

YUM BRANDS INC
Form 10-Q
July 21, 2009

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

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the quarterly period ended June 13, 2009

OR

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

For the transition period from _____ to _____

Commission file number 1-13163

YUM! BRANDS, INC.

(Exact name of registrant as specified in its charter)

North Carolina
(State or other jurisdiction of
incorporation or organization)

13-3951308
(I.R.S. Employer
Identification No.)

1441 Gardiner Lane, Louisville, Kentucky
(Address of principal executive offices)

40213
(Zip Code)

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

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

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

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

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

The number of shares outstanding of the Registrant's Common Stock as of July 13, 2009 was 466,558,003 shares.

YUM! BRANDS, INC.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

YUM! BRANDS, INC. AND SUBSIDIARIES

(in millions, except per share data)

	Quarter		Year to date	
	6/13/09	6/14/08	6/13/09	6/14/08
Revenues				
Company sales	\$ 2,152	\$ 2,323	\$ 4,070	\$ 4,417
Franchise and license fees and income	324	336	623	655
Total revenues	2,476	2,659	4,693	5,072
Costs and Expenses, Net				
Company restaurants				
Food and paper	693	766	1,304	1,435
Payroll and employee benefits	505	574	962	1,107
Occupancy and other operating expenses	630	672	1,172	1,256
Company restaurant expenses	1,828	2,012	3,438	3,798
General and administrative expenses	281	317	536	593
Franchise and license expenses	25	19	45	38
Closures and impairment (income) expenses	22	8	26	6
Refranchising (gain) loss	1	(1)	(13)	24
Other (income) expense	(75)	(13)	(84)	(130)
Total costs and expenses, net	2,082	2,342	3,948	4,329
Operating Profit	394	317	745	743
Interest expense, net	43	52	96	105
Income Before Income Taxes	351	265	649	638
Income tax provision	45	40	124	157
Net Income – including noncontrolling interest	306	225	525	481
Net Income – noncontrolling interest	3	1	4	3
Net Income – YUM! Brands, Inc.	\$ 303	\$ 224	\$ 521	\$ 478
Basic Earnings Per Common Share	\$ 0.65	\$ 0.47	\$ 1.11	\$ 0.99
Diluted Earnings Per Common Share	\$ 0.63	\$ 0.45	\$ 1.08	\$ 0.95
Dividends Declared Per Common Share	\$ 0.38	\$ 0.19	\$ 0.38	\$ 0.34

See accompanying Notes to Condensed Consolidated Financial Statements.

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

	Year to date	
	6/13/09	6/14/08
Cash Flows – Operating Activities		
Net Income – including noncontrolling interest	\$ 525	\$ 481
Depreciation and amortization	246	250
Closures and impairment (income) expenses	26	6
Refranchising (gain) loss	(13)	24
Contributions to defined benefit pension plans	(92)	(2)
Gain upon consolidation of a former unconsolidated affiliate in China	(68)	—
Gain on sale of interest in Japan unconsolidated affiliate	—	(100)
Deferred income taxes	(29)	13
Equity income from investments in unconsolidated affiliates	(17)	(20)
Distributions of income received from unconsolidated affiliates	8	22
Excess tax benefits from share-based compensation	(43)	(31)
Share-based compensation expense	26	29
Changes in accounts and notes receivable	(19)	6
Changes in inventories	15	(1)
Changes in prepaid expenses and other current assets	(18)	(9)
Changes in accounts payable and other current liabilities	(140)	(88)
Changes in income taxes payable	15	(19)
Other non-cash charges and credits, net	73	65
Net Cash Provided by Operating Activities	495	626
Cash Flows – Investing Activities		
Capital spending	(342)	(348)
Proceeds from refranchising of restaurants	63	66
Acquisition of restaurants from franchisees	(22)	(3)
Acquisitions and investments	(56)	—
Sales of property, plant and equipment	8	34
Other, net	(7)	(4)
Net Cash Used in Investing Activities	(356)	(255)
Cash Flows – Financing Activities		
Repayments of long-term debt	(144)	(257)
Revolving credit facilities, three months or less, net	108	475
Short-term borrowings by original maturity		
More than three months - proceeds	—	—
More than three months - payments	—	—
Three months or less, net	4	(9)
Repurchase shares of Common Stock	—	(994)
Excess tax benefits from share-based compensation	43	31
Employee stock option proceeds	77	40
Dividends paid on Common Stock	(175)	(146)
Other, net	5	—
Net Cash Used in Financing Activities	(82)	(860)

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Effect of Exchange Rates on Cash and Cash Equivalents	(6)	8
Net Increase (Decrease) in Cash and Cash Equivalents	51	(481)
Change in Cash and Cash Equivalents due to consolidation of entities in China	17	17
Cash and Cash Equivalents - Beginning of Period	216	789
Cash and Cash Equivalents - End of Period	\$ 284	\$ 325

See accompanying Notes to Condensed Consolidated Financial
Statements.

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

	(Unaudited)	
	6/13/09	12/27/08
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 284	\$ 216
Accounts and notes receivable, net	278	229
Inventories	134	143
Prepaid expenses and other current assets	201	172
Deferred income taxes	84	81
Advertising cooperative assets, restricted	90	110
Total Current Assets	1,071	951
Property, plant and equipment, net	3,807	3,710
Goodwill	760	605
Intangible assets, net	341	335
Investments in unconsolidated affiliates	23	65
Other assets	582	561
Deferred income taxes	340	300
Total Assets	\$ 6,924	\$ 6,527
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)		
Current Liabilities		
Accounts payable and other current liabilities	\$ 1,343	\$ 1,473
Income taxes payable	87	114
Short-term borrowings	32	25
Advertising cooperative liabilities	90	110
Total Current Liabilities	1,552	1,722
Long-term debt	3,516	3,564
Other liabilities and deferred credits	1,299	1,335
Total Liabilities	6,367	6,621
Shareholders' Equity (Deficit)		
Common Stock, no par value, 750 shares authorized; 466 shares and 459 shares issued in 2009 and 2008, respectively	170	7
Retained earnings	646	303
Accumulated other comprehensive income (loss)	(340)	(418)
Total Shareholders' Equity (Deficit) – YUM! Brands, Inc.	476	(108)
Noncontrolling interest	81	14
Total Shareholders' Equity (Deficit)	557	(94)
Total Liabilities and Shareholders' Equity (Deficit)	\$ 6,924	\$ 6,527

See accompanying Notes to Condensed Consolidated Financial Statements.

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

Note 1 - Financial Statement Presentation

We have prepared our accompanying unaudited Condensed Consolidated Financial Statements (“Financial Statements”) in accordance with the rules and regulations of the Securities and Exchange Commission (“SEC”) for interim financial information. Accordingly, they do not include all of the information and footnotes required by United States (“U.S.”) generally accepted accounting principles for complete financial statements. Therefore, we suggest that the accompanying Financial Statements be read in conjunction with the Consolidated Financial Statements and Notes thereto included in our annual report on Form 10-K for the fiscal year ended December 27, 2008 (“2008 Form 10-K”). Except as disclosed herein, there has been no material change in the information disclosed in the Notes to our Consolidated Financial Statements included in the 2008 Form 10-K.

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

YUM’s business consists of three reporting segments: United States, YUM Restaurants International (“YRI” or “International Division”) and YUM Restaurants China (“China Division”). The China Division includes mainland China (“China”), Thailand, and KFC Taiwan, and YRI includes the remainder of our international operations.

Our fiscal year ends on the last Saturday in December and, as a result, a 53rd week is added every five or six years. The first three quarters of each fiscal year consist of 12 weeks and the fourth quarter consists of 16 weeks in fiscal years with 52 weeks and 17 weeks in fiscal years with 53 weeks. Our subsidiaries operate on similar fiscal calendars except that certain international subsidiaries operate on a monthly calendar, with two months in the first quarter, three months in the second and third quarters and four months in the fourth quarter. All of our international businesses except China close one period or one month earlier to facilitate consolidated reporting.

In 2008, we began consolidating an entity in which we have a majority ownership interest and that operates the KFCs in Beijing, China. Additionally, as discussed in Note 4, in the quarter ended June 13, 2009 we began consolidating the entity that operates the KFCs in Shanghai, China. The increases in cash related to the consolidation of these entities’ cash balances (\$17 million in both instances) are presented as a single line item on our Condensed Consolidated Statement of Cash Flows.

Our preparation of the accompanying Financial Statements in conformity with generally accepted accounting principles 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 the estimates.

In our opinion, the accompanying Financial Statements include all normal and recurring adjustments considered necessary to present fairly, when read in conjunction with our 2008 Form 10-K, our financial position as of June 13, 2009, and the results of our operations for the quarters and years to date ended June 13, 2009 and June 14, 2008 and cash flows for the years to date ended June 13, 2009 and June 14, 2008. Our results of operations for these interim periods are not necessarily indicative of the results to be expected for the full year.

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

We have reclassified certain items in the accompanying Financial Statements and Notes to the Financial Statements for the prior periods in order to be comparable with the current classifications. As discussed in our 2008 Form 10-K, we have begun reporting capital spending on our Condensed Consolidated Statements of Cash Flows excluding the impact of purchases that have been accrued but not yet paid. For the year to date ended June 14, 2008 this resulted in increased Capital spending of \$13 million with an offsetting impact to Changes in accounts payable and other current liabilities. Also, as rental income from franchisees has increased over time and is anticipated to continue to increase, we believe it is more appropriate to report such income as Franchise and license fees and income as opposed to a reduction in Franchise and license expenses, as it has historically been reported. For the quarter and year to date ended June 14, 2008 this resulted in an increase of \$6 million and \$11 million, respectively, in both Franchise and license expenses and Franchise and license fees and income in our Condensed Consolidated Statement of Income. A similar amount of rental income was reported in Franchise and license fees and income in the quarter and year to date ended June 13, 2009. These reclassifications had no effect on previously reported Net Income.

