.

ACCOUNTS PAYABLE AND OTHER CURRENT LIABILITIES

NOTE 13

	2004	2003
Accounts payable	**$ 414**	$ 393
Accrued compensation and benefits	**263**	257
Other current liabilities	**483**	507
	$ 1,160	$ 1,157

SHORT-TERM BORROWINGS AND LONG-TERM DEBT

NOTE 14

	2004	2003
Short-term Borrowings		
Current maturities of long-term debt	**$ 11**	$ 10
Long-term Debt		
Senior, Unsecured Revolving Credit Facility, expires September 2009	**19**	—
Senior, Unsecured Notes, due May 2005	**—**	351
Senior, Unsecured Notes, due April 2006	**200**	200
Senior, Unsecured Notes, due May 2008	**251**	251
Senior, Unsecured Notes, due April 2011	**646**	645
Senior, Unsecured Notes, due July 2012	**398**	398
Capital lease obligations (See Note 15)	**128**	112
Other, due through 2019 (6% - 12%)	**79**	80
	1,721	2,037
Less current maturities of long-term debt	**(11)**	(10)
Long-term debt excluding SFAS 133 adjustment	**1,710**	2,027
Derivative instrument adjustment under SFAS 133 (See Note 16)	**21**	29
Long-term debt including SFAS 133 adjustment	**$ 1,731**	$ 2,056

On September 7, 2004, we executed an amended and restated five-year senior unsecured Revolving Credit Facility totaling $1.0 billion which matures on September 7, 2009 (the "Credit Facility"). The Credit Facility serves as our primary bank credit agreement and replaced the $1.0 billion Senior Unsecured Revolving Credit Facility that was scheduled to mature on June 25, 2005 (the "Old Credit Facility"). The Credit Facility is unconditionally guaranteed by our principal domestic subsidiaries and contains financial covenants relating to maintenance of leverage and fixed charge coverage ratios. The Credit Facility also contains affirmative and negative covenants including, among other things, limitations on certain additional indebtedness, guarantees of indebtedness, level of cash dividends, aggregate non-U.S. investment and certain other transactions as defined in the agreement. These covenants are substantially similar to those contained in the Old Credit Facility. We were in compliance with all debt covenants at December 25, 2004.

Under the terms of the Credit Facility, we may borrow up to the maximum borrowing limit less outstanding letters of credit. At December 25, 2004, our unused Credit Facility totaled $776 million, net of outstanding letters of credit of $205 million. There were borrowings of $19 million outstanding under the Credit Facility at the end of 2004. The interest rate for borrowings under the Credit Facility ranges from 0.35% to 1.625% over the London Interbank Offered Rate ("LIBOR") or 0.00% to 0.20% over an Alternate Base Rate, which is the greater of the Prime Rate or the Federal Funds Effective Rate plus 0.50%. The exact spread over LIBOR or the Alternate Base Rate, as applicable, will depend upon our performance under specified financial criteria. Interest on any outstanding borrowings under the Credit Facility is payable at least quarterly. In 2004, 2003 and 2002, we expensed facility fees of approximately $4 million, $6 million and $5 million, respectively. At December 25, 2004, the weighted average contractual interest rate on borrowings outstanding under the Credit Facility was 2.72%.

On November 15, 2004, we voluntarily redeemed all of our 7.45% Senior Unsecured Notes that were due in May 2005 (the "2005 Notes") in accordance with their original terms. The 2005 Notes, which had a total face value of $350 million, were redeemed for approximately $358 million using primarily cash on hand as well as some borrowings under our Credit Facility. The redemption amount approximated the carrying value of the 2005 Notes, including a derivative instrument adjustment under SFAS 133, resulting in no significant impact on net income upon redemption.

In 1997, we filed a shelf registration statement with the Securities and Exchange Commission for offerings of up to $2 billion of senior unsecured debt. The following table summarizes all Senior Unsecured Notes issued under this shelf registration that remain outstanding at December 25, 2004:

Issuance Date	Maturity Date	Principal Amount	Interest Rate Stated	Interest Rate Effective [(d)]
May 1998	May 2008 [(a)]	250	7.65%	7.81%
April 2001	April 2006 [(b)]	200	8.50%	9.04%
April 2001	April 2011 [(b)]	650	8.88%	9.20%
June 2002	July 2012 [(c)]	400	7.70%	8.04%

(a) Interest payments commenced on November 15, 1998 and are payable semi-annually thereafter.
(b) Interest payments commenced on October 15, 2001 and are payable semi-annually thereafter.
(c) Interest payments commenced on January 1, 2003 and are payable semi-annually thereafter.
(d) Includes the effects of the amortization of any (1) premium or discount; (2) debt issuance costs; and (3) gain or loss upon settlement of related treasury locks. Excludes the effect of any interest rate swaps as described in Note 16.

We have $150 million remaining for issuance under the $2 billion shelf registration.

In connection with our acquisition of YGR in 2002, we assumed approximately $168 million in present value of future rent obligations related to three existing sale-leaseback agreements entered into by YGR involving approximately 350 LJS units. As a result of liens held by the buyer/lessor on certain personal property within the units, the sale-leaseback agreements were accounted for as financings upon acquisition. On August 15, 2003, we amended two of these sale-leaseback agreements to remove the liens on the personal property within the units. As the two amended agreements qualify for sale-leaseback accounting, they are accounted for as operating leases. Accordingly, the future rent obligations associated with the two amended agreements, previously recorded as long-term debt of $88 million, were no longer reflected on our Consolidated Balance Sheets at December 25, 2004 or December 27, 2003. There was no gain or loss recorded as a result of this transaction.

The annual maturities of long-term debt as of December 25, 2004, excluding capital lease obligations of $128 million and derivative instrument adjustments of $21 million, are as follows:

Year ended:	
2005	$ 1
2006	202
2007	2
2008	253
2009	22
Thereafter	1,118
Total	$ 1,598

Interest expense on short-term borrowings and long-term debt was $145 million, $185 million and $180 million in 2004, 2003 and 2002, respectively.

NOTE 15 LEASES

At December 25, 2004 we operated over 7,700 restaurants, leasing the underlying land and/or building in over 5,500 of those restaurants with our commitments expiring at various dates through 2087. We also lease office space for headquarters and support functions, as well as certain office and restaurant equipment. We do not consider any of these individual leases material to our operations. Most leases require us to pay related executory costs, which include property taxes, maintenance and insurance.

Future minimum commitments and amounts to be received as lessor or sublessor under non-cancelable leases are set forth below:

	Commitments		Lease Receivables	
	Capital	Operating	Direct Financing	Operating
2005	$ 18	$ 342	$ 7	$ 21
2006	17	298	7	18
2007	15	266	6	15
2008	14	234	7	12
2009	14	208	7	11
Thereafter	106	1,163	67	80
	$ 184	$ 2,511	$ 101	$ 157

At December 25, 2004 and December 27, 2003, the present value of minimum payments under capital leases was $128 million and $112 million, respectively. At December 25, 2004 and December 27, 2003, unearned income associated with direct financing lease receivables was $48 million and $41 million, respectively.

The details of rental expense and income are set forth below:

	2004	2003	2002
Rental expense			
Minimum	**$ 376**	$ 329	$ 303
Contingent	**49**	44	40
	$ 425	$ 373	$ 343
Minimum rental income	**$ 13**	$ 14	$ 11

NOTE 16 FINANCIAL INSTRUMENTS

Interest Rate Derivative Instruments We enter into interest rate swaps with the objective of reducing our exposure to interest rate risk and lowering interest expense for a portion of our debt. Under the contracts, we agree with other parties to exchange, at specified intervals, the difference between variable rate and fixed rate amounts calculated on a notional principal amount. At December 25, 2004, interest rate derivative instruments outstanding included pay-variable interest rate swaps with notional amounts of $850 million. These swaps have reset dates and floating rate indices which match those of our underlying fixed-rate debt and have been designated as fair value hedges of a portion of that debt. As the swaps qualify for the short-cut method under SFAS 133, no ineffectiveness has been recorded. The net fair value of these swaps as of December 25, 2004 was approximately $29 million, of which $30 million and $1 million have been included in other assets and other liabilities and deferred credits, respectively. The portion of this fair value which has not yet been recognized as a reduction to interest expense at December 25, 2004 (approximately $21 million) has been included in long-term debt.

Due to early redemption of the underlying 7.45% Senior Unsecured Notes on November 15, 2004 (see Note 14), pay-variable interest rate swaps with notional amounts of $350 million that qualified for hedge accounting at December 27, 2003, no longer qualify for hedge accounting at December 25, 2004. As we elected to hold these swaps until their May 2005 maturity, we entered into new pay-fixed interest rate swaps with offsetting notional amounts and terms. Gains or losses due to changes in the fair value of the pay-variable swaps will be recognized in the results of operations through May 2005 but these gains or losses are expected to be almost entirely offset by changes in fair value of the pay-fixed swaps. The fair value of both of these swaps were in an asset position as of December 25, 2004 with a fair value totaling approximately $9 million. This fair value has been included in prepaid expenses and other current assets. The fair value of the swaps that previously qualified for hedge accounting was $31 million at December 27, 2003, which was included in other assets. The portion of this fair value which had not been recognized as a reduction to interest expense at December 27, 2003 (approximately $29 million) was included in long-term debt.

Foreign Exchange Derivative Instruments We enter into foreign currency forward contracts with the objective of reducing our exposure to cash flow volatility arising from foreign currency fluctuations associated with certain foreign currency denominated financial instruments, the majority of which are intercompany short-term receivables and payables. The notional amount, maturity date, and currency of these contracts match those of the underlying receivables or payables. For those foreign currency exchange forward contracts that we have designated as cash flow hedges, we measure ineffectiveness by comparing the cumulative change in the forward contract with the cumulative change in the hedged item. No ineffectiveness was recognized in 2004, 2003 or 2002 for those foreign currency forward contracts designated as cash flow hedges.

