

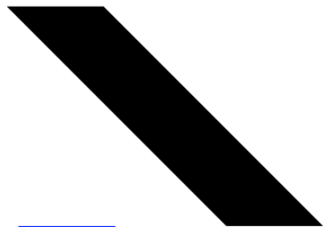
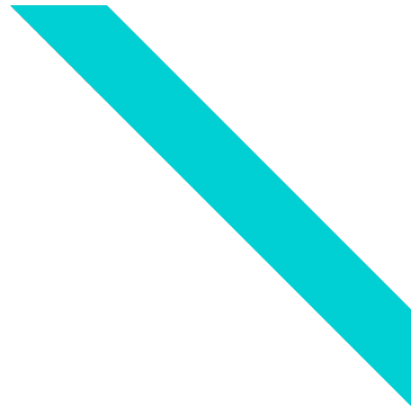


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Q3 2024 YUM CHINA HOLDINGS INC EARNINGS CALL

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- **Joey Wat** *Yum China Holdings Inc - Chief Executive Officer & Executive Director*
- **Adrian Ding** *Yum China Holdings Inc - Acting Chief Financial Officer*

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- **Operator**
- **Xiaopo Wei** *Citigroup Inc - Analyst*
- **Lillian Lou** *Morgan Stanley - Analyst*
- **Ethan Wang** *CLSA Limited - Analyst*
- **Michelle Cheng** *Goldman Sachs Group Inc - Analyst*
- **Sijie Lin** *China International Capital Corporation Limited - Analyst*
- **Anne Ling** *Jefferies Group LLC - Analyst*
- **Wing Woo** *CMB International Securities Limited - Analyst*
- **Linda Huang** *Macquarie - Analyst*

PRESENTATION

Operator

(Operator Instructions) I would now like to hand the conference over to Florence Lip, Senior IR Director. Please go ahead.

Florence Lip *Yum China Holdings Inc - Senior Director of Investor Relations*

Thank you, operator. Hello, everyone. Thank you for joining Yum China's third quarter 2024 earnings conference call. On today's call are our CEO, Ms. Joey Wat; and our Acting CFO, Mr. Adrian Ding. I'd like to remind everyone that our earnings call and investor materials contain forward-looking statements, which are subject to future events and uncertainties. Actual results may differ materially from these forward-looking statements.

All forward-looking statements should be considered in conjunction with the cautionary statement in our earnings release and the risk factors included in our filings with the SEC. This call also includes certain non-GAAP financial measures. You should carefully consider the comparable GAAP measures.

Reconciliation of non-GAAP and GAAP measures is included in our earnings release, which is available to the public through our Investor Relations website located at ir.yumchina.com. You can also find a webcast of this call and PowerPoint presentation on our IR website. Please note that during today's call, all year-over-year growth results exclude the impact of foreign currency, unless otherwise noted. Now I would like to turn the call over to Joey Wat, CEO of Yum China. Joey?

Joey Wat Yum China Holdings Inc - Chief Executive Officer & Executive Director

Hello, everyone, and thank you for joining us. I'm proud to share that we achieved strong results again in Q3 2024. We delivered robust sales growth as well as accelerated profit growth compared to Q2. System sales grew 4% year-over-year. Same-store sales index improved sequentially and reached 97% of prior year's level. Delivery sales achieved double-digit growth as it has for 10 consecutive years.

On a comparable basis, both restaurant margins and OP margin expanded year-over-year. Core operating profit grew 18% and diluted EPS increased by 32%. As we execute our RGM 2.0 strategy, we have a dual focus on operational efficiency and innovation. Savings generated from improved efficiency allow us to reinvest in food innovation and our value-for-money offers.

This broadens our addressable market. It also helps us capture more traffic, drive sales growth, and expand profit margins. Meanwhile, our innovative business models, KCOFFEE Cafe and Pizza Hut WOW, are gaining momentum and successfully capture new customer demand.

In the first nine months, we set several new records. \$8.7 billion in revenue, over \$1 billion in operating profit, 1,200 net new stores and over \$1.2 billion returned to shareholders. We outperformed the industry in a challenging and fluid environment.