Note 2 - Earnings Per Common Share (“EPS”)

	Quarter ended		Year to date	
	6/13/09	6/14/08	6/13/09	6/14/08
Net Income – YUM! Brands, Inc.	\$ 303	\$ 224	\$ 521	\$ 478
Weighted-average common shares outstanding (for basic calculation)	470	480	468	483
Effect of dilutive share-based employee compensation	13	18	13	18
Weighted-average common and dilutive potential common shares outstanding (for diluted calculation)	483	498	481	501
Basic EPS	\$ 0.65	\$ 0.47	\$ 1.11	\$ 0.99
Diluted EPS	\$ 0.63	\$ 0.45	\$ 1.08	\$ 0.95
Unexercised employee stock options and stock appreciation rights (in millions) excluded from the diluted EPS computation(a)	13.9	6.6	14.6	5.4

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

Note 3 - Shareholders’ Equity

Under the authority of our Board of Directors, we repurchased shares of our Common Stock during the year to date ended June 14, 2008, as indicated below. All amounts exclude applicable transaction fees. We had no share repurchases in the year to date ended June 13, 2009.

Authorization Date	Shares Repurchased (thousands)		Dollar Value of Shares Repurchased	
	2009	2008	2009	2008
January 2008	—	5,141	\$ —	\$ 179

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October 2007	—	22,875	—	813
Total	—	28,016	\$	— \$ 992(a)

- (a) Amount excludes the effect of \$13 million in share repurchases (0.4 million shares) with trade dates prior to the 2007 fiscal year end but cash settlement dates subsequent to the 2007 fiscal year end and includes the effect of \$11 million in share repurchases (0.3 million shares) with trade dates prior to June 14, 2008 but cash settlement dates subsequent to June 14, 2008.

Comprehensive income was as follows:

	Quarter ended		Year to date	
	6/13/09	6/14/08	6/13/09	6/14/08
Net Income – YUM! Brands, Inc.	\$ 303	\$ 224	\$ 521	\$ 478
Foreign currency translation adjustment arising during the period	73	20	65	28
Foreign currency translation adjustment included in Net Income	—	—	—	(25)
Changes in fair value of derivatives, net of tax	(9)	—	5	10
Reclassification of derivative (gains) losses to Net Income, net of tax	9	—	3	(9)
Reclassification of pension actuarial losses to Net Income, net of tax	3	2	5	3
Total comprehensive income	\$ 379	\$ 246	\$ 599	\$ 485

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

U.S. Business Transformation

As part of our plan to transform our U.S. business we took several measures in 2008 and are taking similar measures in 2009 (“the U.S. business transformation measures”). These measures include: expansion of our U.S. refranchising; charges relating to General and Administrative (“G&A”) productivity initiatives and realignment of resources (primarily severance and early retirement costs); and investments in our U.S. Brands made on behalf of our franchisees such as equipment purchases.

In the quarter and year to date ended June 13, 2009, we recorded pre-tax gains of \$1 million and \$15 million, respectively, from refranchising in the U.S. In the quarter and year to date ended June 14, 2008, we recorded a pre-tax gain of \$1 million and a pre-tax loss of \$25 million, respectively, from refranchising in the U.S. The refranchising losses recorded for the year to date ended June 14, 2008 were primarily due to our refranchising of, or our offers to refranchise, stores or groups of stores, principally at Long John Silver’s, for prices less than their recorded carrying value.

In connection with our G&A productivity initiatives and realignment of resources we recorded pre-tax charges of \$5 million and \$2 million in the quarters ended June 13, 2009 and June 14, 2008, respectively, and pre-tax charges of \$9 million and \$7 million in the years to date ended June 13, 2009 and June 14, 2008, respectively. The unpaid current liability for the severance portion of these charges was \$15 million as of June 13, 2009. Severance payments in the quarter and year to date ended June 13, 2009 totaled approximately \$8 million and \$16 million, respectively.

Additionally, the Company recognized a reduction to Franchise and license fees and income of \$4 million and \$31 million, pre-tax, in the quarter and year to date ended June 13, 2009, respectively, related to investments in our U.S. Brands. These investments reflect our reimbursements to, or obligations to reimburse, KFC franchisees for installation costs of ovens for the national launch of Kentucky Grilled Chicken. This reduction to Franchise and license fees and income was recorded in accordance with Emerging Issues Task Force (“EITF”) Issue No. 01-9, “Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor’s Products)”. In the quarter and year to date ended June 14, 2008, the Company recognized pre-tax expense of \$2 million and \$3 million, respectively, related to investments in our U.S. Brands.

We are not including the impacts of these U.S. business transformation measures in our U.S. segment for performance reporting purposes as we do not believe they are indicative of our ongoing operations.

Acquisition of Little Sheep

On March 24, 2009, our China Division paid approximately \$44 million to purchase 14% of the outstanding common shares of Little Sheep Group Limited (“Little Sheep”). This investment is included in Other assets on our Condensed Consolidated Balance Sheet as of June 13, 2009. Subsequent to the end of our second quarter, we have purchased an additional 6% of Little Sheep for \$19 million and obtained Board of Directors representation. Accordingly, in the quarter ending September 5, 2009 we will begin reporting our investment in Little Sheep using the equity method of accounting.

Little Sheep is the leading brand in China’s “Hot Pot” restaurant category with approximately 375 restaurants, primarily in China as well as Hong Kong, Japan, Canada and the U.S.

Consolidation of a Former Unconsolidated Affiliate in China

On May 4, 2009 we acquired an additional 7% ownership in the entity that operates more than 200 KFCs in Shanghai, China for \$12 million, increasing our ownership to 58%. The acquisition was driven by our desire to increase our management control over the entity and further integrate the business with the remainder of our KFC operations in China. This entity has historically been accounted for as an unconsolidated affiliate under the equity method of accounting, due to the effective participation of our partners in the significant decisions of the entity that were made in the ordinary course of business as addressed in EITF Issue No. 96-16, "Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights". Concurrent with the acquisition we received additional rights in the governance of the entity, and thus we began consolidating the entity upon acquisition. As required by Statement of Financial Accounting Standards (“SFAS”) No. 141(R), “Business Combinations” (“SFAS 141R”), we remeasured our previously held 51% ownership in the entity, which had a recorded value of \$17 million at the date of acquisition, at fair value and recognized a gain of \$68 million accordingly. This gain, which resulted in no related income tax expense, was recorded in Other (income) expense on our Condensed Consolidated Statements of Income during the quarter ended June 13, 2009 and was not allocated to any segment for performance reporting purposes.

While we have not yet completed the determination of all identifiable assets acquired and liabilities assumed, our Condensed Consolidated Balance Sheet at June 13, 2009 reflects consolidation of this entity using preliminary amounts. We have preliminarily assigned fair values such that assets and liabilities recorded at the acquisition date for the consolidated entity were as follows:

Current assets, including cash of \$17	\$ 27
Property, plant and equipment	66
Goodwill	133
Other long-term assets	2
Total assets acquired	228
Current liabilities	53

Other long-term liabilities	8
Total liabilities assumed	61
Net assets acquired	\$167

Additionally, \$70 million was recorded as Noncontrolling interest in our Condensed Consolidated Balance Sheet, representing the fair value of our partner's interest in the entity's net assets upon acquisition.

We anticipate that the preliminary amount allocated to the China Division's goodwill, which is not expected to be deductible for income purposes, will be retroactively reduced upon completion of the determination of all identifiable assets acquired and liabilities assumed. We do not anticipate any retroactive adjustment to our results of operations will be significant.

Under the equity method of accounting, we previously reported our 51% share of the net income of the unconsolidated affiliate (after interest expense and income taxes) as Other (income) expense in the Condensed Consolidated Statements of Income. We also recorded a franchise fee for the royalty received from the stores owned by the unconsolidated affiliate. From the date of the acquisition through May 31, 2009 (our China Division's second quarter end), we reported Company sales and the associated restaurant costs, general and administrative expense, interest expense and income taxes for the entity in the appropriate line items of our Condensed Consolidated Statement of Income. We no longer recorded franchise fee income for these restaurants nor did we report Other (income) expense as we did under the equity method of accounting. For the quarter ended June 13, 2009 the consolidation of this entity increased Company sales by \$23 million and decreased Franchise and license fees and income by \$1 million. The impacts of consolidation on all other line items within our Condensed Consolidated Statement of Income were not significant.

The pro forma impact on our results of operations if the acquisition had been completed as of the beginning of both 2009 and 2008 would not have been significant.

Cash Tender Offer to Purchase Senior Unsecured Notes

During the quarter ended June 13, 2009 we completed a cash tender offer to repurchase certain of our Senior Unsecured Notes due July 1, 2012 with an aggregate principal amount of \$137 million. In conjunction with this transaction, we settled interest rate swaps with a notional amount of \$150 million that were hedging these Senior Unsecured Notes, receiving \$14 million in cash. The net impact of the Senior Unsecured Notes repurchase and related interest rate swap settlement had no significant impact on Interest expense, net in the quarter ended June 13, 2009.