Equity Derivative Instruments On December 3, 2004, we entered into an accelerated share repurchase program (the "Program"). In connection with the Program, a third-party investment bank borrowed approximately 5.4 million shares of our common stock from shareholders. We then repurchased those shares at their then market value ($46.58) from the investment bank for approximately $250 million. The repurchase of the 5.4 million shares was made pursuant to a $300 million share repurchase program authorized by our Board of Directors in May 2004.

Simultaneously, we entered into a forward contract with the investment bank that was indexed to the number of shares repurchased. Under the terms of the forward contract we will receive or be required to pay a price adjustment based on the difference between the weighted average price of our common stock over the duration of the Program and the initial purchase price of $46.58 per share. We expect the Program to be completed by the end of our first fiscal quarter in 2005. At our election, any payments we are obligated to make will either be in cash or in shares of our common stock (not to exceed 15 million shares as specified in the forward contract). Therefore, in accordance with EITF 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled In, a Company's Own Stock," any changes in the fair value of the forward contract will be recognized as an adjustment to Shareholders' Equity at the end of the Program. Through December 25, 2004, the difference between the weighted average price of our common stock and the initial purchase price was insignificant.

Commodity Derivative Instruments We also utilize, on a limited basis, commodity futures and options contracts to mitigate our exposure to commodity price fluctuations over the next twelve months. Those contracts have not been designated as hedges under SFAS 133. Commodity future and options contracts did not significantly impact the Consolidated Financial Statements in 2004, 2003 or 2002.

Deferred Amounts in Accumulated Other Comprehensive Income (Loss) As of December 25, 2004, we had a net deferred loss associated with cash flow hedges of approximately $2 million, net of tax. The loss, which primarily arose from the settlement of treasury locks entered into prior to the issuance of certain amounts of our fixed-rate debt, will be reclassified into earnings from January 1, 2005 through 2012 as an increase to interest expense on this debt.

Credit Risks Credit risk from interest rate swaps and foreign exchange contracts is dependent both on movement in interest and currency rates and the possibility of non-payment by counterparties. We mitigate credit risk by entering into these agreements with high-quality counterparties, and settle swap and forward rate payments on a net basis.

Accounts receivable consists primarily of amounts due from franchisees and licensees for initial and continuing fees. In addition, we have notes and lease receivables from certain of our franchisees. The financial condition of these franchisees and licensees is largely dependent upon the underlying business trends of our Concepts. This concentration of credit risk is mitigated, in part, by the large number of franchisees and licensees of each Concept and the short-term nature of the franchise and license fee receivables.

Fair Value At December 25, 2004 and December 27, 2003, the fair values of cash and cash equivalents, short-term investments, accounts receivable and accounts payable approximated the carrying values because of the short-term nature of these instruments. The fair value of notes receivable approximates the carrying value after consideration of recorded allowances.

The carrying amounts and fair values of our other financial instruments subject to fair value disclosures are as follows:

	2004		2003	
	Carrying Amount	**Fair Value**	Carrying Amount	Fair Value
Debt				
Short-term borrowings and long-term debt, excluding capital leases and the derivative instrument adjustments	**$ 1,593**	**$ 1,900**	$ 1,925	$ 2,181
Debt-related derivative instruments:				
Open contracts in a net asset position	**38**	**38**	31	31
Foreign currency-related derivative instruments:				
Open contracts in a net asset (liability) position	**(2)**	**(2)**	—	—
Lease guarantees	**10**	**27**	8	28
Guarantees supporting financial arrangements of certain franchisees, unconsolidated affiliates and other third parties	**7**	**8**	8	10
Letters of credit	**—**	**2**	—	3

We estimated the fair value of debt, debt-related derivative instruments, foreign currency-related derivative instruments, guarantees and letters of credit using market quotes and calculations based on market rates.

PENSION AND POSTRETIREMENT MEDICAL BENEFITS

NOTE 17

Pension Benefits We sponsor noncontributory defined benefit pension plans covering substantially all full-time U.S. salaried employees, certain U.S. hourly employees and certain international employees. The most significant of these plans, the YUM Retirement Plan (the "Plan"), is funded while benefits from the other plans are paid by the Company as incurred. During 2001, the plans covering our U.S. salaried employees were amended such that any salaried employee hired or rehired by YUM after September 30, 2001 is not eligible to participate in those plans. Benefits are based on years of service and earnings or stated amounts for each year of service.

Postretirement Medical Benefits Our postretirement plan provides health care benefits, principally to U.S. salaried retirees and their dependents. This plan includes retiree cost sharing provisions. During 2001, the plan was amended such that any salaried employee hired or rehired by YUM after September 30, 2001 is not eligible to participate in this plan. Employees hired prior to September 30, 2001 are eligible for benefits if they meet age and service requirements and qualify for retirement benefits.

We use a measurement date of September 30 for our pension and postretirement medical plans described above.

Obligation and Funded Status at September 30:

	Pension Benefits		Postretirement Medical Benefits	
	2004	2003	**2004**	2003
Change in benefit obligation				
Benefit obligation at beginning of year	**$ 629**	$ 501	**$ 81**	$ 68
Service cost	**32**	26	**2**	2
Interest cost	**39**	34	**5**	5
Plan amendments	**1**	—	**—**	—
Curtailment gain	**(2)**	(1)	**—**	—
Benefits and expenses paid	**(26)**	(21)	**(4)**	(4)
Actuarial (gain) loss	**27**	90	**(3)**	10
Benefit obligation at end of year	**$ 700**	$ 629	**$ 81**	$ 81
Change in plan assets				
Fair value of plan assets at beginning of year	**$ 438**	$ 251		
Actual return on plan assets	**53**	52		
Employer contributions	**54**	157		
Benefits paid	**(26)**	(21)		
Administrative expenses	**(1)**	(1)		
Fair value of plan assets at end of year	**$ 518**	$ 438		
Funded status	**$(182)**	$(191)	**$(81)**	$(81)
Employer contributions[(a)]	**1**	—	**—**	—
Unrecognized actuarial loss	**225**	230	**23**	28
Unrecognized prior service cost	**9**	12	**—**	—
Net amount recognized at year-end	**$ 53**	$ 51	**$(58)**	$(53)

(a) Reflects contributions made between the September 30, 2004 measurement date and December 25, 2004.

	Pension Benefits		Postretirement Medical Benefits	
	2004	2003	**2004**	2003
Amounts recognized in the statement of financial position consist of:				
Accrued benefit liability	**$(111)**	$(125)	**$(58)**	$(53)
Intangible asset	**11**	14	**—**	—
Accumulated other comprehensive loss	**153**	162	**—**	—
	$ 53	$ 51	**$(58)**	$(53)
Additional information				
Other comprehensive (income) loss attributable to change in additional minimum liability recognition	**$ (9)**	$ 48		
Additional year-end information for pension plans with accumulated benefit obligations in excess of plan assets				
Projected benefit obligation	**$ 700**	$ 629		
Accumulated benefit obligation	**629**	563		
Fair value of plan assets	**518**	438		

While we are not required to make contributions to the Plan in 2005, we may make discretionary contributions during the year based on our estimate of the Plan's expected September 30, 2005 funded status.

Components of Net Periodic Benefit Cost

	Pension Benefits		
	2004	2003	2002
Service cost	**$ 32**	$ 26	$ 22
Interest cost	**39**	34	31
Amortization of prior service cost	**3**	4	1
Expected return on plan assets	**(40)**	(30)	(28)
Recognized actuarial loss	**19**	6	1
Net periodic benefit cost	**$ 53**	$ 40	$ 27
Additional loss recognized due to:			
Curtailment	**$ —**	$ —	$ 1

	Postretirement Medical Benefits		
	2004	2003	2002
Service cost	**$ 2**	$ 2	$ 2
Interest cost	**5**	5	4
Amortization of prior service cost	**—**	—	—
Recognized actuarial loss	**1**	1	1
Net periodic benefit cost	**$ 8**	$ 8	$ 7

Prior service costs are amortized on a straight-line basis over the average remaining service period of employees expected to receive benefits. Curtailment gains and losses have been recognized in facility actions as they have resulted primarily from refranchising and closure activities.

Weighted-Average Assumptions Used to Determine Benefit Obligations at September 30:

	Pension Benefits		Postretirement Medical Benefits	
	2004	2003	**2004**	2003
Discount rate	**6.15%**	6.25%	**6.15%**	6.25%
Rate of compensation increase	**3.75%**	3.75%	**3.75%**	3.75%

Weighted-Average Assumptions Used to Determine the Net Periodic Benefit Cost for Fiscal Years:

	Pension Benefits			Postretirement Medical Benefits		
	2004	2003	2002	**2004**	2003	2002
Discount rate	**6.25%**	6.85%	7.60%	**6.25%**	6.85%	7.58%
Long-term rate of return on plan assets	**8.50%**	8.50%	10.00%	**—**	—	—
Rate of compensation increase	**3.75%**	3.85%	4.60%	**3.75%**	3.85%	4.60%

Our estimated long-term rate of return on plan assets represents the weighted average of expected future returns on the asset categories included in our target investment allocation based primarily on the historical returns for each asset category, adjusted for an assessment of current market conditions.

Assumed Health Care Cost Trend Rates at September 30:

	Postretirement Medical Benefits	
	2004	2003
Health care cost trend rate assumed for next year	**11%**	12%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	**5.5%**	5.5%
Year that the rate reaches the ultimate trend rate	**2012**	2012

There is a cap on our medical liability for certain retirees. The cap for Medicare eligible retirees was reached in 2000 and the cap for non-Medicare eligible retirees is expected to be reached between the years 2007-2008; once the cap is reached, our annual cost per retiree will not increase.