Today, I will provide an update on our operations and store opening strategy. Adrian will then go through the financial performance and our latest capital return plan. I will start with operational efficiency. We are making great progress with Project Fresh Eye and Project Red Eye. We introduced these projects in quarter four of last year and quarter one of this year, respectively. These projects are to enhance operational efficiency through innovations across all aspects of our operations. Project Fresh Eye has reshaped our operations. We are evaluating processes through the fresh eyes of our restaurant managers, redesigning to support them more effectively. By simplifying, centralizing, and automating key processes, we are easing the burdens on restaurant managers so that they can focus on better serving customers. We are also using innovative technology and automation in our operations. This makes us more efficient. For example, intelligent energy management reduces utility costs. Project Red Eye has created a fresh mindset to innovate and deliver results by spending better and buying better. Our procurement teams are serving our marketing teams better and faster. Generated savings are passed on to our customers and fund innovations. We are also gearing our product design to optimize ingredient use and improve operational efficiency. These initiatives have enabled us to home in on product innovations and value for money, while expanding margins. On a comparable basis, Q3 restaurant margin improved 50 basis points year-over-year and core OP margin expanded 140 basis points. Importantly, these are sustainable improvements that strengthen our business capabilities while driving high levels of customer satisfaction.

Turning to sales. It's true that consumers are becoming more rational and sophisticated in their choices. But we know that the demand is there. Consumers seek value-for-money, good quality and emotional value (Foreign Language). That's exactly what we are offering them and it's working.

We regard both system-sales and same-store sales growth as equally important. On one hand, we see ample opportunities across China to enter underserved markets and enhance customer access. On the other hand, we look to balance our unit growth with same-store sales growth. Seven consecutive quarters of same-store traffic growth and sequential improvement in same-store sales index for both KFC and Pizza Hut show the strength of our strategy.

Our delivery sales grew 18%, continuing the double-digit annual growth Yum China has maintained over the past decade. In quarter three, delivery sales reached around 40% of our sales mix. We have strategically adjusted delivery fees and introduced more entry price offerings to capture incremental consumer demand.

We have enhanced our presence on aggregator platforms and expanded delivery coverage. Through these initiatives and more, we have captured incremental orders, especially from solo diners and value-conscious customers. As a result, both KFC and Pizza Hut have increased their market share on aggregator platforms.

Even as we expand on aggregator platforms, we continue to maintain strong control over our business. Sales outside the delivery aggregators account for over 70% of our total sales, including dine-in, takeaway and delivery.

Let me share a few highlights on KFC. We continue to breathe fresh energy into our flagship products. Take the new original recipe chicken burger as we introduced in quarter two, it's an exciting innovation, though not so obvious. Taking our cue from the classic way kids in China enjoy KFC's original recipe chicken with mashed potatoes - we combined them into a new burger product. It's been very successful. Building on that success, we introduced an original recipe chicken with curry gravy in August, (Tang Ga Li Yuan Wei Ji). This time, we add curry gravy to the original recipe chicken and mashed potatoes. Customers are loving it. As a

bonus, it doesn't require new ingredients in the stores. We maximized the use of existing ones, while delivering exceptional value and taste to our loyal customers. In the first nine months, KFC sold nearly 200 million cups of KCOFFEE, surpassing all cups sold in 2023. During the period, both sales and cups sold increased by about 30%. As our membership data indicates that a significant majority of our members have yet to try KCOFFEE, we see huge potential for growth.

We have just opened 500th side-by-side KCOFFEE cafe (Ken Yue Ka Fei) this morning China Time, with a prime location in Shanghai, (Xu Jia Hui). We are also tapping into strategic locations like college campuses and transportation hubs. By the end of the year, we expect to exceed 600 cafes.