Facility Actions

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

	Quarter ended June 13, 2009			
	U.S.	YRI	China Division	Worldwide
Refranchising (gain) loss(a)	\$ (1)	\$ 2	\$ —	\$ 1
Store closure (income) costs(b)	\$ 2	\$ —	\$ (1)	\$ 1
Store impairment charges	12	3	6	21
Closure and impairment (income) expenses	\$ 14	\$ 3	\$ 5	\$ 22
	Quarter ended June 14, 2008			
	U.S.	YRI	China Division	Worldwide
Refranchising (gain) loss(a)	\$ (1)	\$ 1	\$ (1)	\$ (1)
Store closure (income) costs(b)	\$ (6)	\$ (1)	\$ (2)	\$ (9)
Store impairment charges	12	1	4	17
Closure and impairment (income) expenses	\$ 6	\$ —	\$ 2	\$ 8
	Year to date ended June 13, 2009			
	U.S.	YRI	China Division	Worldwide
Refranchising (gain) loss(a)	\$ (15)	\$ 2	\$ —	\$ (13)
Store closure (income) costs(b)	\$ 3	\$ 1	\$ —	\$ 4
Store impairment charges	13	3	6	22
Closure and impairment (income) expenses	\$ 16	\$ 4	\$ 6	\$ 26

	Year to date ended June 14, 2008			
	U.S.	YRI	China Division	Worldwide
Refranchising (gain) loss(a)	\$ 25	\$ —	\$ (1)	\$ 24
Store closure (income) costs(b)	\$ (8)	\$ (3)	\$ (2)	\$ (13)
Store impairment charges	13	2	4	19
Closure and impairment (income) expenses	\$ 5	\$ (1)	\$ 2	\$ 6

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

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

Assets held for sale at June 13, 2009 and December 27, 2008 total \$21 million and \$31 million, respectively, of U.S. property, plant and equipment and are included in Prepaid expenses and other current assets on our Condensed Consolidated Balance Sheets.

Note 5 - Recently Adopted Accounting Pronouncements

In February 2008, the Financial Accounting Standards Board (“FASB”) issued FASB Staff Position (“FSP”) No. 157-2, “Effective Date of FASB Statement No. 157” which permitted a one-year deferral for the implementation of SFAS No. 157, “Fair Value Measurements” (“SFAS 157”) with regard to non-financial assets and liabilities that are not recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). We adopted SFAS 157 at the beginning of 2009 for such non-financial assets and liabilities, which, for the Company, primarily includes long-lived assets, goodwill and intangibles. The fair values of such non-financial assets and liabilities at June 13, 2009 are included in the required disclosures in Note 12. The full adoption of SFAS 157 did not materially impact the measurement of these disclosed amounts.

In December 2007, the FASB issued SFAS 141R. SFAS 141R, which is broader in scope than SFAS 141, applies to all transactions or other events in which an entity obtains control of one or more businesses, and requires that the acquisition method be used for such transactions or events. SFAS 141R, with limited exceptions, will require an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date. This will result in acquisition related costs and anticipated restructuring costs related to the acquisition being recognized separately from the business combination. The Company adopted SFAS 141R on December 28, 2008. Adoption of SFAS 141R did not significantly impact the accounting for the Company’s acquisitions of franchise restaurants in the quarter or year to date ended June 13, 2009. SFAS 141R did require that our existing equity interest in the entity that operates the KFCs in Shanghai, China be remeasured at its fair value upon our acquisition of additional ownership in and consolidation of the entity (See Note 4).

In December 2007, the FASB issued SFAS No. 160, “Noncontrolling Interests in Consolidated Financial Statements” (“SFAS 160”). SFAS 160 amends Accounting Research Bulletin No. 51, “Consolidated Financial Statements,” and changed the accounting and reporting for noncontrolling interests, which are the portion of equity in a subsidiary not attributable, directly or indirectly, to a parent. SFAS 160 was effective for the quarter ended March 21, 2009 for the Company and requires retroactive adoption of its presentation and disclosure requirements. SFAS 160 requires us to report net income attributable to the noncontrolling interests separately on the face of our Condensed Consolidated Statements of Income. Additionally, SFAS 160 requires that the portion of equity in the entity not attributable to the Company be reported within equity, separately from the Company’s equity on the Condensed Consolidated Balance Sheets.

In 2008, the Company consolidated one entity for which a third party owned a noncontrolling interest. This entity operates the KFCs in Beijing, China. Prior to the adoption of SFAS 160, we reported Operating Profit attributable to the noncontrolling interest in the Beijing entity in Other (income) expense and the related tax impact as a reduction to our Income tax provision. Additionally, we reported the equity attributable to the noncontrolling interest in the Beijing entity within Other liabilities and deferred credits. As required, the presentation requirements of SFAS 160 were applied retroactively to the quarter and year to date ended June 14, 2008 for this noncontrolling interest.

During second quarter 2009, we began consolidating the entity that operates the KFCs in Shanghai, China in which a third party owns a noncontrolling interest (See Note 4). We are accounting for the noncontrolling interest in this entity in accordance with SFAS 160.

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

Noncontrolling interest as of December 27, 2008 \$ 14

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Net income – noncontrolling interest	4
Purchase of subsidiary shares from noncontrolling interest (See Note 4)	70
Dividends declared	(7)
Noncontrolling interest as of June 13, 2009	\$ 81

In March 2008, the FASB issued SFAS No. 161, “Disclosures about Derivative Instruments and Hedging Activities” (“SFAS 161”). SFAS 161 amends and expands the disclosure requirements in SFAS 133, “Accounting for Derivative Instruments and Hedging Activities”. SFAS 161 was effective for the quarter ended March 21, 2009 for the Company, and we have included the required disclosures in Note 11.

Note 6 - New Accounting Pronouncements Not Yet Adopted

In December 2008, the FASB issued FSP No. FAS 132(R)-1 (“FSP FAS 132(R)-1”), “Employers’ Disclosures about Postretirement Benefit Plan Assets,” which expands the disclosure requirements about plan assets for defined benefit pension plans and postretirement plans. FSP FAS 132(R)-1 is effective for financial statements issued for fiscal years ending after December 15, 2009, the year ending December 26, 2009 for the Company.

In April 2009, the FASB issued FSP No. FAS 157-4 (“FSP FAS 157-4”), “Determining Fair Value When the Volume and Level of Activity for the Asset or Liability has Significantly Decreased and Identifying Transactions That Are Not Orderly” and FSP No. FAS 115-2 and FAS 124-2 (“FSP FAS 115-2”), “Recognition and Presentation of Other-Than-Temporary Impairments”. These two FSPs were issued to provide additional guidance about (1) measuring the fair value of financial instruments when the markets become inactive and quoted prices may reflect distressed transactions, and (2) recording impairment charges on investments in debt instruments. Additionally, the FASB issued FSP No. FAS 107-1 and APB 28-1 (“FSP FAS 107-1”), “Interim Disclosures about Fair Value of Financial Instruments,” to require disclosures of fair value of certain financial instruments in interim financial statements. We do not anticipate the adoption of these FSPs will materially impact the Company. These FSPs are effective for financial statements issued for interim and annual reporting periods ending after June 15, 2009, the quarter ending September 5, 2009 for the Company.

In May 2009, the FASB issued SFAS No. 165, “Subsequent Events” (“SFAS 165”). SFAS 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. We do not anticipate the adoption of SFAS 165 will materially impact the Company. SFAS 165 is effective for interim or annual financial periods ending after June 15, 2009, the quarter ending September 5, 2009 for the Company.

In June 2009, the FASB issued SFAS No. 166, “Accounting for Transfers of Financial Assets – an amendment of FASB Statement No. 140” (“SFAS 166”) and SFAS No. 167, “Amendments to FASB Interpretation No. 46(R)” (“SFAS 167”). SFAS 166 will require more information about transfers of financial assets, eliminates the qualifying special purpose entity (QSPE) concept, changes the requirements for derecognizing financial assets and requires additional disclosures. SFAS 167 amends FASB Interpretation No. 46(R), “Consolidation of Variable Interest Entities” regarding certain guidance for determining whether an entity is a variable interest entity and modifies the methods allowed for determining the primary beneficiary of a variable interest entity. In addition, SFAS 167 requires ongoing reassessments of whether an enterprise is the primary beneficiary of a variable interest entity and enhanced disclosures related to an enterprise’s involvement in a variable interest entity. We are evaluating whether the adoption of SFAS 166 and SFAS 167 will require the Company to consolidate an entity that provides loans used primarily to assist franchisees in the development of new restaurants and, to a lesser extent, in connection with the Company’s historical refranchising programs. The consolidation of this entity would increase the Company’s long-term debt by approximately \$49 million with a corresponding increase to receivables. See Note 13 for additional information regarding this franchisee loan program. SFAS 166 and SFAS 167 are effective for the first annual reporting period that begins after November 15, 2009, our fiscal 2010.

In June 2009, the FASB issued SFAS No. 168, “The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles – a replacement of FASB Statement No. 162” (“SFAS 168”). SFAS 168 provides for the FASB Accounting Standards Codification™ (the “Codification”) to become the single official source of authoritative, nongovernmental U.S. generally accepted accounting principles (GAAP). The Codification did not change GAAP but reorganizes the literature. SFAS 168 is effective for interim and annual periods ending after September 15, 2009, the quarter ending December 26, 2009 for the Company.