Assumed health care cost trend rates have a significant effect on the amounts reported for our postretirement health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effects:

	1-Percentage-Point Increase	1-Percentage-Point Decrease
Effect on total of service and interest cost	$ —	$ —
Effect on postretirement benefit obligation	$ 2	$ (2)

Plan Assets Our pension plan weighted-average asset allocations at September 30, by asset category are set forth below:

Asset Category	2004	2003
Equity securities	**70%**	65%
Debt securities	**28%**	30%
Cash	**2%**	5%
Total	**100%**	100%

Our primary objectives regarding the pension assets are to optimize return on assets subject to acceptable risk and to maintain liquidity, meet minimum funding requirements and minimize plan expenses. To achieve these objectives, we have adopted a passive investment strategy in which the asset performance is driven primarily by the investment allocation. Our target investment allocation is 70% equity securities and 30% debt securities, consisting primarily of low cost index mutual funds that track several sub-categories of equity and debt security performance. The investment strategy is primarily driven by our Plan's participants' ages and reflects a long-term investment horizon favoring a higher equity component in the investment allocation.

A mutual fund held as an investment by the Plan includes YUM stock in the amount of $0.2 million at both September 30, 2004 and 2003 (less than 1% of total plan assets in each instance).

Benefit Payments The benefits expected to be paid in each of the next five years and in the aggregate for the five years thereafter are set forth below:

Year ended:	Pension Benefits	Postretirement Medical Benefits
2005	$ 17	$ 5
2006	22	5
2007	25	6
2008	28	6
2009	32	6
2010–2014	242	35

Expected benefits are estimated based on the same assumptions used to measure our benefit obligation on our measurement date of September 30, 2004 and include benefits attributable to estimated further employee service.

NOTE 18

STOCK-BASED EMPLOYEE COMPENSATION

At year-end 2004, we had four stock option plans in effect: the YUM! Brands, Inc. Long-Term Incentive Plan ("1999 LTIP"), the 1997 Long-Term Incentive Plan ("1997 LTIP"), the YUM! Brands, Inc. Restaurant General Manager Stock Option Plan ("RGM Plan") and the YUM! Brands, Inc. SharePower Plan ("SharePower"). During 2003, the 1999 LTIP was amended, subsequent to shareholder approval, to increase the total number of shares available for issuance and to make certain other technical and clarifying changes.

We may grant awards of up to 29.8 million shares and 45.0 million shares of stock under the 1999 LTIP, as amended, and 1997 LTIP, respectively. Potential awards to employees and non-employee directors under the 1999 LTIP include stock options, incentive stock options, stock appreciation rights, restricted stock, stock units, restricted stock units, performance shares and performance units. Potential awards to employees and non-employee directors under the 1997 LTIP include stock appreciation rights, restricted stock and performance-restricted stock units. Prior to January 1, 2002, we also could grant stock options and incentive stock options under the 1997 LTIP. We have issued only stock options and performance-restricted stock units under the 1997 LTIP and have issued only stock options under the 1999 LTIP.

We may grant stock options under the 1999 LTIP to purchase shares at a price equal to or greater than the average market price of the stock on the date of grant. New option grants under the 1999 LTIP can have varying vesting provisions and exercise periods. Previously granted options under the 1997 LTIP and 1999 LTIP vest in periods ranging from immediate to 2008 and expire ten to fifteen years after grant.

We may grant options to purchase up to 15.0 million shares of stock under the RGM Plan at a price equal to or greater than the average market price of the stock on the date of grant. RGM Plan options granted have a four-year vesting period and expire ten years after grant. We may grant options to purchase up to 14.0 million shares of stock at a price equal to or greater than the average market price of the stock on the date of grant under SharePower. Previously granted SharePower options have expirations through 2014.

At the Spin-off Date, we converted certain of the unvested options to purchase PepsiCo stock that were held by our employees to YUM stock options under either the 1997 LTIP or SharePower. We converted the options at amounts and exercise prices that maintained the amount of unrealized stock appreciation that existed immediately prior to the Spin-off. The vesting dates and exercise periods of the options were not affected by the conversion. Based on their original PepsiCo grant date, these converted options vest in periods ranging from one to ten years and expire ten to fifteen years after grant.

We estimated the fair value of each option grant made during 2004, 2003 and 2002 as of the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	2004	2003	2002
Risk-free interest rate	**3.2%**	3.0%	4.3%
Expected life (years)	**6.0**	6.0	6.0
Expected volatility	**40.0%**	33.6%	33.9%
Expected dividend yield	**0.1%**[(a)]	0.0%	0.0%

(a) The weighted-average assumption for the expected dividend yield reflects an assumption of 0% for stock options granted prior to the initiation of our quarterly stock dividend in 2004 and 1% thereafter.

A summary of the status of all options granted to employees and non-employee directors as of December 25, 2004, December 27, 2003 and December 28, 2002, and changes during the years then ended is presented below (tabular options in thousands):

	2004		2003		2002	
	Options	**Wtd. Avg. Exercise Price**	Options	Wtd. Avg. Exercise Price	Options	Wtd. Avg. Exercise Price
Outstanding at beginning of year	**46,971**	**$ 18.77**	49,630	$ 17.54	54,452	$ 16.04
Granted at price equal to average market price	**5,223**	**35.17**	7,344	24.78	6,974	25.52
Exercised	**(12,306)**	**16.27**	(6,902)	16.18	(8,876)	14.06
Forfeited	**(2,780)**	**23.75**	(3,101)	19.18	(2,920)	19.07
Outstanding at end of year	**37,108**	**$ 21.53**	46,971	$ 18.77	49,630	$ 17.54
Exercisable at end of year	**21,033**	**$ 17.64**	19,875	$ 17.22	17,762	$ 13.74
Weighted-average fair value of options granted during the year		**$ 15.11**		$ 9.43		$ 10.44

The following table summarizes information about stock options outstanding and exercisable at December 25, 2004 (tabular options in thousands):

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Options	Wtd. Avg. Remaining Contractual Life	Wtd. Avg. Exercise Price	Options	Wtd. Avg. Exercise Price
$ 0–10	338	0.51	$ 8.87	338	$ 8.87
10–15	4,418	2.46	12.96	4,258	13.01
15–20	13,536	5.17	16.21	10,392	15.76
20–30	13,172	6.85	24.46	5,625	23.75
30–40	5,500	8.76	34.75	408	36.17
40–50	144	9.79	41.41	12	43.52
	37,108			21,033	

In November 1997, we granted performance-restricted stock units of YUM's Common Stock in the amount of $3.6 million to our Chief Executive Officer ("CEO"). The award was made under the 1997 LTIP and may be paid in Common Stock or cash at the discretion of the Compensation Committee of the Board of Directors. Payment of the award is contingent upon his employment through January 25, 2006 and our attainment of certain pre-established earnings thresholds. The annual expense related to this award included in earnings was $0.4 million for 2004, 2003 and 2002.

NOTE 19

OTHER COMPENSATION AND BENEFIT PROGRAMS

We sponsor two deferred compensation benefit programs, the Restaurant Deferred Compensation Plan and the Executive Income Deferral Program (the "RDC Plan" and the "EID Plan," respectively) for eligible employees and non-employee directors.

Effective October 1, 2001, participants can no longer defer funds into the RDC Plan. Prior to that date, the RDC Plan allowed participants to defer a portion of their annual salary. The participant's balances will remain in the RDC Plan until their scheduled distribution dates. As defined by the RDC Plan, we credit the amounts deferred with earnings based on the investment options selected by the participants. Investment options in the RDC Plan consist of phantom shares of various mutual funds and YUM Common Stock. We recognize compensation expense for the appreciation or depreciation, if any, attributable to all investments in the RDC Plan. Our obligations under the RDC program as of both year-end 2004 and 2003 were $11 million. We recognized compensation expense of $2 million in 2004, $3 million in 2003 and less than $1 million in 2002 for the RDC Plan.

The EID Plan allows participants to defer receipt of a portion of their annual salary and all or a portion of their incentive compensation. As defined by the EID Plan, we credit the amounts deferred with earnings based on the investment options selected by the participants. These investment options are limited to cash and phantom shares of our Common Stock. The EID Plan allows participants to defer incentive compensation to purchase phantom shares of our Common Stock at a 25% discount from the average market price at the date of deferral (the "Discount Stock Account"). Participants bear the risk of forfeiture of both the discount and any amounts deferred to the Discount Stock Account if they voluntarily separate from employment during the two-year vesting period. We expense the intrinsic value of the discount over the vesting period. As investments in the phantom shares of our Common Stock can only be settled in shares of our Common Stock, we do not recognize compensation expense for the appreciation or the depreciation, if any, of these investments. Deferrals into the phantom shares of our Common Stock are credited to the Common Stock Account.

Our cash obligations under the EID Plan as of the end of 2004 and 2003 were $23 million and $25 million, respectively. We recognized compensation expense of $4 million in 2004, $3 million in 2003 and $2 million in 2002 for the EID Plan.

We sponsor a contributory plan to provide retirement benefits under the provisions of Section 401(k) of the Internal Revenue Code (the "401(k) Plan") for eligible U.S. salaried and hourly employees. During 2004, participants were able to elect to contribute up to 25% of eligible compensation on a pre-tax basis (the maximum participant contribution increased from 15% to 25% effective January 1, 2003). Participants may allocate their contributions to one or any combination of 10 investment options within the 401(k) Plan. The Company matches 100% of the participant's contribution to the 401(k) Plan up to 3% of eligible compensation and 50% of the participant's contribution on the next 2% of eligible compensation. All matching contributions are made to the YUM Common Stock Fund. We recognized as compensation expense our total matching contribution of $11 million in 2004, $10 million in 2003 and $8 million in 2002.