Our distinctive menu of coffee, drinks and food, stunning value proposition, and cafe ambience are resonating well with their customers. Our disruptive limited time offer of Original Recipe Chicken Latte (Shun Zhi Yuan Wei Ji Feng Wei Na Tie), generated first disbelief, then curiosity, and finally, trial. Perhaps surprisingly, it's become one of our best sellers. KCOFFEE Cafes also effectively cross-sell to KFC's loyal customers, driving incremental sales and profit. KCOFFEE Cafe's potential is exciting.

Turning to Pizza Hut. The brand is making solid progress. Pizza Hut opened nearly 300 net new stores in the first nine months, exceeding 3,600 stores. Since 2017, Pizza Hut has been strategically lowering its ticket average to drive traffic and enhance its mass market appeal. We have launched more entry price products designed for value conscious customers and solo diners, capturing more smaller ticket orders.

Pizza Hut has also improved its profitability. Core OP increased 20% year-over-year in quarter three. Core OP margin was up by 140 basis points. We boost operational efficiency with simplified ingredients and redesigned kitchen processes. This also allowed us to further improve our high food quality and service level. We continue to fortify our reputation as pizza expert. We recently upgraded the hand-tossed Pizza dough for better taste, consistency, and easier preparation.

In addition, we continue to build on our signature product, Durian pizza, now our number one best-selling pizza. One in every four pizzas sold in Pizza Hut China is now a durian pizza. We sold nearly 30 million durian pizzas year-to-date.

We have extended our success with durian to burgers, launching the Pizza Dough Beef Burger with durian and pineapple (Zhi Shi Jin Zhen Liu Lian Bo Luo Niu Bao). It sounds unusual, but it's perfect for our durian lovers and sold out quickly. Our breakthrough Pizza Hut WOW store is looking like a promising vehicle for expanding our addressable market. It's been only five months since we converted our first store. Initial results are encouraging. For dine-in, we have seen significant same-store sales growth, driven by incremental transactions despite lower ticket averages. So far, we have converted around 150 stores, expanding from Guangdong to over 10 provinces, covering Tier 1 cities to lower tier towns. We will continue to refine the model across different locations for both dine-in and delivery.

With our dual focus on system sales and same-store sales growth in mind, let's talk about our store expansion plan. In Q3, we opened 438 net new stores. With over 1,200 net new stores year-to-date, we are on track to meet our target of 1,500 to 1,700 net new stores this year. This growth is underpinned by strong new store performance. At KFC, the payback period held steady at two years, and at Pizza Hut, payback improved to two to three years. Around 80% of new stores opened in the past two years, turned profitable within three months of opening.

Alongside our successful equity store model, we are accelerating franchise development to unlock additional opportunities. Our franchise strategy focuses on assessing strategic and remote locations as well as the lower tier cities that were previously beyond our reach. We have built the infrastructure to support our franchisees, from food safety to store management.

We have also innovated new store models suitable for franchisees, such as KFC's small town mini, so we are now prepared to pick up the speed. Currently, franchisees represent 12% of KFC's store portfolio. The franchise mix for net new stores increased from 15% in 2023 to 27% year-to-date, exceeding the guidance we gave at last year's Investor Day of 15% to 20%. We now expect this ratio will gradually increase to 40% to 50% over the next few years.

Pizza Hut will be on a similar path but will take more time to get there. For Pizza Hut's net new stores, the franchise mix was 7% year-to-date. We anticipate this ratio will gradually increase to 20% to 30% over the next few years.

With that, I will hand the call over to Adrian Ding, our acting CFO. By way of background, Adrian has been with Yum China since in 2019. Leveraging his investment banking background, Adrian has led multiple successful strategic investments and capital market projects in his role as our Chief Investment Officer.

He was also instrumental in establishing our Lavazza joint venture and building the business in China as our General Manager of Lavazza JV. Adrian's combination of financial background with operational experience makes him well-suited for this position. I'm thrilled to welcome Adrian to his new role. Adrian?

Adrian Ding Yum China Holdings Inc - Acting Chief Financial Officer

Thank you, Joey, and great to be with everyone today for my first earnings call. In the third quarter, we achieved strong results with major KPIs trending positively. System sales grew 4%, and same-store sales index sequentially improved to 97% of prior year level. Restaurant margin expanded 50 basis points year-over-year on a comparable basis. Core OP margin also saw a significant rise of 140 basis points.