Note 7 - Other (Income) Expense

	Quarter ended		Year to date	
	6/13/09	6/14/08	6/13/09	6/14/08
Equity income from investments in unconsolidated affiliates	\$ (7)	\$ (9)	\$ (17)	\$ (20)
Gain upon consolidation of former unconsolidated affiliate in China(a)	(68)	—	(68)	—
Gain upon sale of investment in unconsolidated affiliate(b)	—	—	—	(100)
Foreign exchange net (gain) loss and other	—	(4)	1	(10)
Other (income) expense	\$ (75)	\$ (13)	\$ (84)	\$ (130)

(a) See Note 4 for further discussion of the consolidation of a former unconsolidated affiliate in China.

(b) Reflects the gain recognized on the sale of our interest in our unconsolidated affiliate in Japan. See our 2008 Form 10-K for further discussion of this transaction.

Note 8 – Supplemental Balance Sheet Information

	6/13/09	12/27/08
Accounts and notes receivable	\$ 305	\$ 252
Allowance for doubtful accounts	(27)	(23)
Accounts and notes receivable, net	\$ 278	\$ 229
Property, plant and equipment, gross	\$ 7,093	\$ 6,897
Accumulated depreciation and amortization	(3,286)	(3,187)
Property, plant and equipment, net	\$ 3,807	\$ 3,710

Note 9 - Reportable Operating Segments

In connection with our U.S. business transformation measures our reported segment results began reflecting increased allocations of certain expenses in 2009 that were previously reported as unallocated and corporate G&A expenses. While our consolidated results were not impacted, we believe the revised allocation better aligns costs with accountability of our segment managers. These revised allocations are being used by our Chairman and Chief Executive Officer, in his role as chief operating decision maker, in his assessment of operating performance. We have restated segment information for the quarter and year to date ended June 14, 2008 to be consistent with the current period presentation. This resulted in a \$15 million decrease in Unallocated and corporate G&A expense and increases in U.S. and YRI G&A expense of \$13 million and \$2 million, respectively, for the quarter ended June 14, 2008, and a \$27 million decrease in Unallocated and corporate G&A expense and increases in U.S. and YRI G&A expense of \$24 million and \$3 million, respectively, for the year to date ended June 14, 2008.

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

	Quarter ended		Year to date	
	6/13/09	6/14/08	6/13/09	6/14/08
Revenues				
United States	\$ 1,099	\$ 1,226	\$ 2,145	\$ 2,418
YRI(a)	588	730	1,169	1,431
China Division (b)	793	703	1,410	1,223

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Unallocated Franchise and license fees and
income(c)(f)

(4)	—	(31)	—
\$ 2,476	\$ 2,659	\$ 4,693	\$ 5,072

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	Quarter ended		Year to date	
	6/13/09	6/14/08	6/13/09	6/14/08
Operating Profit				
United States	\$ 169	\$ 155	\$ 326	\$ 301
YRI	100	118	223	256
China Division (d)	105	92	236	195
Unallocated Franchise and license fees and income(c)(f)	(4)	—	(31)	—
Unallocated and corporate G&A expenses(f)	(43)	(53)	(89)	(95)
Unallocated Other income (expense)(e)(f)	68	4	67	110
Unallocated Refranchising gain (loss)(f)	(1)	1	13	(24)
Operating Profit	394	317	745	743
Interest expense, net	(43)	(52)	(96)	(105)
Income Before Income Taxes	\$ 351	\$ 265	\$ 649	\$ 638

- (a) Includes revenues of \$236 million and \$296 million for the quarters ended June 13, 2009 and June 14, 2008, respectively, and \$469 million and \$591 million for the years to date ended June 13, 2009 and June 14, 2008, respectively, for entities in the United Kingdom.
- (b) Includes revenues of approximately \$727 million and \$625 million for the quarters ended June 13, 2009 and June 14, 2008, respectively, and approximately \$1.3 billion and \$1.1 billion for the years to date ended June 13, 2009 and June 14, 2008, respectively, in mainland China.
- (c) Amount consists of reimbursements to, or obligations to reimburse, KFC franchisees for installation costs of ovens for the national launch of Kentucky Grilled Chicken. See Note 4.
- (d) Includes equity income from investments in unconsolidated affiliates of \$7 million and \$9 million for the quarters ended June 13, 2009 and June 14, 2008, respectively, and \$17 million and \$19 million for years to date ended June 13, 2009 and June 14, 2008, respectively, for the China Division.
- (e) The quarter and year to date ended June 13, 2009 includes a \$68 million gain recognized upon our acquisition of additional ownership in, and consolidation of, the operating entity that owns the KFCs in Shanghai, China. See Note 4 for further discussion of this transaction. The year to date ended June 14, 2008 includes a \$100 million gain recognized on the sale of our interest in our unconsolidated affiliate in Japan. See our 2008 Form 10-K for further discussion of this transaction.
- (f) Amounts have not been allocated to the U.S., YRI or China Division segments for performance reporting purposes.

Note 10 - Pension Benefits

We sponsor noncontributory defined benefit pension plans covering certain full-time salaried and hourly U.S. employees. The most significant of these plans, the YUM Retirement Plan (the "Plan"), is funded while benefits from the other U.S. 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. We also sponsor various defined benefit pension plans covering certain of our non-U.S. employees, the most significant of which are in the United Kingdom ("U.K."). Our plans in the U.K. have previously been amended such that new employees are not eligible to participate in these plans.

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

	U.S. Pension Plans		International Pension Plans	
	Quarter ended		Quarter ended	
	6/13/09	6/14/08	6/13/09	6/14/08
Service cost	\$ 6	\$ 7	\$ 1	\$ 2
Interest cost	14	12	1	2
Expected return on plan assets	(14)	(12)	(2)	(3)
Amortization of net loss	3	1	1	—
Net periodic benefit cost	\$ 9	\$ 8	\$ 1	\$ 1

	U.S. Pension Plans		International Pension Plans	
	Year to date		Year to date	
	6/13/09	6/14/08	6/13/09	6/14/08
Service cost	\$ 12	\$ 14	\$ 2	\$ 4
Interest cost	27	24	3	4
Expected return on plan assets	(27)	(24)	(3)	(5)
Amortization of net loss	6	3	1	—
Net periodic benefit cost	\$ 18	\$ 17	\$ 3	\$ 3

We made contributions of \$84 million to the Plan during the year to date ended June 13, 2009. Required contributions to the Plan, if any, for the remainder of 2009 are not expected to be significant. However, we may choose to make additional discretionary contributions as part of our overall capital structure strategy. We contributed \$6 million to our U.K. plans during the year to date ended June 13, 2009. The U.K. plans are currently under review to determine if additional pension funding payments will be committed to in 2009.

Note 11 - Derivative Instruments

The Company is exposed to certain market risks relating to its ongoing business operations. The primary market risks managed by using derivative instruments are interest rate risk and cash flow volatility arising from foreign currency fluctuations.

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 June 13, 2009, our interest rate derivative instruments outstanding had notional amounts of \$625 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 No. 133, "Accounting for Derivative Instruments and Hedging Activities", no ineffectiveness has been recorded.

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 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. At June 13, 2009, foreign currency forward contracts outstanding had a total notional amount of \$512 million.

The fair values of derivatives designated as hedging instruments under SFAS 133 at the quarter ended June 13, 2009 were:

	Fair Value	Condensed Consolidated Balance Sheet Location
Interest Rate Swaps	\$ 40	Other assets
Foreign Currency Forwards – Asset	25	Prepaid expenses and other current assets
Foreign Currency Forwards – Liability	(8)	Accounts payable and other current liabilities
Total	\$ 57	

The unrealized gains associated with our interest rate swaps that hedge the interest rate risk for a portion of our debt have been reported as an addition of \$35 million to long-term debt at June 13, 2009. During the quarter and year to date ended June 13, 2009, Interest expense, net was reduced by \$15 million and \$18 million, respectively, for recognized gains on these interest rate swaps, including \$13 million related to the settlement of interest rate swaps that were hedging the 2012 Senior Notes that were extinguished (See Note 4).

For our foreign currency forward contracts the following effective portions of gains and losses were recognized into Other Comprehensive Income (“OCI”) and reclassified into income from OCI in the quarter and year to date ended June 13, 2009.

	Quarter ended	Year to date
Gains (losses) recognized into OCI, net of tax	\$ (9)	\$ 5
Gains (losses) reclassified from Accumulated OCI into income, net of tax	\$ (9)	\$ (3)

The gains/losses reclassified from Accumulated OCI into income were recognized as Other income in our Condensed Consolidated Statement of Income, largely offsetting foreign currency transaction losses/gains recorded when the related intercompany receivables and payables were adjusted for foreign currency fluctuations. Changes in fair values of the foreign currency forwards recognized directly in our results of operations either from ineffectiveness or exclusion from effectiveness testing were insignificant in the quarter and year to date ended June 13, 2009.

Additionally, we had a net deferred loss of \$10 million, net of tax, as of June 13, 2009 within Accumulated OCI due to treasury locks and forward starting interest rate swaps that were cash settled in previous years. The majority of this loss arose from the settlement of forward starting interest rate swaps entered into prior to the issuance of Senior Unsecured Notes due in 2037 and is being reclassified into earnings through 2037 to interest expense. In the quarter and year to date ended June 13, 2009, an insignificant amount was reclassified from Accumulated OCI to Interest expense, net as a result of these previously settled cash flow hedges.