SHAREHOLDERS' RIGHTS PLAN

NOTE 20

In July 1998, our Board of Directors declared a dividend distribution of one right for each share of Common Stock outstanding as of August 3, 1998 (the "Record Date"). As a result of the two-for-one stock split distributed on June 17, 2002, each holder of Common Stock is entitled to one right for every two shares of Common Stock (one-half right per share). Each right initially entitles the registered holder to purchase a unit consisting of one one-thousandth of a share (a "Unit") of Series A Junior Participating Preferred Stock, without par value, at a purchase price of $130 per Unit, subject to adjustment. The rights, which do not have voting rights, will become exercisable for our Common Stock ten business days following a public announcement that a person or group has acquired, or has commenced or intends to commence a tender offer for, 15% or more, or 20% or more if such person or group owned 10% or more on the adoption date of this plan, of our Common Stock. In the event the rights become exercisable for Common Stock, each right will entitle its holder (other than the Acquiring Person as defined in the Agreement) to purchase, at the right's then-current exercise price, YUM Common Stock having a value of twice the exercise price of the right. In the event the rights become exercisable for Common Stock and thereafter we are acquired in a merger or other business combination, each right will entitle its holder to purchase, at the right's then-current exercise price, common stock of the acquiring company having a value of twice the exercise price of the right.

We can redeem the rights in their entirety, prior to becoming exercisable, at $0.01 per right under certain specified conditions. The rights expire on July 21, 2008, unless we extend that date or we have earlier redeemed or exchanged the rights as provided in the Agreement.

This description of the rights is qualified in its entirety by reference to the original Rights Agreement, dated July 21, 1998, and the Agreement of Substitution and Amendment of Common Share Rights Agreement, dated August 28, 2003, between YUM and American Stock Transfer and Trust Company, the Rights Agent (both including the exhibits thereto).

SHARE REPURCHASE PROGRAM

NOTE 21

In May 2004, our Board of Directors authorized a share repurchase program. This program authorized us to repurchase, through November 2005, up to $300 million (excluding applicable transaction fees) of our outstanding Common Stock. During the year ended December 25, 2004, we repurchased approximately 5.9 million shares for approximately $275 million at an average price per share of approximately $46 under this program. Based on market conditions and other factors, additional repurchases may be made from time to time in the open market or through privately negotiated transactions at the discretion of the Company.

In November 2003, our Board of Directors authorized a share repurchase program. This program authorized us to repurchase, through May 21, 2005, up to $300 million of our outstanding Common Stock (excluding applicable transaction fees). This share repurchase program was completed in 2004. During 2004, we repurchased approximately 8.1 million shares for approximately $294 million at an average price per share of approximately $36 under this program. During 2003, we repurchased approximately 169,000 shares for approximately $6 million at an average price per share of approximately $34 under this program.

In November 2002, our Board of Directors authorized a share repurchase program. This program authorized us to repurchase up to $300 million (excluding applicable transaction fees) of our outstanding Common Stock. This share repurchase program was completed in 2003. During 2003, we repurchased approximately 9.2 million shares for approximately $272 million at an average price per share of approximately $30 under this program. During 2002, we repurchased approximately 1.2 million shares for approximately $28 million at an average price per share of approximately $24 under this program.

In February 2001, our Board of Directors authorized a share repurchase program. This program authorized us to repurchase up to $300 million (excluding applicable transaction fees) of our outstanding Common Stock. This share repurchase program was completed in 2002. During 2002, we repurchased approximately 7.0 million shares for approximately $200 million at an average price per share of approximately $29 under this program.

INCOME TAXES

NOTE 22

The details of our income tax provision (benefit) are set forth below. Amounts do not include the income tax benefit of approximately $1 million on the $2 million cumulative effect adjustment recorded on December 29, 2002 due to the adoption of SFAS 143.

		2004	2003	2002
Current:	Federal	**$ 78**	$ 181	$ 137
	Foreign	**79**	114	93
	State	**(13)**	(4)	24
		144	291	254
Deferred:	Federal	**41**	(23)	29
	Foreign	**67**	(16)	(6)
	State	**34**	16	(2)
		142	(23)	21
		$ 286	$ 268	$ 275

Included in the federal deferred tax provision above is approximately $6 million in tax provided on undistributed earnings in one of our foreign investments which we intend to repatriate to the U.S. We have made the determination to repatriate such earnings as the result of The American Jobs Creation Act of 2004 which became law on October 22, 2004 (the "Act"). The Act allows a dividends received deduction of 85% of repatriated qualified foreign earnings in fiscal year 2005. The $6 million in tax is being provided as a result of our determination to repatriate approximately $110 million at December 25, 2004. In accordance with FASB Staff Position 109-2, "Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provisions within the American Jobs Creation Act of 2004," we continue to evaluate whether we will now repatriate other undistributed earnings from foreign investments as a result of the Act. The range of additional amounts that we might repatriate through the Act's effective date is $0 to approximately $400 million. The associated tax if such amounts were repatriated in accordance with the Act would range from $0 to $20 million. We will complete the evaluation of which of these earnings we will repatriate, if any, during 2005.

Taxes payable were reduced by $102 million, $26 million and $49 million in 2004, 2003 and 2002, respectively, as a result of stock option exercises.

Valuation allowances related to deferred tax assets in foreign countries increased by $45 million, $19 million and $6 million in 2004, 2003 and 2002, respectively. Valuation allowances in certain states increased by $6 million ($4 million, net of federal tax) and $1 million ($1 million, net of federal tax) in 2003 and 2002, respectively. These increases were as a result of determining that it is more likely than not that certain loss carryforwards will not be utilized prior to expiration.

In 2004, the deferred foreign tax provision included a $1 million credit to reflect the impact of changes in statutory tax rates in various countries. The deferred foreign tax provision for 2002 included a $2 million credit to reflect the impact of changes in statutory tax rates in various countries.

U.S. and foreign income before income taxes are set forth below:

	2004	2003	2002
U.S.	**$ 704**	$ 669	$ 665
Foreign	**322**	217	193
	$ 1,026	$ 886	$ 858

The reconciliation of income taxes calculated at the U.S. federal tax statutory rate to our effective tax rate is set forth below:

	2004	2003	2002
U.S. federal statutory rate	**35.0%**	35.0%	35.0%
State income tax, net of federal tax benefit	**1.3**	1.8	2.0
Foreign and U.S. tax effects attributable to foreign operations	**(5.8)**	(3.6)	(2.8)
Adjustments to reserves and prior years	**(6.7)**	(1.7)	(1.8)
Foreign tax credit amended return benefit	**—**	(4.1)	—
Valuation allowance additions (reversals)	**4.2**	2.8	—
Other, net	**(0.1)**	—	(0.3)
Effective income tax rate	**27.9%**	30.2%	32.1%

The adjustments to reserves and prior years in 2004 was primarily driven by the reversal of reserves associated with audits that were settled.

We amended certain prior year returns in 2003 upon our determination that it was more beneficial to claim credit on our U.S. tax returns for foreign taxes paid than to deduct such taxes, as had been done when the returns were originally filed. The benefit for amending such returns will be non-recurring.

The details of 2004 and 2003 deferred tax liabilities (assets) are set forth below:

	2004	2003
Intangible assets and property, plant and equipment	**$ 153**	$ 131
Other	**209**	126
Gross deferred tax liabilities	**$ 362**	$ 257
Net operating loss and tax credit carryforwards	**$ (231)**	$ (231)
Employee benefits	**(111)**	(105)
Self-insured casualty claims	**(46)**	(52)
Capital leases and future rent obligations related to sale-leaseback agreements	**(25)**	(20)
Various liabilities and other	**(479)**	(362)
Gross deferred tax assets	**(892)**	(770)
Deferred tax asset valuation allowances	**351**	183
Net deferred tax assets	**(541)**	(587)
Net deferred tax (assets) liabilities	**$ (179)**	$ (330)
Reported in Consolidated Balance Sheets as:		
Deferred income taxes	**$ (156)**	$ (165)
Other assets	**(89)**	(178)
Other liabilities and deferred credits	**52**	—
Accounts payable and other current liabilities	**14**	13
	$ (179)	$ (330)

Federal income tax receivables of $59 million were included in prepaid expenses and other current assets at December 25, 2004.

We have previously not provided deferred tax on the undistributed earnings from our foreign investments, except for amounts to be repatriated as a result of the Act, as we believed they were permanent in nature. We estimate that our total net undistributed earnings upon which we have not provided deferred tax total approximately $300 million at December 25, 2004. A determination of the deferred tax liability on such earnings is not practicable.

We have available net operating loss and tax credit carryforwards totaling approximately $1.7 billion at December 25, 2004 to reduce future tax of YUM and certain subsidiaries. The carryforwards are related to a number of foreign and state jurisdictions. Of these carryforwards, $30 million expire in 2005 and $1.3 billion expire at various times between 2006 and 2023. The remaining carryforwards of approximately $400 million do not expire.

NOTE 23

REPORTABLE OPERATING SEGMENTS

We are principally engaged in developing, operating, franchising and licensing the worldwide KFC, Pizza Hut and Taco Bell concepts, and since May 7, 2002, the LJS and A&W concepts, which were added when we acquired YGR. KFC, Pizza Hut, Taco Bell, LJS and A&W operate throughout the U.S. and in 88, 85, 10, 3 and 12 countries and territories outside the U.S., respectively. Our five largest international markets based on operating profit in 2004 are China, United Kingdom, Australia, Asia Franchise and Korea. At December 25, 2004, we had investments in nine unconsolidated affiliates outside the U.S. which operate principally KFC and/or Pizza Hut restaurants. These unconsolidated affiliates operate in China, Japan, Poland and the United Kingdom.

We identify our operating segments based on management responsibility within the U.S. and International. For purposes of applying SFAS No. 131, "Disclosure About Segments of An Enterprise and Related Information" ("SFAS 131") in the U.S., we consider LJS and A&W to be a single segment. We consider our KFC, Pizza Hut, Taco Bell and LJS/A&W operating segments in the U.S. to be similar and therefore have aggregated them into a single reportable operating segment.