As we grew our top line, core operating profit surged by 18% and diluted EPS grew 19%, excluding the mark-to-market gain from our equity investments. As a reminder, restaurant margin on a comparable basis excludes VAT deductions as well as temporary relief from landlords and government agencies received in the prior year.

Core operating profit further excludes foreign exchange impact and special items. We are immensely satisfied with this meaningful sequential improvement in our quarter three results. They demonstrate our ability to outperform the industry in both good times and bad. With our confidence on our cash-generating capabilities, we plan to step up our capital return to shareholders.

First, let's take a closer look at our third quarter performance. By brand, KFC system sales increased 6% year-over-year. Same-store sales were at 98% of prior year levels with 1% same-store transaction growth. Our strategies to widen the price range and capture lower ticket average delivery orders are yielding results. Entry-price combos have driven incremental traffic, and delivery sales continue to grow double digits. Our quarter three ticket average was RMB38, 3% lower than prior year levels, an increase from RMB37 in quarter two.

More ticket items like coffee and breakfast continue to outperform. Pizza Hut system sales increased 2% year-over-year. Same-store sales were at 94% of prior year levels with same-store transaction growth of 4%. Ticket average was 9% lower year-over-year. It is in line with our strategy to transform the brand to increase mass market appeal. Our entry-priced pizzas, burgers and single person meals attracted incremental traffic from value-conscious consumers and solo diners, which, of course, lowered per-person spending.

The WOW store model is positioned with even more accessible pricing. Pizza Hut's traffic has grown in response to our strategy and profit margins have improved year-over-year. Thanks to our team's relentless drive for operational efficiency and innovation.

Now let's go through our margin and key cost lines. Our OP margin as a percentage of revenue was 12.1%. 100 basis points higher year-over-year or 140 basis points higher on a comparable basis. Resilient restaurant margin and savings in G&A expenses helped us achieve that. Our restaurant margin was 17%, steady year-over-year.

On a comparable basis, restaurant margin was 50 basis points higher. Savings in the cost of labor and occupancy and other costs offset the increase in COS. Cost of sales was 31.7%, 60 basis points higher year-over-year or 30 basis points higher on a comparable basis.

We kept cost of sales rather stable compared to 31.5% in quarter two, while continuing to offer excellent value for money. Key factors include favorable commodity prices and savings from spending better and buying better initiatives under Project Red Eye. Cost of labor was 25.1%. 20 basis points lower year-over-year. Improved operational efficiency more than offset wage increases for our frontline staff and the impact of sales deleveraging.

Occupancy and other was 26.2%, 40 basis points lower year-over-year or 60 basis points lower on a comparable basis. This came from more efficient marketing and advertising initiatives as well as other cost optimization. Our G&A expenses decreased 19% year-over-year. This was due to operational efficiency gains and lower performance-based compensation this year, among other factors.

G&A expenses as a percentage of revenue were 4.5% in the quarter down by 130 basis points from 5.8% a year ago. For the full year, we aim to keep the G&A ratio around 5%. Operating profit was \$371 million, growing 14% year-over-year. Core OP increased 18% year-over-year.

Our effective tax rate was 27.3% in quarter three, on par with the same period last year. We expect a full year ETR in the high 20s. Net income was \$297 million, growing 21% year-over-year. Our mark-to-market equity investment had a \$26 million positive impact in quarter three this year compared to a negative impact of \$3 million in the same period last year. Excluding this impact, our net profit grew 9%. As a reminder, we received lower interest income this year from a lower cash balance. Diluted EPS was \$0.77, growing 32% year-over-year or 19%, excluding the mark-to-market equity investment impact.

Now let's turn to capital return to shareholders. Since our spinoff, we've returned over \$4 billion to shareholders. In the first nine months this year, we already returned more than \$1.2 billion, including over \$1 billion in share repurchases and \$187 million in

quarterly dividends.

