

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Unless otherwise noted, the section references to (i) “us”, “our”, “we”, “the Company” and “YUM” refer to YUM Brands, Inc. and its consolidated subsidiaries, (ii) “the Parent” refers to Yum! Brands, Inc., on a stand-alone basis, (iii) “the Issuers” refers to KFC Holding Co., Pizza Hut Holdings, LLC and Taco Bell of America, LLC, which are direct wholly-owned subsidiaries of the Parent and co-issuers of \$1.05 billion of 5.00% Senior Notes due 2024, \$1.05 billion of 5.25% Senior Notes due 2026, and \$750 million of 4.75% Senior Notes due 2027 (collectively, the “Subsidiary Senior Unsecured Notes”) and co-borrowers under the Credit Agreement, as defined in our annual report on Form 10-K for the year ended December 31, 2019 filed with the SEC (the “2019 10-K”) on February 19, 2020; (iv) “the Specified Guarantors” refers to collectively Yum Restaurant Services Group, LLC, Restaurant Concepts LLC and Taco Bell Corp. (including their subsidiaries except for Taco Bell Funding, LLC and its special-purpose, wholly owned subsidiaries), which are directly wholly-owned subsidiaries of the Parent and guarantors of the Notes and under the Credit Agreement; (v) “the Companies” refers to collectively the Issuers and the Specified Guarantors, (vi) “the Taco Bell Securitization Entities” refers to collectively Taco Bell Funding, LLC, a Delaware special purpose limited liability company and wholly owned subsidiary of Taco Bell Corp, and its special-purpose, wholly owned subsidiaries, and (vii) the “Restricted Group” refers collectively to the Companies and their subsidiaries, other than the Taco Bell Securitization Entities which will not be subject to the covenants under the Indenture governing the Subsidiary Senior Unsecured Notes and the Credit Agreement, and also excludes the Parent and ABR Insurance Company which will not be subject to such covenants as well.

This discussion should be read in conjunction with the Consolidated Financial Statements (“Financial Statements”) and the section “Management’s Discussion and Analysis of Financial Condition and Results of Operations” contained in our 2019 10-K and contains additional information related to the pro forma results of operations and financial condition of the Restricted Group. None of the financial information in this discussion has been audited or reviewed by our auditors. This discussion has been prepared and posted to our website in accordance with our reporting obligations under the Indenture governing the Subsidiary Senior Unsecured Notes and the Credit Agreement. You should read the following Restricted Group’s pro forma results of operation and financial condition together with the information included in our 2019 10-K, especially the information under the heading “Risk Factors”.

### ***Pro Forma Results of Operations for the Restricted Group***

The following table sets forth certain unaudited financial and operating data of the Restricted Group as of the dates and for the periods indicated after giving pro forma effect to the exclusion of the Taco Bell Securitization Entities from the Restricted Group as if the Securitization Transaction had occurred on the first day of fiscal year 2017.

| (in millions)                                              | Amount          |                 |                 | % B/(W)   |           |
|------------------------------------------------------------|-----------------|-----------------|-----------------|-----------|-----------|
|                                                            | 2019            | 2018            | 2017            | 2019      | 2018      |
| Company sales                                              | \$ 1,546        | \$ 2,000        | \$ 3,572        | (23)      | (44)      |
| Franchise and property revenues                            | 2,060           | 1,944           | 1,816           | 6         | 7         |
| Franchise contributions for advertising and other services | 1,391           | 1,206           | -               | 15        | N/A       |
| Total revenues                                             | <u>\$ 4,997</u> | <u>\$ 5,150</u> | <u>\$ 5,388</u> | (3)       | (4)       |
| Restaurant profit                                          | \$ 260          | \$ 309          | \$ 544          | (16)      | (43)      |
| Restaurant margin %                                        | 16.9%           | 15.5%           | 15.2%           | 1.4 ppts. | 0.3 ppts. |
| G&A expenses                                               | \$ 778          | \$ 766          | \$ 879          | (2)       | 13        |
| Franchise and property expenses                            | 180             | 188             | 237             | 4         | 21        |
| Franchise advertising and other services expense           | 1,368           | 1,208           | -               | (13)      | N/A       |
| Refranchising (gain) loss                                  | (37)            | (540)           | (1,083)         | (93)      | (50)      |
| Other (income) expense                                     | 4               | 7               | 10              | NM        | NM        |
| Operating Profit                                           | <u>\$ 1,418</u> | <u>\$ 1,830</u> | <u>\$ 2,317</u> | (23)      | (21)      |