As a result of the use of derivative instruments, the Company is exposed to risk that the counterparties will fail to meet their contractual obligations. Recent adverse developments in the global financial and credit markets could negatively impact the creditworthiness of our counterparties and cause one or more of our counterparties to fail to perform as expected. To mitigate the counterparty credit risk, we only enter into contracts with carefully selected major financial institutions based upon their credit ratings and other factors, and continually assess the creditworthiness of counterparties. At June 13, 2009, all of the counterparties to our interest rate swaps and foreign currency forwards had investment grade ratings. To date, all counterparties have performed in accordance with their contractual obligations.

Note 12 - Fair Value Measurements

The following table presents the fair values for those assets and liabilities measured on a recurring basis as of June 13, 2009 and December 27, 2008:

Description	Total	Fair Value Measurements at June 13, 2009		
		Level 1(a)	Level 2(b)	Level 3(c)
Foreign Currency Forwards, net	\$ 17	\$ —	\$ 17	\$ —
Interest Rate Swaps, net	40	—	40	—
Other Investments(d)	11	11	—	—
Total	\$ 68	\$ 11	\$ 57	\$ —

Description	Total	Fair Value Measurements at December 27, 2008		
		Level 1(a)	Level 2(b)	Level 3(c)
Foreign Currency Forwards, net	\$ 12	\$ —	\$ 12	\$ —
Interest Rate Swaps, net	62	—	62	—
Other Investments(d)	10	10	—	—
Total	\$ 84	\$ 10	\$ 74	\$ —

The following table presents the fair values for those assets and liabilities measured on a non-recurring basis and remaining on our Condensed Consolidated Balance Sheet as of June 13, 2009 and the losses recognized from all such measurements during the quarter and year to date ended June 13, 2009:

Description	As of June 13, 2009	Fair Value Measurements Using			Total Losses	
		Level 1(a)	Level 2(b)	Level 3(c)	Quarter	Year to date
Long-lived assets held for use	\$ 19	\$ —	\$ —	\$ 19	\$ 21	\$ 24

- (a) Inputs based upon quoted prices in active markets for identical assets.
- (b) Inputs other than quoted prices included within Level 1 that are observable for the asset, either directly or indirectly.
- (c) Inputs that are unobservable for the asset.
- (d) The Other Investments include investments in mutual funds, which are used to offset fluctuations in deferred compensation liabilities that employees have chosen to invest in phantom shares of a Stock Index Fund or Bond Index Fund.

In accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"), we review our long-lived assets (primarily property, plant and equipment and allocated intangible assets subject to amortization) related to each restaurant that we are currently operating and have not offered to rebrand, 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. Fair value is determined by discounting the forecasted after tax cash flows of the restaurant. The discount rate is our estimate of the required rate of return that a third-party buyer would expect to receive when purchasing a restaurant or groups of restaurants and its related long-lived assets. The discount rate incorporates observed rates of returns for historical refranchising market transactions and we believe it is commensurate with the risks and uncertainty inherent in the forecasted cash flows. We limit assumptions about important factors such as sales growth and margin improvement to those that are supportable based upon our plans for the store and actual results at comparable restaurants.

Additionally, when we have offered to rebrand stores or groups of stores for a price less than their carrying value, but do not believe the store(s) have met the criteria to be classified as held for sale, we recognize impairment at the offer date for any excess of carrying value over the expected sales proceeds plus holding period cash flows, if any. Such impairment is classified as rebranding loss.

Long-lived assets held for use presented in the table above include restaurants or groups of restaurants that were impaired as a result of our semi-annual impairment review or restaurants not meeting held for sale criteria that have been offered for sale at a price less than their carrying value during the quarter and year to date ended June 13, 2009. Of the \$21 million in impairment charges shown in the table above for the quarter ended June 13, 2009, \$17 million was included in Closures and impairment (income) expenses and \$4 million was included in Rebranding (gain) loss in the Condensed Consolidated Statements of Income. For the \$24 million of impairment charges shown in the table above for the year to date ended June 13, 2009, \$17 million was included in Closures and impairment (income) expenses and \$7 million was included in Rebranding (gain) loss.

Note 13 - Guarantees, Commitments and Contingencies

Lease Guarantees

As a result of (a) assigning our interest in obligations under real estate leases as a condition to the rebranding 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 2026. As of June 13, 2009, the potential amount of undiscounted payments we could be required to make in the event of non-payment by the primary lessee was approximately \$475 million. The present value of these potential payments discounted at our pre-tax cost of debt at June 13, 2009 was approximately \$375 million. Our franchisees are the primary lessees under the vast majority of these leases. We generally have cross-default provisions with these franchisees that would put them in default of their franchise 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 probable exposure under such leases at June 13, 2009 was not material.

Franchise Loan Pool and Equipment Guarantees

We have provided a partial guarantee of approximately \$15 million of a franchisee loan program used primarily to assist franchisees in the development of new restaurants and, to a lesser extent, in connection with the Company's historical rebranding programs at June 13, 2009. We have also provided two letters of credit totaling approximately \$23 million in support of the franchisee loan program. One such letter of credit could be used if we fail to meet our obligations under our guarantee. The other letter of credit could be used, in certain circumstances, to fund our participation in the funding of the franchisee loan program. The total loans outstanding under the loan pool were approximately \$49 million at June 13, 2009.

In addition to the guarantee described above, YUM has provided guarantees of approximately \$37 million on behalf of franchisees for several equipment financing programs related to specific initiatives, the most significant of which was the purchase of ovens by KFC franchisees for the launch of Kentucky Grilled Chicken. We have provided a letter of credit totaling \$5 million which could be used if we fail to meet our obligations under our guarantee under one equipment financing program. The total loans outstanding under these equipment financing programs were approximately \$46 million at June 13, 2009.

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 and long-term disability for eligible participating employees subject to certain deductibles and limitations. We have accounted for our retained liabilities for property and casualty losses, healthcare and long-term disability 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.

Legal Proceedings

We are subject to various claims and contingencies related to lawsuits, real estate, environmental and other matters arising in the normal course of business. We provide reserves for such claims and contingencies when payment is probable and reasonably estimable in accordance with SFAS No. 5, "Accounting for Contingencies."

On November 26, 2001, Kevin Johnson, a former LJS restaurant manager, filed a collective action against LJS in the United States District Court for the Middle District of Tennessee alleging violation of the Fair Labor Standards Act ("FLSA") on behalf of himself and allegedly similarly-situated LJS general and assistant restaurant managers. Johnson alleged that LJS violated the FLSA by perpetrating a policy and practice of seeking monetary restitution from LJS employees, including Restaurant General Managers ("RGMs") and Assistant Restaurant General Managers ("ARGMs"), when monetary or property losses occurred due to knowing and willful violations of LJS policies that resulted in losses of company funds or property, and that LJS had thus improperly classified its RGMs and ARGMs as exempt from overtime pay under the FLSA. Johnson sought overtime pay, liquidated damages, and attorneys' fees for himself and his proposed class.

LJS moved the Tennessee district court to compel arbitration of Johnson's suit. The district court granted LJS's motion on June 7, 2004, and the United States Court of Appeals for the Sixth Circuit affirmed on July 5, 2005.

On December 19, 2003, while the arbitrability of Johnson's claims was being litigated, former LJS managers Erin Cole and Nick Kaufman, represented by Johnson's counsel, initiated an arbitration with the American Arbitration Association ("AAA") (the "Cole Arbitration"). The Cole Claimants sought a collective arbitration on behalf of the same putative class as alleged in the Johnson lawsuit and alleged the same underlying claims.

On June 15, 2004, the arbitrator in the Cole Arbitration issued a Clause Construction Award, finding that LJS's Dispute Resolution Policy did not prohibit Claimants from proceeding on a collective or class basis. LJS moved unsuccessfully to vacate the Clause Construction Award in federal district court in South Carolina. On September 19, 2005, the arbitrator issued a Class Determination Award, finding, inter alia, that a class would be certified in the Cole Arbitration on an "opt-out" basis, rather than as an "opt-in" collective action as specified by the FLSA.

On January 20, 2006, the district court denied LJS's motion to vacate the Class Determination Award and the United States Court of Appeals for the Fourth Circuit affirmed the district court's decision on January 28, 2008. A petition for a writ of certiorari filed in the United States Supreme Court seeking a review of the Fourth Circuit's decision was denied on October 7, 2008. The parties participated in mediation on April 24, 2008, and again on February 28, 2009, without reaching resolution. Arbitration on liability during a portion of the alleged restitution policy period is currently scheduled for November, 2009.

LJS expects that, based on the rulings issued to date in this matter, the Cole Arbitration will more likely than not proceed as an "opt-out" class action, rather than as an "opt-in" collective action. LJS denies liability and is vigorously defending the claims in the Cole Arbitration. We have provided for a reasonable estimate of the cost of the Cole Arbitration, taking into account a number of factors, including our current projection of eligible claims, the estimated amount of each eligible claim, the estimated claim recovery rate, the estimated legal fees incurred by Claimants and the reasonable settlement value of this and other wage and hour litigation matters. However, in light of the inherent uncertainties of litigation, the fact-specific nature of Claimants' claims, and the novelty of proceeding in an FLSA lawsuit on an "opt-out" basis, there can be no assurance that the arbitration will not result in losses in excess of those currently provided for in our Condensed Consolidated Financial Statements.

On August 4, 2006, a putative class action lawsuit against Taco Bell Corp. styled *Rajeev Chhibber vs. Taco Bell Corp.* was filed in Orange County Superior Court. On August 7, 2006, another putative class action lawsuit styled *Marina Puchalski v. Taco Bell Corp.* was filed in San Diego County Superior Court. Both lawsuits were filed by a Taco Bell RGM purporting to represent all current and former RGMs who worked at corporate-owned restaurants in California from August 2002 to the present. The lawsuits allege violations of California's wage and hour laws involving unpaid overtime and meal period violations and seek unspecified amounts in damages and penalties. As of September 7, 2006, both cases have been consolidated in San Diego County.