Revenues	**2004**	2003	2002
United States	**$ 5,763**	$ 5,655	$ 5,347
International[(a)]	**3,248**	2,725	2,410
	$ 9,011	$ 8,380	$ 7,757

Operating Profit; Interest Expense, Net; and Income Before Income Taxes	**2004**	2003	2002
United States	**$ 777**	$ 812	$ 802
International[(b)]	**542**	441	361
Unallocated and corporate expenses	**(204)**	(179)	(178)
Unallocated other income (expense)	**(2)**	(3)	(1)
Unallocated facility actions[(c)]	**12**	4	19
Wrench litigation income (expense)[(d)]	**14**	(42)	—
AmeriServe and other (charges) credits[(d)]	**16**	26	27
Total operating profit	**1,155**	1,059	1,030
Interest expense, net	**(129)**	(173)	(172)
Income before income taxes and cumulative effect of accounting change	**$ 1,026**	$ 886	$ 858

Depreciation and Amortization	**2004**	2003	2002
United States	**$ 267**	$ 240	$ 228
International	**168**	146	122
Corporate	**13**	15	20
	$ 448	$ 401	$ 370

Capital Spending	**2004**	2003	2002
United States	**$ 365**	$ 395	$ 453
International	**239**	246	295
Corporate	**41**	22	12
	$ 645	$ 663	$ 760

Identifiable Assets	**2004**	2003	2002
United States	**$ 3,316**	$ 3,279	$ 3,285
International[(e)]	**2,054**	1,880	1,732
Corporate[(f)]	**326**	461	383
	$ 5,696	$ 5,620	$ 5,400

Long-Lived Assets[(g)]	**2004**	2003	2002
United States	**$ 2,900**	$ 2,880	$ 2,805
International	**1,340**	1,206	1,021
Corporate	**99**	72	60
	$ 4,339	$ 4,158	$ 3,886

(a) Includes revenues of $903 million, $703 million and $531 million in Mainland China for 2004, 2003 and 2002, respectively.
(b) Includes equity income of unconsolidated affiliates of $57 million, $44 million and $31 million in 2004, 2003 and 2002, respectively.
(c) Unallocated facility actions comprises refranchising gains (losses) which are not allocated to the U.S. or International segments for performance reporting purposes.
(d) See Note 7 for a discussion of AmeriServe and other (charges) credits and Note 24 for a discussion of Wrench litigation.
(e) Includes investment in unconsolidated affiliates of $194 million, $182 million and $225 million for 2004, 2003 and 2002, respectively. On November 10, 2003, we dissolved our unconsolidated affiliate in Canada. See Note 8 for further discussion.
(f) Primarily includes deferred tax assets, property, plant and equipment, net, related to our office facilities, taxes receivable and fair value of derivative instruments.
(g) Includes property, plant and equipment, net; goodwill; and intangible assets, net.

See Note 7 for additional operating segment disclosures related to impairment, store closure costs and the carrying amount of assets held for sale.

GUARANTEES, COMMITMENTS AND CONTINGENCIES

NOTE 24

Lease Guarantees and Contingencies As a result of (a) assigning our interest in obligations under real estate leases as a condition to the refranchising of certain Company restaurants; (b) contributing certain Company restaurants to unconsolidated affiliates; and (c) guaranteeing certain other leases, we are frequently contingently liable on lease agreements. These leases have varying terms, the latest of which expires in 2031. As of December 25, 2004 and December 27, 2003, the potential amount of undiscounted payments we could be required to make in the event of non-payment by the primary lessee was $365 million and $393 million, respectively. The present values of these potential payments discounted at our pre-tax cost of debt at December 25, 2004 and December 27, 2003 were $306 million and $312 million, respectively. 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 agreement in the event of non-payment under the lease. 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 exposure under such leases at December 25, 2004 and December 27, 2003 was not material.

Included in the potential payments described above are contingent liabilities related to our guarantees of lease agreements of certain former non-core businesses of PepsiCo which were sold prior to Spin-off. Two of these businesses, Chevys Mexican Restaurant and Hot 'n Now filed for bankruptcy protection in October 2003 and January 2004, respectively. We believe that we have appropriately provided for our estimated probable exposure under these guarantees and we do not expect any necessary, future adjustments to recorded reserves to have a material impact on our Financial Statements. Any related expenses have been recorded as AmeriServe and other charges (credits) in our Consolidated Income Statement.

Guarantees Supporting Financial Arrangements of Franchisees, Unconsolidated Affiliates and Other Third Parties We had provided approximately $16 million and $32 million of partial guarantees of two franchisee loan pools related primarily to the Company's historical refranchising programs and, to a lesser extent, franchisee development of new restaurants, at December 25, 2004 and December 27, 2003, respectively. In support of these guarantees, we posted letters of credit of $4 million and $32 million at December 25, 2004 and December 27, 2003, respectively. We also provided a standby letter of credit of $18 million and $23 million at December 25, 2004 and December 27, 2003, respectively, under which we could potentially be required to fund a portion of one of the franchisee loan pools. The total loans outstanding under these loan pools were approximately $90 million at December 25, 2004. In 2004, approximately $26 million of loans were sold from one of the loan pools to the other resulting in a reduction of our related guarantees and letters of credit by $16 million. Additionally, in 2004 a $12 million letter of credit related to our guarantee of one of the loan pools was eliminated based on our improved credit rating and a third party assumed a portion of the risk associated with one of the loan pools resulting in a $5 million reduction of our standby letter of credit. These changes resulted in a $21 million decrease in our maximum exposure related to the franchisee loan pools.

Any funding under the guarantees or letters of credit would be secured by the franchisee loans and any related collateral. We believe that we have appropriately provided for our estimated probable exposures under these contingent liabilities. These provisions were primarily charged to net refranchising loss (gain). New loans are not currently being added to either loan pool.

We have guaranteed certain lines of credit and loans of unconsolidated affiliates totaling $34 million and $28 million at December 25, 2004 and December 27, 2003, respectively. Our unconsolidated affiliates had total revenues of over $1.7 billion for the year ended December 25, 2004 and assets and debt of approximately $884 million and $49 million, respectively, at December 25, 2004.

We have also guaranteed certain lines of credit, loans and letters of credit of third parties totaling $9 million and $8 million at December 25, 2004 and December 27, 2003, respectively. If all such lines of credit and letters of credit were fully drawn the maximum contingent liability under these arrangements would be approximately $26 million as of December 25, 2004 and $25 million as of December 27, 2003.

We have varying levels of recourse provisions and collateral that mitigate the risk of loss related to our guarantees of these financial arrangements of unconsolidated affiliates and other third parties. Accordingly, our recorded liability as of December 25, 2004 and December 27, 2003 is not significant.

Insurance Programs We are self-insured for a substantial portion of our current and prior years' coverage including workers' compensation, employment practices liability, general liability, automobile liability and property losses (collectively, "property and casualty losses"). To mitigate the cost of our exposures for certain property and casualty losses, we make annual decisions to self-insure the risks of loss up to defined maximum per occurrence retentions on a line by line basis or to combine certain lines of coverage into one loss pool with a single self-insured aggregate retention. The Company then purchases insurance coverage, up to a certain limit, for losses that exceed the self-insurance per occurrence or aggregate retention. The insurers' maximum aggregate loss limits are significantly above our actuarially determined probable losses; therefore, we believe the likelihood of losses exceeding the insurers' maximum aggregate loss limits is remote.

In the U.S. and in certain other countries, we are also self-insured for healthcare claims for eligible participating employees subject to certain deductibles and limitations. We have accounted for our retained liabilities for property and casualty losses and healthcare claims, including reported and incurred but not reported claims, based on information provided by independent actuaries.

Due to the inherent volatility of actuarially determined property and casualty loss estimates, it is reasonably possible that we could experience changes in estimated losses which could be material to our growth in quarterly and annual net income. We believe that we have recorded reserves for property and casualty losses at a level which has substantially mitigated the potential negative impact of adverse developments and/or volatility.

Change of Control Severance Agreements The Company has severance agreements with certain key executives (the "Agreements") that are renewable on an annual basis. These Agreements are triggered by a termination, under certain conditions, of the executive's employment following a change in control of the Company, as defined in the Agreements. If triggered, the affected executives would generally receive twice the amount of both their annual base salary and their annual incentive, at the higher of target or actual for the preceding year, a proportionate bonus at the higher of target or actual performance earned through the date of termination, outplacement services and a tax gross-up for any excise taxes. These Agreements have a three-year term and automatically renew each January 1 for another three-year term unless the Company elects not to renew the Agreements. If these Agreements had been triggered as of December 25, 2004, payments of approximately $34 million would have been made. In the event of a change of control, rabbi trusts would be established and used to provide payouts under existing deferred and incentive compensation plans.

Litigation We are subject to various claims and contingencies related to lawsuits, taxes, environmental and other matters arising out of the normal course of business.

On August 13, 2003, a class action lawsuit against Pizza Hut, Inc., entitled *Coldiron v. Pizza Hut, Inc.*, was filed in the United States District Court, Central District of California. Plaintiff alleges that she and other current and former Pizza Hut Restaurant General Managers ("RGM's") were improperly classified as exempt employees under the U.S. Fair Labor Standards Act ("FLSA"). There is also a pendent state law claim, alleging that current and former RGM's in California were misclassified under that state's law. Plaintiff seeks unpaid overtime wages and penalties. On May 5, 2004, the District Court granted conditional certification of a nationwide class of RGM's under the FLSA claim, providing notice to prospective class members and an opportunity to join the class. Approximately 10 percent of the eligible class members have joined the litigation. Once class certification discovery is completed, Pizza Hut intends to challenge the propriety of conditional class certification. On July 20, 2004, the District Court granted summary judgment on Ms. Coldiron's individual FLSA claim. Pizza Hut believes that the District Court's summary judgment ruling in favor of Ms. Coldiron is clearly erroneous under well-established legal precedent. As of February 23, 2005, Ms. Coldiron has also filed a motion to certify an additional class of current and former California RGM's under California state law, a motion for summary judgment on her individual state law claims and a motion requesting that the District Court enter summary judgment on the damages that FLSA class members would be due upon successful prosecution of the class-wide litigation. Pizza Hut is opposing all three motions.