For fiscal years 2019, 2018 and 2017 rent expense for the Restricted Group was \$121 million, \$151 million and \$214 million, respectively.

|                     | 2019          | 2018          | 2017          | % Increase<br>(Decrease) |      |
|---------------------|---------------|---------------|---------------|--------------------------|------|
|                     |               |               |               | 2019                     | 2018 |
| <u>Unit Count</u>   |               |               |               |                          |      |
| Franchise & License | 42,958        | 41,142        | 37,804        | 4                        | 9    |
| Company-owned       | 913           | 856           | 1,481         | 7                        | (42) |
|                     | <u>43,871</u> | <u>41,998</u> | <u>39,285</u> | 4                        | 7    |

|                                                             | 2019 | 2018 |
|-------------------------------------------------------------|------|------|
| System Sales Growth (decline), reported                     | 6%   | 4%   |
| System Sales Growth, excluding FX                           | 9%   | 4%   |
| System Sales Growth, excluding FX and 53 <sup>rd</sup> week | 8%   | N/ A |
| Same-Store Sales Growth %                                   | 3%   | 2%   |

The Securitization Transaction and the exclusion of the Taco Bell Securitization Entities from the Restricted Group had the following pro forma impact on the financial and operating data of the Restricted Group and the Taco Bell Division of the Restricted Group in comparison to the corresponding data of YUM and the Taco Bell Division:

Units

- A total of 6,299, 6,126 and 5,799 U.S. Taco Bell franchise units were excluded from the Restricted Group for the fiscal years 2019, 2018 and 2017, respectively, as the Restricted Group no longer receives franchise fees from these restaurants.

Franchise and Property Revenues

- Franchise and property revenues of \$600 million, \$538 million and \$490 million were excluded from the Restricted Group for the fiscal years 2019, 2018 and 2017, respectively, due to the exclusion of the franchise fees paid by all U.S. Taco Bell franchise restaurants as a result of the Securitization Transaction.

Company Restaurant Expenses

- The Restricted Group includes \$51 million, \$57 million and \$74 million of additional company restaurant expenses for the fiscal years 2019, 2018 and 2017, respectively, due to the payment of royalty fees of 5.5% of annual sales to the Taco Bell Securitization Entities by all U.S. Company-owned Taco Bell restaurants (which are part of the Restricted Group).

G&A Expenses

- Management fees of \$132 million, \$123 million and \$120 million for the fiscal years 2019, 2018 and 2017 were paid by the Taco Bell Securitization Entities to Taco Bell Corp. as manager of the Taco Bell Securitization Entities, and were recorded as a reduction of G&A expenses for the Restricted Group. On an annual basis, these management fees are equal to the sum of a base fee of \$35 million (subject to 2% per annum escalation, compounded annually) plus 15.1% of total securitization cash revenue paid to the Taco Bell Securitization Entities by U.S. company stores and U.S. franchisees for the year.

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

Beginning in 2018, amounts transferred to or on behalf of Yum! Brands, Inc. as Parent Entity Expenses (as defined in the Indentures) or operating costs and expenses incurred in the ordinary course of business (as permitted by the Credit Agreement) were excluded from G&A expenses of the Restricted Group. G&A expenses of the Restricted Group were reduced for such costs by \$7 million and \$6 million for the fiscal years 2019 and 2018, respectively.

System sales growth was negatively impacted by the refranchising of U.S. Company-owned Taco Bell restaurants. These refranchised units were no longer included in the Restricted Group upon completion of the refranchising transaction.