Based on plaintiffs' revised class definition in their class certification motion, Taco Bell removed the case to federal court in San Diego on August 29, 2008. On March 17, 2009, the court granted plaintiffs' motion to remand. A hearing on plaintiffs' class certification motion has been continued to September 25, 2009.

Taco Bell denies liability and intends 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 September 10, 2007, a putative class action against Taco Bell Corp., the Company and other related entities styled *Sandrika Medlock v. Taco Bell Corp.*, was filed in United States District Court, Eastern District, Fresno, California. The case was filed on behalf of all hourly employees who have worked for the defendants within the last four years and alleges numerous violations of California labor laws including unpaid overtime, failure to pay wages on termination, denial of meal and rest breaks, improper wage statements, unpaid business expenses and unfair or unlawful business practices in violation of California Business & Professions Code §17200. The Company was dismissed from the case without prejudice on January 10, 2008.

On April 11, 2008, Lisa Hardiman filed a Private Attorneys General Act ("PAGA") complaint in the Superior Court of the State of California, County of Fresno against Taco Bell Corp., the Company and other related entities. This lawsuit, styled *Lisa Hardiman vs. Taco Bell Corp., et al.*, is filed on behalf of Hardiman individually and all other aggrieved employees pursuant to PAGA. The complaint seeks penalties for alleged violations of California's Labor Code. On June 25, 2008, Hardiman filed an amended complaint adding class action allegations on behalf of hourly employees in California very similar to the Medlock case, including allegations of unpaid overtime, missed meal and rest periods, improper wage statements, non-payment of wages upon termination, unreimbursed business expenses and unfair or unlawful business practices in violation of California Business & Professions Code §17200.

On June 16, 2008, a putative class action lawsuit against Taco Bell Corp. and the Company, styled *Miriam Leyva vs. Taco Bell Corp., et al.*, was filed in Los Angeles Superior Court. The case was filed on behalf of Leyva and purportedly all other California hourly employees and alleges failure to pay overtime, failure to provide meal and rest periods, failure to pay wages upon discharge, failure to provide itemized wage statements, unfair business practices and wrongful termination and discrimination. The Company was dismissed from the case without prejudice on August 20, 2008.

On November 5, 2008, a putative class action lawsuit against Taco Bell Corp. and the Company styled *Lorraine Naranjo vs. Taco Bell Corp., et al.*, was filed in Orange County Superior Court. The case was filed on behalf of Naranjo and purportedly all other California employees and alleges failure to pay overtime, failure to reimburse for business related expenses, improper wage statements, failure to pay accrued vacation wages, failure to pay minimum wage and unfair business practices. The Company filed a motion to dismiss on December 15, 2008, which was denied on January 20, 2009.

Taco Bell moved to consolidate the Medlock, Hardiman, Leyva and Naranjo matters and the court granted the motion to consolidate on May 19, 2009. The consolidated case is styled In Re Taco Bell Wage and Hour Actions. Plaintiffs filed a consolidated complaint on June 29, 2009, and the court set a filing deadline of August 26, 2010 for motions regarding class certification. The hearing on any class certification motion is currently scheduled for January 2011. Discovery is underway.

Taco Bell denies liability and intends 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 March 26, 2009, Taco Bell was served with a putative class action lawsuit filed in Orange County Superior Court against Taco Bell and the Company styled *Endang Widjaja vs. Taco Bell Corp., et al.* The case was filed on behalf of Widjaja, a former California hourly assistant manager, and purportedly all other individuals employed in Taco Bell's California restaurants as managers and alleges failure to reimburse for business related expenses, failure to provide rest periods, unfair business practices and conversion. This case appears to be duplicative of Taco Bell's pending consolidated hourly class action case (*In Re Taco Bell Wage and Hour Actions*). Taco Bell removed the case to federal district court and filed a notice of related case. On June 18, 2009 the case was transferred to the Eastern District of California where the *In Re Taco Bell Wage and Hour Actions* case is pending and was subsequently transferred to the same district court judge. Taco Bell requested that the court consolidate this case with the *In Re Taco Bell Wage and Hour Actions*, and the court deferred its decision pending a noticed motion.

Taco Bell denies liability and intends 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 October 14, 2008, a putative class action, styled *Kenny Archila v. KFC U.S. Properties, Inc.*, was filed in California state court on behalf of all California hourly employees alleging various California Labor Code violations, including rest and meal break violations, overtime violations, wage statement violations and waiting time penalties. KFC removed the case to the United States District Court for the Central District of California on January 7, 2009. On July 7, 2009, the Judge ruled that the case will not go forward as a class action. Plaintiff seeks recovery of civil penalties under the California Private Attorney General Act as a representative of other "aggrieved employees." Discovery is now complete, and a trial date has been set for August 11, 2009.

KFC denies liability and intends 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 styled *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 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 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.

On February 23, 2004, the District Court granted plaintiffs' motion for class certification. 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.

On May 17, 2007, a hearing was held on plaintiffs' Motion for Partial Summary Judgment seeking judicial declaration that Taco Bell was in violation of accessibility laws as to three specific issues: indoor seating, queue rails and door opening force. On August 8, 2007, the court granted plaintiffs' motion in part with regard to dining room seating. In addition, the court granted plaintiffs' motion in part with regard to door opening force at some restaurants (but not all) and denied the motion with regard to queue lines.

The parties participated in mediation on March 25, 2008, and again on March 26, 2009, without reaching resolution. The court granted Taco Bell's request for an extension to file its motion for summary judgment on the ADA claims until October 20, 2009. A hearing on the motion is now scheduled for December 16, 2009.

Taco Bell has denied liability and intends to vigorously defend against all claims in this lawsuit. Taco Bell has taken certain steps to address potential architectural and structural compliance issues at the restaurants in accordance with applicable state and federal disability access laws. The costs associated with addressing these issues have not significantly impacted our results of operations. It is not possible at this time to reasonably estimate the probability or amount of liability for monetary damages on a class wide basis to Taco Bell.

On March 14, 2007, a lawsuit styled *Boskovich Farms, Inc. v. Taco Bell Corp. and Does 1 through 100* was filed in the Superior Court of the State of California, Orange County. Boskovich Farms, a supplier of produce to Taco Bell, alleges in its Complaint, among other things, that it suffered damage to its reputation and business as a result of publications and/or statements it claims were made by Taco Bell in connection with Taco Bell's reporting of results of certain tests conducted during investigations on green onions used at Taco Bell restaurants. The parties participated in mediation on April 10, 2008, without reaching resolution. An arbitration panel has been selected, and the arbitration is currently scheduled for September, 2009. The Company denies liability and intends to vigorously defend against all claims in any arbitration and the 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.

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

Introduction and Overview

The following Management's Discussion and Analysis ("MD&A") should be read in conjunction with the unaudited Condensed Consolidated Financial Statements ("Financial Statements"), the Cautionary Note Regarding Forward-Looking Statements and our annual report on Form 10-K for the fiscal year ended December 27, 2008. Throughout the MD&A, YUM! Brands, Inc. ("YUM" or the "Company") makes reference to certain performance measures as described below.

- The Company provides the percentage changes 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.
- 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 restaurant sales are not included in Company sales on the Condensed Consolidated Statements of Income; however, the franchise and license fees are included in the Company's revenues. We believe system sales growth is useful to investors as a significant indicator of the overall strength of our business as it incorporates all of our revenue drivers, Company and franchise same store sales as well as net unit development.
- Same store sales is the estimated growth in sales of all restaurants that have been open one year or more.
- Company restaurant margin as a percentage of sales is defined as Company sales less expenses incurred directly by our Company restaurants in generating Company sales divided by Company sales.
- Operating margin is defined as Operating Profit divided by Total revenues.

All Note references herein refer to the accompanying Notes to the Financial Statements. Tabular amounts are displayed in millions except per share and unit count amounts, or as otherwise specifically identified.

Description of Business

YUM is the world's largest restaurant company based on number of system units, with more than 36,000 units in more than 110 countries and territories operating under the KFC, Pizza Hut, Taco Bell, Long John Silver's and A&W All-American Food Restaurants brands. Four of the Company's restaurant brands – KFC, Pizza Hut, Taco Bell and Long John Silver's – are the global leaders in the quick-service chicken, pizza, Mexican-style food and seafood categories, respectively. Of the over 36,000 restaurants, 21% are operated by the Company, 73% are operated by franchisees and unconsolidated affiliates and 6% are operated by licensees.

YUM's business consists of three reporting segments: United States, YUM Restaurants International ("YRI" or "International Division") and YUM Restaurants China ("China Division"). The China Division includes mainland China ("China"), Thailand and KFC Taiwan, and YRI includes the remainder of our international operations. The China Division and YRI have been experiencing dramatic growth and now represent nearly 60% of the Company's operating

profits. The U.S. business operates in a highly competitive marketplace resulting in slower profit growth, but continues to produce strong cash flows.