We continue to believe that Pizza Hut has properly classified its RGM's as exempt under the FLSA and California law and accordingly intend to vigorously defend against all claims in this lawsuit. However, in view of the inherent uncertainties of litigation, the outcome of this case cannot be predicted at this time. Likewise, the amount of any potential loss cannot be reasonably estimated.

On December 17, 2002, Taco Bell was named as the defendant in a class action lawsuit filed in the United States District Court for the Northern District of California entitled *Moeller, et al. v. Taco Bell Corp*. On August 4, 2003, plaintiffs filed an amended complaint that alleges, among other things, that Taco Bell has discriminated against the class of people who use wheelchairs or scooters for mobility by failing to make its approximately 220 company-owned restaurants in California (the "California Restaurants") accessible to the class. Plaintiffs contend that queue rails and other architectural and structural elements of the Taco Bell restaurants relating to the path of travel and use of the facilities by persons with mobility-related disabilities (including parking spaces, ramps, counters, restroom facilities and seating) do not comply with the U.S. Americans with Disabilities Act (the "ADA"), the Unruh Civil Rights Act (the "Unruh Act"), and the California Disabled Persons Act (the "CDPA"). Plaintiffs have requested: (a) an injunction from the District Court ordering Taco Bell to comply with the ADA and its implementing regulations; (b) that the District Court declare Taco Bell in violation of the ADA, the Unruh Act, and the CDPA; and (c) monetary relief under the Unruh Act or CDPA. Plaintiffs, on behalf of the class, are seeking the minimum statutory damages per offense of either $4,000 under the Unruh Act or $1,000 under the CDPA for each aggrieved member of the class. Plaintiffs contend that there may be in excess of 100,000 individuals in the class. For themselves, the four named plaintiffs have claimed aggregate minimum statutory damages of no less than $16,000, but are expected to claim greater amounts based on the number of Taco Bell outlets they visited at which they claim to have suffered discrimination.

On February 23, 2004, the District Court granted Plaintiffs' motion for class certification. The District Court certified a Rule 23(b)(2) mandatory injunctive relief class of all individuals with disabilities who use wheelchairs or electric scooters for mobility who, at any time on or after December 17, 2001, were denied, or are currently being denied, on the basis of disability, the full and equal enjoyment of the California Restaurants. The class includes claims for injunctive relief and minimum statutory damages.

Pursuant to the parties' agreement, on or about August 31, 2004, the District Court ordered that the trial of this action be bifurcated so that stage one will resolve Plaintiffs' claims for equitable relief and stage two will resolve Plaintiffs' claims for damages. The parties are currently proceeding with the equitable relief stage of this action. During this stage, Taco Bell filed a motion to partially decertify the class to exclude from the Rule 23(b)(2) class claims for monetary damages. The District Court denied the motion. Plaintiffs filed their own motion for partial summary judgment as to liability relating to a subset of the California Restaurants. The District Court denied that motion as well.

Taco Bell has denied liability and intends to vigorously defend against all claims in this lawsuit. Although this lawsuit is at an early stage in the proceedings, it is likely that certain of the California restaurants will be determined to be not fully compliant with accessibility laws and that Taco Bell will be required to take certain steps to make these restaurants fully compliant. However, at this time, it is not possible to estimate with reasonable certainty the potential costs to bring any non-compliant California Restaurants into compliance with applicable state and federal disability access laws. Nor is it possible at this time to estimate with reasonable certainty the probability or amount of liability for monetary damages on a class-wide basis to Taco Bell.

On January 16, 1998, a lawsuit against Taco Bell Corp., entitled *Wrench LLC, Joseph Shields and Thomas Rinks v. Taco Bell Corp*. ("Wrench") was filed in the United States District Court for the Western District of Michigan. The lawsuit alleged that Taco Bell Corp. misappropriated certain ideas and concepts used in its advertising featuring a Chihuahua. The plaintiffs sought to recover monetary damages under several theories, including breach of implied-in-fact contract, idea misappropriation, conversion and unfair competition. On June 10, 1999, the District Court granted summary judgment in favor of Taco Bell Corp. Plaintiffs filed an appeal with the U.S. Court of Appeals for the Sixth Circuit, and oral arguments were held on September 20, 2000. On July 6, 2001, the Sixth Circuit Court of Appeals reversed the District Court's judgment in favor of Taco Bell Corp. and remanded the case to the District Court. Taco Bell Corp. unsuccessfully petitioned the Sixth Circuit Court of Appeals for rehearing en banc, and its petition for writ of certiorari to the United States Supreme Court was denied on January 21, 2002. The case was returned to District Court for trial which began on May 14, 2003 and on June 4, 2003 the jury awarded $30 million to the plaintiffs. Subsequently, the plaintiffs moved to amend the judgment to include pre-judgment interest and post-judgment interest and Taco Bell filed its post-trial motion for judgment as a matter of law or a new trial. On September 9, 2003, the District Court denied Taco Bell's motion and granted the plaintiff's motion to amend the judgment.

In view of the jury verdict and subsequent District Court ruling, we recorded a charge of $42 million in 2003. We appealed the verdict to the Sixth Circuit Court of Appeals and interest continued to accrue during the appeal process. Prior to a ruling from the Sixth Circuit Court of Appeals, we settled this matter with the Wrench plaintiffs on January 15, 2005. Concurrent with the settlement with the plaintiffs, we also settled the matter with certain of our insurance carriers. As a result of these settlements, reversals of previously recorded expense of $14 million were recorded in the year ended December 25, 2004. The amount to be paid to the plaintiffs per the settlement agreement is included in accounts payable and other current liabilities in our Consolidated Balance Sheet.

We intend to seek additional recoveries from our other insurance carriers during the periods in question. We have also filed suit against Taco Bell's former advertising agency in the United States District Court for the Central District of California seeking reimbursement for the settlement amount as well as any costs that we have incurred in defending this matter. Any additional recoveries will be recorded as they are realized.

Obligations to PepsiCo, Inc. After Spin-off In connection with the Spin-off, we entered into separation and other related agreements (the "Separation Agreements") governing the Spin-off and our subsequent relationship with PepsiCo. These agreements provide certain indemnities to PepsiCo.

Under terms of the agreement, we have indemnified PepsiCo for any costs or losses it incurs with respect to all letters of credit, guarantees and contingent liabilities relating to our businesses under which PepsiCo remains liable. As of December 25, 2004, PepsiCo remains liable for approximately $39 million on a nominal basis related to these contingencies. This obligation ends at the time PepsiCo is released, terminated or replaced by a qualified letter of credit. We have not been required to make any payments under this indemnity.

Under the Separation Agreements, PepsiCo maintains full control and absolute discretion with regard to any combined or consolidated tax filings for periods through October 6, 1997. PepsiCo also maintains full control and absolute discretion regarding any common tax audit issues. Although PepsiCo has contractually agreed to, in good faith, use its best efforts to settle all joint interests in any common audit issue on a basis consistent with prior practice, there can be no assurance that determinations made by PepsiCo would be the same as we would reach, acting on our own behalf. Through December 25, 2004, there have not been any determinations made by PepsiCo where we would have reached a different determination.

NOTE 25

SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

2004	**First Quarter**	**Second Quarter**	**Third Quarter**	**Fourth Quarter**	**Total**
Revenues:					
Company sales	**$ 1,747**	**$ 1,846**	**$ 1,935**	**$ 2,464**	**$ 7,992**
Franchise and license fees	**223**	**231**	**244**	**321**	**1,019**
Total revenues	**1,970**	**2,077**	**2,179**	**2,785**	**9,011**
Wrench litigation (income) expense	**—**	**—**	**—**	**(14)**	**(14)**
AmeriServe and other charges (credits)	**—**	**(14)**	**—**	**(2)**	**(16)**
Total costs and expenses, net	**1,727**	**1,802**	**1,888**	**2,439**	**7,856**
Operating profit	**243**	**275**	**291**	**346**	**1,155**
Net income	**142**	**178**	**185**	**235**	**740**
Diluted earnings per common share	**0.47**	**0.58**	**0.61**	**0.77**	**2.42**
Dividends declared per common share	**—**	**0.10**	**—**	**0.20**	**0.30**

2003	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
Revenues:					
Company sales	$ 1,597	$ 1,723	$ 1,765	$ 2,356	$ 7,441
Franchise and license fees	205	213	224	297	939
Total revenues	1,802	1,936	1,989	2,653	8,380
Wrench litigation (income) expense	—	35	7	—	42
AmeriServe and other charges (credits)	—	2	(3)	(25)	(26)
Total costs and expenses, net	1,585	1,716	1,720	2,300	7,321
Operating profit	217	220	269	353	1,059
Income before cumulative effect of accounting change	118	122	164	214	618
Cumulative effect of accounting change, net of tax	(1)	—	—	—	(1)
Net income	117	122	164	214	617
Diluted earnings per common share	0.39	0.40	0.53	0.70	2.02

In the fourth quarter of 2004, we recorded an $11.5 million ($7 million after tax) adjustment primarily through increased U.S. depreciation expense so that all of our leasehold improvements are now being depreciated over the shorter of their useful lives or the underlying term of the lease. See Note 2.

See Note 24 for details of Wrench litigation and Note 7 for details of AmeriServe other charges (credits).

Management's Responsibility for Financial Statements and Management's Report on Internal Control Over Financial Reporting

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

To Our Shareholders:

We are responsible for the preparation, integrity and fair presentation of the Consolidated Financial Statements, related notes and other information included in this annual report. The financial statements were prepared in accordance with accounting principles generally accepted in the United States of America and include certain amounts based upon our estimates and assumptions, as required. Other financial information presented in the annual report is derived from the financial statements.