**Restricted Group - Taco Bell Division**

| (in millions)                                              |                 |                 |                 | % B/(W)   |           |                                   | % B/(W)   |           |
|------------------------------------------------------------|-----------------|-----------------|-----------------|-----------|-----------|-----------------------------------|-----------|-----------|
|                                                            |                 |                 |                 | 2019      |           |                                   | 2018      |           |
|                                                            | 2019            | 2018            | 2017            | Reported  | Ex FX     | Ex FX and<br>53rd Week<br>in 2019 | Reported  | Ex FX     |
| System Sales                                               | \$ 1,410        | \$ 1,459        | \$ 1,711        | (3)       | (2)       | (4)                               | (15)      | (15)      |
| Same-Store Sales Growth %                                  |                 |                 |                 | 4         | N/A       | N/A                               | 5         | N/A       |
| Company sales                                              | \$ 921          | \$ 1,037        | \$ 1,359        | (11)      | (11)      | (13)                              | (24)      | (24)      |
| Franchise and property revenues                            | 73              | 52              | 31              | 38        | 39        | 38                                | 66        | 66        |
| Franchise contributions for advertising and other services | 485             | 429             | —               | 13        | 13        | 11                                | N/A       | N/A       |
| Total revenues                                             | <u>\$ 1,479</u> | <u>\$ 1,518</u> | <u>\$ 1,390</u> | (3)       | (3)       | (4)                               | 9         | 9         |
| Restaurant profit                                          | \$ 170          | \$ 187          | \$ 231          | (9)       | (9)       | (11)                              | (19)      | (19)      |
| Restaurant margin %                                        | 18.5%           | 18.0%           | 16.9%           | 0.5 ppts. | 0.5 ppts. | 0.4 ppts.                         | 1.1 ppts. | 1.1 ppts. |
| G&A expenses                                               | \$ 49           | \$ 54           | \$ 68           | 9         | 8         | 6                                 | 21        | 21        |
| Franchise and property expenses                            | 38              | 28              | 22              | (33)      | (33)      | (32)                              | (31)      | (31)      |
| Franchise advertising and other services expense           | 481             | 428             | —               | (12)      | (12)      | (11)                              | N/A       | N/A       |
| Operating Profit                                           | \$ 164          | \$ 161          | \$ 175          | 2         | 2         | (1)                               | (8)       | (8)       |

|                     |              |            |              | % Increase<br>(Decrease) |      |
|---------------------|--------------|------------|--------------|--------------------------|------|
|                     | 2019         | 2018       | 2017         | 2019                     | 2018 |
| <u>Unit Count</u>   |              |            |              |                          |      |
| Franchise & License | 596          | 476        | 397          | 25                       | 20   |
| Company-owned       | 468          | 470        | 653          | -                        | (28) |
|                     | <u>1,064</u> | <u>946</u> | <u>1,050</u> | 12                       | (10) |

**Company Sales.** In 2019, the decrease in Company sales, excluding the impact of 53<sup>rd</sup> week, was driven by refranchising partially offset by company same-store sales growth of 4% and net new unit growth.

In 2018, the decrease in Company sales was driven primarily by refranchising, partially offset by company same-store sales growth of 4% and net unit growth.

**Restaurant Margin Percentage.** In 2019, the increase in restaurant margin percentage was driven by same-store sales growth partially offset by higher labor and commodity costs.

In 2018, the increase in restaurant margin percentage was driven by same-store sales growth partially offset by higher labor costs.

*G&A Expenses.* In 2019, the decrease in G&A expenses, excluding the impact of 53<sup>rd</sup> week, was driven by higher management fees paid by the Taco Bell Securitization Entities and the positive impact of YUM's Strategic Transformation Initiatives, partially offset by higher expenses related to our deferred and incentive compensation programs and the unfavorable impact of lapping prior year forfeitures related to share based compensation awards.

In 2018, the decrease in G&A expenses was driven by the positive impact of YUM's Strategic Transformation Initiatives, including reductions in G&A directly attributable to refranchising, the favorable impact of forfeitures related to share based compensation awards and higher management fees paid by the Taco Bell Securitization Entities, partially offset by lapping lower litigation costs.

*Operating Profit.* In 2019, the increase in Operating Profit, excluding the impacts of foreign currency translation and 53<sup>rd</sup> week, was driven by same-store sales growth, partially offset by refranchising and higher restaurant operating costs.

In 2018, the decrease in Operating Profit was driven by refranchising and higher restaurant operating costs, partially offset by same-store sales growth.

#### **Additional Information Related to Restricted Group:**

##### **Adoption of Topic 842**

Starting in February 2016 and continuing into 2019, the Financial Accounting Standards Board ("FASB") issued standards on the recognition and measurement of leases ("Topic 842"). We adopted these standards beginning with the quarter ended March 31, 2019, using a modified retrospective transition approach for leases existing at, or entered into after, the beginning of 2019. The impact on the Restricted Group Operating Profit was not significant.

##### **Adoption of Topic 606**

From 2014 through 2017 the FASB issued standards to provide principles within a single framework for revenue recognition of transactions involving contracts with customers across all industries ("Topic 606"). We adopted these standards beginning with the quarter ended March 31, 2018, using the modified retrospective method. The impact on the Restricted Group Operating Profit was not significant.

Refer to the 2019 10-K for further discussion.