Strategies

The Company continues to focus on four key strategies:

Build Leading Brands in China in Every Significant Category – The Company has developed the KFC and Pizza Hut brands into the leading quick service and casual dining restaurants, respectively, in mainland China. Additionally, the Company owns and operates the distribution system for its restaurants in mainland China which we believe provides a significant competitive advantage. Given this strong competitive position, a rapidly growing economy and a population of 1.3 billion in mainland China, the Company is rapidly adding KFC and Pizza Hut Casual Dining restaurants and testing the additional restaurant concepts of Pizza Hut Home Service (pizza delivery) and East Dawning (Chinese food). Our ongoing earnings growth model includes annual system-sales growth of 20% in mainland China driven by new unit development each year, which we expect to drive annual Operating Profit growth of 20% in the China Division.

Drive Aggressive International Expansion and Build Strong Brands Everywhere – The Company and its franchisees opened over 900 new restaurants in 2008 in the Company's International Division, representing 9 straight years of opening over 700 restaurants. The International Division generated \$528 million in Operating Profit in 2008 up from \$186 million in 1998. The Company expects to continue to experience strong growth by building our existing markets and growing in new markets including India, France and Russia. Our ongoing earnings growth model includes annual Operating Profit growth of 10% driven by new unit development and same store sales growth for YRI. New unit development is expected to contribute to system sales growth of at least 6% each year.

Dramatically Improve U.S. Brand Positions, Consistency and Returns – The Company continues to focus on improving its U.S. position through differentiated products and marketing and an improved customer experience. The Company also strives to provide industry leading new product innovation which adds sales layers and expands day parts. We are the leader in multibranding, with more than 5,000 restaurants providing customers two or more of our brands at a single location. We continue to evaluate our returns and ownership positions with an earn the right to own philosophy on Company owned restaurants. Our ongoing earnings growth model calls for annual Operating Profit growth of 5% in the U.S. with same store sales growth of 2% to 3% and leverage of our General and Administrative ("G&A") infrastructure.

Drive Industry-Leading, Long-Term Shareholder and Franchisee Value – The Company is focused on delivering high returns and returning substantial cash flows to its shareholders via share repurchases and dividends. The Company has one of the highest returns on invested capital in the Quick Service Restaurants ("QSR") industry. Additionally, 2008 was the fourth consecutive year in which the Company returned over \$1.1 billion to its shareholders through share repurchases and dividends. The Company is targeting an annual dividend payout ratio of 35% to 40% of net income.

Details of our 2009 Guidance by division and updates can be found online at <http://www.yum.com/investors>.

Quarter Ended June 13, 2009 Highlights

- International development of 328 new restaurants including 118 new units in mainland China and 193 in YRI.
- Worldwide system sales growth prior to foreign currency translation of 3% including 8% in mainland China, 6% in YRI, and a 1% decline in the U.S.
- Worldwide restaurant margin improved 1.7 percentage points driven by the combination of prior year pricing, flat commodity costs and refranchising; all three divisions improved margins.
- Worldwide operating profit growth of 31%, excluding foreign currency translation, including a \$68 million gain recognized upon the consolidation of an entity that operates KFCs in Shanghai, China. Each of our divisions generated profit growth: 11% in the China Division, 8% in the U.S. and 6% for YRI.
- EPS growth was negatively impacted by foreign currency translation of approximately \$0.03 per share partially offset by the benefit of last year's substantial share repurchases, which reduced average shares outstanding by 3%.

All preceding comparisons are versus the same period a year ago.

Significant Known Events, Trends or Uncertainties Impacting or Expected to Impact Comparisons of Reported or Future Results

The following factors impacted comparability of operating performance for the quarters and/or years to date ended June 13, 2009 and June 14, 2008 and/or could impact comparability with the remainder of our results in 2009 or beyond. Certain of these factors were previously discussed in our 2008 Form 10-K.

Restaurant Margin

In the U.S., restaurant margin as a percentage of sales increased 2.3 percentage points and 1.6 percentage points versus the quarter and year to date ended June 14, 2008, respectively. In the China Division, restaurant margin as a percentage of sales increased 0.8 percentage points and 1.2 percentage points versus the quarter and year to date ended June 14, 2008, respectively. These improvements were largely driven by pricing actions we took or have previously taken, as well as moderating commodity inflation partially offset by lower same store sales. For the quarter ended June 13, 2009, we experienced commodity deflation of \$4 million in both our U.S. and China Divisions. For the year ended June 13, 2009 U.S. commodity inflation was \$5 million and the China Division experienced commodity deflation of \$1 million. We expect the commodity deflation to continue in the second half of 2009 resulting in commodity deflation of about \$10 million in the U.S. and nearly \$50 million in the China Division for the balance of the year. On a full year basis, same store sales are expected to decline slightly in the U.S. and remain about flat in mainland China partially offsetting this anticipated commodity deflation. For the full year we anticipate that the U.S. and China Divisions restaurant margins will each be up at least 1 percentage point versus 2008.

YRI's restaurant margin as a percentage of sales in the second half of 2009 is expected to be positively impacted by same store sales growth partially offset by moderate commodity inflation. YRI's commodity costs, as compared to the U.S. and China Divisions, are more significantly impacted by a higher percentage of fixed price commodity commitments and the impact of a strengthening U.S. Dollar on commodity purchases denominated in that currency.

Impact of Foreign Currency Translation on Operating Profit

Changes in foreign currency exchange rates negatively impacted the translation of our foreign currency denominated Operating Profit in our International Division by \$24 million and \$45 million for the quarter and year to date ended June 13, 2009, respectively, and positively impacted Operating Profit in our China Division by \$3 million and \$9 million for the quarter and year to date ended June 13, 2009, respectively. Given the nature and volatility of the foreign currency markets the full year forecasted foreign currency impact is difficult to quantify. However, for YRI we currently expect Operating Profit to be negatively impacted by foreign currency translation of nearly \$25 million in the second half of the year. We do not anticipate that the impact of foreign currency translation on the China Division's Operating Profit will be significant in the remainder of 2009.

U.S. Business Transformation

As part of our plan to transform our U.S. business we took several measures in 2008 and are taking similar measures in 2009 that we do not believe are indicative of our ongoing operations. These measures (“the U.S. business transformation measures”) include: expansion of our U.S. refranchising, potentially reducing our Company ownership in the U.S. to below 10%; charges relating to G&A productivity initiatives and realignment of resources (primarily severance and early retirement costs); and investments in our U.S. Brands made on behalf of our franchisees such as equipment purchases. As discussed in Note 4, we are not including the impacts of these U.S. business transformation measures in our U.S. segment for performance reporting purposes.

We recorded pre-tax gains of \$1 million and \$15 million from refranchising in the U.S. for the quarter and year to date ended June 13, 2009, respectively. We recorded a pre-tax gain of \$1 million and a pre-tax loss of \$25 million from refranchising in the U.S. for the quarter and year to date ended June 14, 2008, respectively. The refranchising losses recorded for the year to date ended June 14, 2008 were primarily due to our refranchising of, or our offers to refranchise, stores or groups of stores for a price less than their carrying values. The refranchising gains and losses are more fully discussed in Note 4 and the Store Portfolio Strategy Section of the MD&A.

In connection with our G&A productivity initiatives and realignment of resources we recorded pre-tax charges of \$5 million and \$2 million in the quarters ended June 13, 2009 and June 14, 2008, respectively. In the years to date ended June 13, 2009 and June 14, 2008, we recorded pre-tax charges of \$9 million and \$7 million, respectively.

Additionally, the Company recognized a reduction to Franchise and license fees and income of \$4 million and \$31 million, pre-tax, in the quarter and year to date ended June 13, 2009, respectively, related to investments in our U.S. Brands. These investments reflect our reimbursements to, or obligations to reimburse, KFC franchisees for installation costs of ovens for the national launch of Kentucky Grilled Chicken. In the quarter and year to date ended June 14, 2008, the Company recognized pre-tax expense of \$2 million and \$3 million, respectively, related to the investments in our U.S. Brands.

In 2009, we currently expect to refranchise 500 restaurants in the U.S. The impact of this refranchising on our 2009 results will be determined by the stores that we are able to sell and the specific prices we are able to obtain for these stores.

We currently anticipate ongoing G&A savings of at least \$70 million, primarily within the U.S. segment, as a result of the U.S. business transformation measures we took in 2008 and are taking in 2009.

Consolidation of a Former Unconsolidated Affiliate in China

On May 4, 2009 we acquired an additional 7% ownership in the entity that operates more than 200 KFCs in Shanghai, China for \$12 million, increasing our ownership to 58%. This entity has historically been accounted for as an unconsolidated affiliate under the equity method of accounting. Concurrent with the acquisition we received additional rights in the governance of the entity and thus we began consolidating the entity upon acquisition. As required by Statement of Financial Accounting Standards (“SFAS”) No. 141(R), “Business Combinations”, we remeasured our previously held 51% ownership, which had a recorded value of \$17 million at the date of acquisition, in the entity at fair value and recognized a gain of \$68 million accordingly. This gain, which resulted in no related income tax expense, was recorded in Other (income) expense in our Condensed Consolidated Statements of Income and was not allocated to any segment for performance reporting purposes.