We maintain a system of internal control over financial reporting, designed to provide reasonable assurance as to the reliability of the financial statements, as well as to safeguard assets from unauthorized use or disposition. The system is supported by formal policies and procedures, including an active Code of Conduct program intended to ensure employees adhere to the highest standards of personal and professional integrity. We have conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation, we concluded that our internal control over financial reporting was effective as of December 25, 2004. Our internal audit function monitors and reports on the adequacy of and compliance with the internal control system, and appropriate actions are taken to address significant control deficiencies and other opportunities for improving the system as they are identified.

The Consolidated Financial Statements have been audited and reported on by our independent auditors, KPMG LLP, who were given free access to all financial records and related data, including minutes of the meetings of the Board of Directors and Committees of the Board. We believe that management representations made to the independent auditors were valid and appropriate. Additionally, our assessment of the effectiveness of our internal control over financial reporting has been audited and reported on by KPMG LLP.

The Audit Committee of the Board of Directors, which is composed solely of outside directors, provides oversight to our financial reporting process and our controls to safeguard assets through periodic meetings with our independent auditors, internal auditors and management. Both our independent auditors and internal auditors have free access to the Audit Committee.

Although no cost-effective internal control system will preclude all errors and irregularities, we believe our controls as of December 25, 2004 provide reasonable assurance that our assets are reasonably safeguarded.

David J. Deno
Chief Financial Officer and Chief Operating Officer

Gregory N. Moore
Senior Vice President and Controller

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) under the Securities Exchange Act of 1934. Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal controls over financial reporting based on the framework in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in *Internal Control — Integrated Framework*, our management concluded that our internal control over financial reporting was effective as of December 25, 2004. Our management's assessment of the effectiveness of our internal control over financial reporting as of December 25, 2004 has been audited by KPMG LLP, an independent registered public accounting firm, as stated in their report which is included herein.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
YUM! Brands, Inc.:

We have audited the accompanying consolidated balance sheets of YUM! Brands, Inc. and Subsidiaries ("YUM") as of December 25, 2004 and December 27, 2003, and the related consolidated statements of income, cash flows, and shareholders' equity and comprehensive income for each of the years in the three-year period ended December 25, 2004. These consolidated financial statements are the responsibility of YUM's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of YUM as of December 25, 2004 and December 27, 2003, and the results of its operations and its cash flows for each of the years in the three-year period ended December 25, 2004, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of YUM's internal control over financial reporting as of December 25, 2004, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 28, 2005 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

KPMG LLP

KPMG LLP
Louisville, Kentucky
February 28, 2005

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
YUM! Brands, Inc.:

We have audited management's assessment, included in Management's Report on Internal Control over Financial Reporting, appearing on page 74 of the Company's Annual Report for the fiscal year ended December 25, 2004, that YUM! Brands, Inc. and Subsidiaries ("YUM") maintained effective internal control over financial reporting as of December 25, 2004, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). YUM's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that YUM maintained effective internal control over financial reporting as of December 25, 2004, is fairly stated, in all material respects, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, YUM maintained, in all material respects, effective internal control over financial reporting as of December 25, 2004, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of YUM as of December 25, 2004 and December 27, 2003, and the related consolidated statements of income, cash flows, and shareholders' equity and comprehensive income for each of the years in the three-year period ended December 25, 2004, and our report dated February 28, 2005, expressed an unqualified opinion on those consolidated financial statements.

KPMG LLP

KPMG LLP
Louisville, KY
February 28, 2005

Selected Financial Data

	Fiscal Year				
(in millions, except per share and unit amounts)	**2004**	2003	2002	2001	2000
Summary of Operations					
Revenues					
Company sales	**$ 7,992**	$ 7,441	$ 6,891	$ 6,138	$ 6,305
Franchise and license fees	**1,019**	939	866	815	788
Total	**9,011**	8,380	7,757	6,953	7,093
Facility actions[(a)]	**(26)**	(36)	(32)	(1)	176
Wrench litigation income (expense)[(b)]	**14**	(42)	—	—	—
AmeriServe and other (charges) credits[(c)]	**16**	26	27	3	(204)
Operating profit	**1,155**	1,059	1,030	891	860
Interest expense, net	**129**	173	172	158	176
Income before income taxes and cumulative effect of accounting change	**1,026**	886	858	733	684
Income before cumulative effect of accounting change	**740**	618	583	492	413
Cumulative effect of accounting change, net of tax[(d)]	**—**	(1)	—	—	—
Net income	**740**	617	583	492	413
Basic earnings per common share[(e)]	**2.54**	2.10	1.97	1.68	1.41
Diluted earnings per common share[(e)]	**2.42**	2.02	1.88	1.62	1.39
Cash Flow Data					
Provided by operating activities	**$ 1,131**	$ 1,053	$ 1,088	$ 832	$ 491
Capital spending, excluding acquisitions	**645**	663	760	636	572
Proceeds from refranchising of restaurants	**140**	92	81	111	381
Balance Sheet					
Total assets	**$ 5,696**	$ 5,620	$ 5,400	$ 4,425	$ 4,149
Long-term debt	**1,731**	2,056	2,299	1,552	2,397
Total debt	**1,742**	2,066	2,445	2,248	2,487
Other Data					
Number of stores at year end					
Company	**7,743**	7,854	7,526	6,435	6,123
Unconsolidated Affiliates	**1,662**	1,512	2,148	2,000	1,844
Franchisees	**21,858**	21,471	20,724	19,263	19,287
Licensees	**2,345**	2,362	2,526	2,791	3,163
System	**33,608**	33,199	32,924	30,489	30,417
U.S. Company blended same store sales growth[(f)]	**3%**	—	2%	1%	(2)%
International system sales growth[(g)]					
Reported	**15%**	14%	8%	1%	6%
Local currency[(h)]	**9%**	7%	9%	8%	8%
Shares outstanding at year end[(e)]	**290**	292	294	293	293
Cash dividends declared per common share	**$ 0.30**	—	—	—	—
Market price per share at year end[(e)]	**$ 46.27**	$ 33.64	$ 24.12	$ 24.62	$ 16.50

Fiscal years 2004, 2003, 2002 and 2001 include 52 weeks and fiscal year 2000 includes 53 weeks. From May 7, 2002, results include Long John Silver's ("LJS") and A&W All-American Food Restaurants ("A&W"), which were added when we acquired Yorkshire Global Restaurants, Inc. Fiscal year 2002 includes the impact of the adoption of Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"). As a result we ceased amortization of goodwill and indefinite-lived assets beginning December 30, 2001. If SFAS 142 had been effective for 2001 and 2000, reported net income would have increased $26 million and $24 million, respectively. Both basic earnings per share and diluted earnings per share would have increased $0.09 and $0.08 in 2001 and 2000, respectively. The selected financial data should be read in conjunction with the Consolidated Financial Statements and the Notes thereto.

(a) See Note 7 to the Consolidated Financial Statements for a description of Facility actions in 2004, 2003 and 2002.
(b) See Note 24 to the Consolidated Financial Statements for a description of Wrench litigation in 2004 and 2003.
(c) See Note 7 to the Consolidated Financial Statements for a description of AmeriServe and other charges (credits) in 2004, 2003 and 2002.
(d) Fiscal year 2003 includes the impact of the adoption of SFAS No. 143, "Accounting for Asset Retirement Obligations." See Note 2 to the Consolidated Financial Statements for further discussion.
(e) Per share and share amounts have been adjusted to reflect the two-for-one stock split distributed on June 17, 2002.
(f) U.S. Company blended same-store sales growth includes the results of Company owned KFC, Pizza Hut and Taco Bell restaurants that have been open one year or more. LJS and A&W are not included.
(g) International system sales growth includes the results of all international restaurants regardless of ownership, including Company owned, franchise, unconsolidated affiliate and license restaurants. Sales of franchise, unconsolidated affiliate and license restaurants generate franchise and license fees for the Company (typically at a rate of 4% to 6% of sales). Franchise, unconsolidated affiliate and license restaurant sales are not included in Company sales we present on the Consolidated Statements of Income; however, the 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 all our revenue drivers, Company and franchise same store sales as well as net unit development.
(h) Local currency represents the percentage change excluding the impact of foreign currency translation. These amounts are derived by translating current year results at prior year average exchange rates. We believe the elimination of the foreign currency translation impact provides better year-to-year comparability without the distortion of foreign currency fluctuations.

Board of Directors

David C. Novak 52
Chairman, Chief Executive Officer and President,
Yum! Brands, Inc.

Andrall E. Pearson 79
Founding Chairman, Yum! Brands, Inc.

David W. Dorman 51
Chairman and Chief Executive Officer,
AT&T Corporation

Massimo Ferragamo 47
Chairman, Ferragamo USA, Inc.,
a subsidiary of Salvatore Ferragamo Italia

J. David Grissom 66
Chairman, Mayfair Capital, Inc., a private investment firm

Bonnie G. Hill 63
Chairman and President, B. Hill Enterprises, LLC

Robert Holland, Jr. 64
Industry Partner,
Cordova, Smart & Williams, LLC

Kenneth Langone 69
Founder, Chairman of the Board,
Chief Executive Officer and President,
Invemed Associates, LLC, an investment banking firm,
Founder, Home Depot, Inc.

Jonathan S. Linen 61
Vice Chairman, American Express Company

Thomas M. Ryan 52
Chairman, Chief Executive Officer and President of
CVS Corporation and CVS Pharmacy, Inc.

Jackie Trujillo 69
Chairman Emeritus of the Board,
Harman Management Corporation

Robert J. Ulrich 61
Chairman and Chief Executive Officer, Target Corporation

Senior Officers

David C. Novak 52
Chairman, Chief Executive Officer and President,
Yum! Brands, Inc.

Graham D. Allan 49
President, Yum! Restaurants International

Jonathan D. Blum 46
Senior Vice President, Public Affairs, Yum! Brands, Inc.

Emil J. Brolick 57
President and Chief Concept Officer, Taco Bell, U.S.A.

Harvey Brownlee, Jr. 44
Chief Operating Officer, KFC, U.S.A.

Jared E. Buss 62
Chief Operating Officer, Pizza Hut, U.S.A.

Anne P. Byerlein 46
Chief People Officer, Yum! Brands, Inc.

Christian L. Campbell 54
Senior Vice President, General Counsel, Secretary and
Chief Franchise Policy Officer, Yum! Brands, Inc.

Richard T. Carucci 47
Senior Vice President and Chief Financial Officer,
Yum! Brands, Inc.

Steven A. Davis 46
President, Long John Silver's/A&W and
Yum! Multibranding

Gregg R. Dedrick 45
President and Chief Concept Officer, KFC, U.S.A.

David J. Deno 47
Chief Operating Officer, Yum! Brands, Inc.

Peter R. Hearl 53
President and Chief Concept Officer, Pizza Hut, U.S.A.

Robert C. Kreidler 41
Senior Vice President, Corporate Strategy
and Treasurer, Yum! Brands, Inc.

Gregory N. Moore 55
Senior Vice President and Controller, Yum! Brands, Inc.

Charles E. Rawley, III 54
Chief Development Officer, Yum! Brands, Inc.

Rob Savage 43
Chief Operating Officer, Taco Bell, U.S.A.

Sam Su 52
President, Yum! Restaurants China

Shareholder Information

Annual Meeting The Annual Meeting of Shareholders will be held at Yum! Brands' headquarters, Louisville, Kentucky, at 9:00 a.m. (EDT), Thursday, May 19, 2005. Proxies for the meeting will be solicited by an independent proxy solicitor. This Annual Report is not part of the proxy solicitation.

INQUIRIES REGARDING YOUR YUM! HOLDINGS

Registered Shareholders (those who hold YUM shares in their own names) should address communications concerning statements, address changes, lost certificates and other administrative matters to:

American Stock Transfer & Trust Company
59 Maiden Lane
Plaza Level
New York, NY 10038
Phone: (888) 439-4986
www.amstock.com
or
Shareholder Coordinator
Yum! Brands, Inc.
1441 Gardiner Lane, Louisville, KY 40213
Phone: (888) 298-6986
E-mail: yum.investor@yum.com

In all correspondence or phone inquires, please provide your name, your Social Security Number, and your YUM account number if you know it.

Registered Shareholders can access their accounts and complete the following functions online at the Web site of American Stock Transfer & Trust ("AST").

- Access account balance and other general account information
- Change an account's mailing address
- View a detailed list of holdings represented by certificates and the identifying certificate numbers
- Request a certificate for shares held by AST
- Replace a lost or stolen certificate
- Retrieve a duplicate Form 1099-B
- Purchase shares of YUM through the Company's direct stock purchase plan
- Sell shares held by AST

Access accounts online at the following URL: *https://secure.amstock.com/Shareholder/sh_login.asp.* Your account number and Social Security Number are required. If you do not know your account number, please call AST at (888) 439-4986 or YUM Shareholder Coordinator at (888) 298-6986. You may also request a Personal Identification Number (PIN) to access your account at the same URL. For security purposes, PINs are mailed to shareholders.

Beneficial Shareholders (those who hold YUM shares in the name of a bank or broker) should direct communications on all administrative matters to their stockbroker.

YUMBUCKS and SharePower Participants (employees with YUMBUCKS options or SharePower options) should address all questions regarding your account, outstanding options or shares received through option exercises to:

Merrill Lynch/SharePower
Stock Option Plan Services
P.O. Box 30446
New Brunswick, NJ 08989-0446
Phone: (800) 637-2432 (U.S.A., Puerto Rico and Canada)
(732) 560-9444 (all other locations)

In all correspondence, please provide your account number (for U.S. citizens, this is your Social Security Number), your address, your telephone number and mention either YUMBUCKS or SharePower. For telephone inquiries, please have a copy of your most recent statement available.

Employee Benefit Plan Participants

Direct Stock Purchase Program . . . . . . (888) 439-4986
YUM 401(k) Plan. . . . . (888) 875-4015
YUM Savings Center . . . . . (617) 847-1013 (outside U.S.)
P.O. Box 1389
Boston, MA 02104-1389

Please have a copy of your most recent statement available when calling. Press *0 for a customer service representative and give the representative the name of the plan.

Shareholder Services

Direct Stock Purchase Plan A prospectus and a brochure explaining this convenient plan are available from our transfer agent:

American Stock Transfer & Trust Company
P.O. Box 922
Wall Street Station
New York, NY 10269-0560
Attn: DRIP Dept.
Phone: (888) 439-4986

Low-Cost Investment Plan Investors may purchase their initial shares of stock through NAIC's Low-Cost Investment Plan. For details contact:

National Association of Investors Corporation (NAIC)
711 West Thirteen Mile Road
Madison Heights, MI 48071
Phone: (877) ASK-NAIC (275-6242)
www.better-investing.org

Financial and Other Information Earnings and other financial results, corporate news and company information are now available on Yum! Brands' Web site: www.yum.com

Copies of Yum! Brands' SEC Forms 8-K, 10-K and 10-Q and quarterly earnings releases are available free of charge. Contact Yum! Brands' Shareholder Relations at (888) 2YUMYUM (298-6986) or e-mail yum.investor@yum.com

Securities analysts, portfolio managers, representatives of financial institutions and other individuals with questions regarding Yum! Brands' performance are invited to contact:

Tim Jerzyk
Vice President, Investor Relations
Yum! Brands, Inc.
1441 Gardiner Lane
Louisville, KY 40213
Phone: (888) 298-6986

Independent Auditors

KPMG LLP
400 West Market Street, Suite 2600
Louisville, KY 40202
Phone: (502) 587-0535

CAPITAL STOCK INFORMATION

The following table sets forth the high and low stock prices, as well as cash dividends declared on common stock, for each quarter in the two-year period ended December 25, 2004:

	2004			2003	
Quarter	**High**	**Low**	**Dividends Declared Per Share**	High	Low
First	**$ 38.28**	**$ 32.56**	**—**	$ 25.75	$ 22.06
Second	**39.50**	**35.72**	**$ 0.10**	28.54	23.40
Third	**40.13**	**35.88**	**—**	30.82	28.55
Fourth	**46.95**	**39.33**	**0.20**	35.13	29.40

Stock Trading Symbol—YUM
The New York Stock Exchange is the principal market for YUM Common Stock.

Shareholders At year-end 2004, Yum! Brands had approximately 101,000 registered shareholders of record of YUM common stock.

Dividend Policy Yum! Brands initiated payment of quarterly dividends to our shareholders in 2004. Future dividend payments have been targeted to equal an annual payout ratio of 15% to 20% of net income.

FRANCHISE INQUIRIES

Domestic Franchising Inquiry Phone Line
(866) 2YUMYUM (298-6986)

International Franchising Inquiry Phone Line
(972) 338-8100 ext. 4480

Online Franchise Information
http://www.yum.com/franchising/info.htm

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Supplement to Yum! Brands, Inc. Annual Report to Shareholders

On June 28, 2004, David Novak, Yum Brands, Inc. (the Company) Chairman and Chief Executive Officer submitted a certification to the New York Stock Exchange (the NYSE) as required by Section 303A.12(a) of the NYSE Listed Company Manual. This certification indicated that Mr. Novak was not aware of any violations by the Company of NYSE Corporate Governance listing standards.

In connection with the filing of the Company's Form 10-K for the year ended December 25, 2004, the Company has included as exhibits certifications signed by Mr. Novak and Mr. David Deno, 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.

These statements are required by the NYSE as part of the Company's Annual Report to Shareholders.

"power of giving back!"

At Yum! Brands, we believe in the power of giving back to the community to make a difference in the lives of our customers and their families.

While we commit ourselves to making a difference by financially supporting hundreds and hundreds of charities across the globe, our efforts are primarily focused on nourishing the **bodies, minds, souls and spirits** of children in need. We do this through programs dedicated to hunger relief, daycare subsidies, reading incentives and mentoring at-risk teens.

Here's a brief snapshot of the work that is under way:

From America to Europe, Asia and all around the globe, we're committed to improving the lives of the customers we serve.

That's community mania!

Nourishing Bodies: YUMeals. In America alone, one in ten children under the age of five runs the risk of going to bed hungry every night. One in ten. So we decided to do something about this and have created the world's largest prepared food recovery program. We now donate millions of pounds of prepared food to the hungry. Food that has nutritional value and will provide nourishment to those most in need, the underprivileged.

Nourishing Young Minds: Pizza Hut's BOOK IT! Program. For 20 years, children have found reading a little more fun and rewarding, as a result of participating in BOOK IT! As the nation's largest reading incentive program, BOOK IT! provides pizza, praise and recognition for children's reading achievements. Since 1985, Pizza Hut has invested nearly a half billion dollars in BOOK IT! to encourage children to read more and discover the joy and pleasure of reading.

Nourishing Souls: KFC's Colonel's Kids. With more and more double-income and single-parent households, finding safe, affordable high-quality child care has become an increasing burden. Today, Colonel's Kids helps fund extended-hour and infant/toddler child care programs across the country for the millions of people who work "after hours" or on weekends. Since 2000, more than $4.5 million has been awarded to YMCA Child Care Centers nationwide.

Nourishing Spirits: Taco Bell's TEENSupreme. The Taco Bell Foundation is committed to helping teens become successful and productive leaders in their communities. Through its partnership with the Boys & Girls Clubs of America, the Taco Bell Foundation supports teen-focused initiatives that are designed to build self-esteem, leadership skills and values. Since 1995, Taco Bell and its franchisees have donated over $15 million dollars to the Boys & Girls Clubs of America for teen programming.

Tsunami Relief: Finally, we're very proud that our teammates and franchisees around the globe came together in support of victims of the Tsunami natural disaster in Southeast Asia in late 2004. Together, the YUM Foundation and its employees and franchisees donated over $2.2 million to aid those in their time of need.


必胜客欢乐餐厅
Pizza Hut
A&W
All American Food
KFC
Long John Silver's
Pizza Hut
Taco Bell
Alone we're delicious. Together we're Yum!