Under the equity method of accounting, we previously reported our 51% share of the net income of the unconsolidated affiliate (after interest expense and income taxes) as Other (income) expense in the Condensed Consolidated Statements of Income. We also recorded a franchise fee for the royalty received from the stores owned by the unconsolidated affiliate. From the date of the acquisition through May 31, 2009 (our China Division’s second quarter end), we reported Company sales and the associated restaurant costs, general and administrative expense, interest expense and income taxes associated with the restaurants previously unconsolidated in the appropriate line items of our Condensed Consolidated Statement of Income. We no longer recorded franchise fee income for these restaurants nor did we report Other (income) expense as we did under the equity method of accounting. Net income attributable to our partner’s ownership percentage is recorded as Net Income-noncontrolling interest within our Condensed Consolidated Statements of Income. For the quarter ended June 13, 2009 the consolidation of this entity increased Company sales by \$23 million and decreased Franchise and license fees and income by \$1 million. The impacts of consolidation on all other line items within our Condensed Consolidated Statement of Income were not significant for the quarter ended June 13, 2009. For the full year we expect the China Division’s Company sales to increase by approximately \$200 million and Franchise and license fees and income to decrease by approximately \$12 million as a result of this transaction. We do not expect the full year impact on Operating Profit or Net Income – YUM! Brands, Inc. to be significant.

Sale of our Interest in Our Unconsolidated Affiliate in Japan

During the year to date ended June 14, 2008 we recorded a pre-tax gain of approximately \$100 million related to the sale of our interest in our unconsolidated affiliate in Japan. This gain was recorded in Other (income) expenses in our Condensed Consolidated Statement of Income and was not allocated to any segment for performance reporting purposes.

Segment Reporting Changes

In connection with our U.S. business transformation measures our reported segment results began reflecting increased allocations of certain expenses in 2009 that were previously reported as unallocated and corporate G&A expenses. While our consolidated results were not impacted, we believe the revised allocation better aligns costs with accountability of our segment managers. These revised allocations are being used by our Chairman and Chief Executive Officer, in his role as chief operating decision maker, in his assessment of operating performance. We have restated segment information for the quarter and year to date ended June 14, 2008 to be consistent with the current period presentation and will restate previously reported 2008 quarters as they are reported in 2009.

The following table summarizes the 2008 quarterly impact of the revised allocations by segment:

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Increase/(Decrease)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
U.S. G&A	\$ 11	\$ 13	\$ 12	\$ 17	\$ 53
YRI G&A	1	2	1	2	6
Unallocated and corporate G&A expenses	(12)	(15)	(13)	(19)	(59)

Store Portfolio Strategy

From time to time we sell Company restaurants to existing and new franchisees where geographic synergies can be obtained or where franchisees' expertise can generally be leveraged to improve our overall operating performance, while retaining Company ownership of strategic U.S. and international markets. In the U.S., we are targeting Company ownership of restaurants potentially below 10%, down from its current level of 18%. Consistent with this strategy, 188 Company restaurants in the U.S. were sold to franchisees, for a net gain of \$15 million, in the year to date ended June 13, 2009. We currently anticipate refranchising 500 units in the U.S. in 2009 for approximately \$175 million in proceeds.

Refranchisings reduce our reported revenues and restaurant profits and increase the importance of system sales growth as a key performance measure. Additionally, G&A expenses will decline over time as a result of these refranchising activities. The timing of G&A declines will vary and often lag the actual refranchising activities as the synergies are typically dependent upon the size and geography of the respective deals. G&A expenses included in the tables below reflect only direct G&A that we no longer incurred as a result of stores that were operated by us for all or some portion of the respective comparable period in 2008 and were no longer operated by us as of the last day of the current quarter.

The following table summarizes our refranchising activities:

	Quarter ended		Year to date	
	6/13/09	6/14/08	6/13/09	6/14/08
Number of units refranchised	85	170	205	207
Refranchising proceeds, pre-tax	\$ 27	\$ 47	\$ 63	\$ 66
Refranchising (gain) loss, pre-tax	\$ 1	\$ (1)	\$ (13)	\$ 24

The impact on Operating Profit arising from refranchising is the net of (a) the estimated reductions in restaurant profit, which reflects the decrease in Company sales, and G&A expenses and (b) the increase in franchise fees from the restaurants that have been refranchised. The tables presented below reflect the impacts on Total revenues and on Operating Profit from stores that were operated by us for all or some portion of the prior year period and were no longer operated by us as of the last day of the current quarter. In these tables, Decreased Company sales and Decreased Restaurant profit represents the amount of sales or restaurant profit earned by the refranchised restaurants during the period we owned them in the prior year but did not own them in the current year. Increased Franchise and license fees and income represents the franchise and license fees from the refranchised restaurants that were recorded by the Company in the current year during periods in which the restaurants were Company stores in the prior year.

The following tables summarize the impact of refranchising as described above:

	Quarter ended 6/13/09			
	U.S.	YRI	China Division	Worldwide
Decreased Company sales	\$ (167)	\$ (21)	\$ (1)	\$ (189)
Increased Franchise and license fees and income	10	1	—	11
Decrease in Total revenues	\$ (157)	\$ (20)	\$ (1)	\$ (178)

	Year to date ended 6/13/09			
	U.S.	YRI	China Division	Worldwide

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Decreased Company sales	\$	(324)	\$	(37)	\$	(2)	\$	(363)
Increased Franchise and license fees and income		18		2		—		20
Decrease in Total revenues	\$	(306)	\$	(35)	\$	(2)	\$	(343)

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The following tables summarize the estimated impact on Operating Profit of refranchising:

	Quarter ended 6/13/09			
	U.S.	YRI	China Division	Worldwide
Decreased Restaurant profit	\$ (16)	\$ (1)	\$ —	\$ (17)
Increased Franchise and license fees and income	10	1	—	11
Decreased G&A	4	—	—	4
Increase (decrease) in Operating Profit	\$ (2)	\$ —	\$ —	\$ (2)

	Year to date ended 6/13/09			
	U.S.	YRI	China Division	Worldwide
Decreased Restaurant profit	\$ (33)	\$ (1)	\$ —	\$ (34)
Increased Franchise and license fees and income	18	2	—	20
Decreased G&A	7	—	—	7
Increase (decrease) in Operating Profit	\$ (8)	\$ 1	\$ —	\$ (7)

Results of Operations

	Quarter ended			Year to date		
	6/13/09	6/14/08	% B/(W)	6/13/09	6/14/08	% B/(W)
Company sales	\$ 2,152	\$ 2,323	(7)	\$ 4,070	\$ 4,417	(8)
Franchise and license fees and income	324	336	(4)	623	655	(5)
Total revenues	\$ 2,476	\$ 2,659	(7)	\$ 4,693	\$ 5,072	(7)
Company restaurant profit	\$ 324	\$ 311	4	\$ 632	\$ 619	2
% of Company sales	15.1%	13.4%	1.7 ppts.	15.5%	14.0%	1.5 ppts.
Operating Profit	394	317	25	745	743	—
Interest expense, net	43	52	15	96	105	8
Income tax provision	45	40	(13)	124	157	21
Net Income – including noncontrolling interest	306	225	35	525	481	9
Net Income – noncontrolling interest	3	1	(31)	4	3	(14)
Net Income – YUM! Brands, Inc.	\$ 303	\$ 224	35	\$ 521	\$ 478	9
Diluted earnings per share (a)	\$ 0.63	\$ 0.45	40	\$ 1.08	\$ 0.95	14

(a) See Note 2 for the number of shares used in this calculation.

Restaurant Unit Activity

		Unconsolidated		Total Excluding Licensees (a)
	Company	Affiliates	Franchisees	
Worldwide				
Beginning of year	7,568	645	25,911	34,124
New Builds	222	41	440	703
Acquisitions	42	—	(42)	—
Refranchising	(205)	—	204	(1)
Closures	(59)	(4)	(309)	(372)
Other(b)	236	(236)	(4)	(4)
End of quarter	7,804	446	26,200	34,450
% of Total	23%	1%	76%	100%

		Unconsolidated		Total Excluding Licensees(a)
	Company	Affiliates	Franchisees	
United States				
Beginning of year	3,314	—	14,482	17,796
New Builds	10	—	109	119
Acquisitions	42	—	(42)	—
Refranchising	(188)	—	187	(1)
Closures	(15)	—	(168)	(183)
Other	—	—	(1)	(1)
End of quarter	3,163	—	14,567	17,730
% of Total	18%	—	82%	100%

		Unconsolidated		Total Excluding Licensees(a)
	Company	Affiliates	Franchisees	
YRI				
Beginning of year	1,589	—	11,157	12,746
New Builds	19	—	319	338
Acquisitions	—	—	—	—
Refranchising	(15)	—	15	—
Closures	(19)	—	(139)	(158)
Other	—	—	(3)	(3)
End of quarter	1,574	—	11,349	12,923
% of Total	12%	—	88%	100%

		Unconsolidated		
China Division	Company	Affiliates	Franchisees	Total
Beginning of year	2,665	645	272	3,582
New Builds	193	41	12	246
Acquisitions	—	—	—	—
Refranchising	(2)	—	2	—
Closures	(25)	(4)	(2)	(31)
Other(b)	236	(236)	—	—
End of quarter	3,067	446	284	3,797
% of Total	81%	12%	7%	100%

(a) The Worldwide, U.S. and YRI totals exclude 2,162, 1,994 and 168 licensed units, respectively, at June 13, 2009. There are no licensed units in the China Division. Licensed units are generally units that offer limited menus and operate in non-traditional locations like malls, airports, gasoline service stations, convenience stores, stadiums and amusement parks where a full scale traditional outlet would not be practical or efficient. As licensed units have lower average unit sales volumes than our traditional units and our current strategy does not place a significant emphasis on expanding our licensed units, we do not believe that providing further detail of licensed unit activity provides significant or meaningful information.

(b) During the second quarter of 2009 we acquired additional ownership in and began consolidating an entity that operates the KFC business in Shanghai, China and have reclassified the units accordingly. This entity was previously accounted for as an unconsolidated affiliate.