We bought back more than 27 million shares around 7% of our total shares outstanding, partially contributing to our EPS growth. Our cash position remains healthy with net cash of \$3.1 billion as of the end of the quarter. We're committed to returning excess capital to our shareholders.

A year ago, we set our 3-year plan to return \$3 billion to shareholders through dividends and share repurchases from 2024 to 2026. With our cash generation capabilities proven in good times and bad, we now plan to step up our capital returns by 50% to \$4.5 billion over the same period. This includes \$1.5 billion in 2024.

Finally, moving on to our outlook. We are encouraged by the recent stimulus policies. These measures are a positive step forward, but as you all know, such things can take quite a while to trickle down to consumers and thereby move the needle in businesses like ours.

Entering the fourth quarter, we've not observed significant changes in market conditions and consumer sentiment. Despite this, we remain confident in China's midterm and long-term growth opportunities. Quarter four is traditionally a low season for us with smaller sales and profits.

We maintain our focus on operational efficiency and innovation to pass on savings to our consumers. We expect these efforts to continue driving overall sales and profit growth. I am confident in our strategy and our ability to navigate this complex and evolving environment and achieve sustainable long-term growth.

As a reminder, in quarter four last year, we benefited from \$6 million in temporary relief, equivalent to around 30 basis points in OP margin, which we do not expect to repeat this year. Let me pass it back to Joey for closing remarks.

Joey Wat Yum China Holdings Inc - Chief Executive Officer & Executive Director

Thank you, Adrian. Before we turn to Q&A, I would like just to recap the three key messages I want you to take away today. First, our quarter three results highlight our resiliency and growth strategy. With our dual focus on operational efficiency and innovation, we are well-positioned to capture opportunities in this market. Both system-sales growth and same-store sales growth are key focus for us.

Second, we remain bullish on China's long-term growth opportunities. Our widened price ranges, optimized delivery strategy, and breakthrough business models, help us broaden our addressable market. We continue to capture underserved customer segments with both equity and franchise new stores. Lastly, we maintain our dual focus on sustainable growth and capital returns to shareholders. We plan to step up our 3-year capital returns to \$4.5 billion for 2024 to 2026.

With that, I will pass it back to Florence.

Florence Lip Yum China Holdings Inc - Senior Director of Investor Relations

Thanks, Joey. Now we will open the call for questions. (Operator Instructions)

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Xiaopo Wei, Citigroup.

Xiaopo Wei Citigroup Inc - Analyst

Hi. Can you hear me, Joey, or Adrian?

Joey Wat Yum China Holdings Inc - Chief Executive Officer & Executive Director

Yes.

Xiaopo Wei Citigroup Inc - Analyst

Okay. Thank you. Thank you for taking quick question. Congratulations on the strong third quarter. I probably want to ask a long-term question. It is the first quarter we are seeing both your core OP margin expanding and same store sales was down. As you know, the market has been focusing on same-store sales for long, but it seemed to me that it's actually as Joey said, the system sales is equally important as same-store sales.

Shall we say looking forward, shall we look more into the same-store sales base of transaction volume rather than the same-store sales value because, as Joey readily pointed out, you guys have innovative formats, so menu actually widens your pricing range. So the mix of your products, or the ASP, actually distorts the traditional understanding of same-store sales. If that's the case, are there any other areas you will build your economies of scale in terms of enlarged volume to drive your margin resilience looking forward?

Joey Wat Yum China Holdings Inc - Chief Executive Officer & Executive Director

Xiaopo, thank you for your long-term question. If I'm allowed to indulge -- to give a comprehensive view of our long-term strategy. Quarter three actually is a good result and illustration of how Yum China execute our RGM 2.0 strategy in the long-term. We dual focuses on multiple areas. As a CEO, I often get questions posed, or decisions presented on either/or, such as either same store sales or system sales, the fact is the only acceptable answer is, it's both. We want both.

And then the same-store sales, obviously, is composed of the transactions. So, the way that we deal with it is we really are pursuing dual focus because we cannot just focus on one or the other. So, I referred to it in several of my earlier remarks, but just to recap: first, we have dual focus on system sales growth and same-store sales growth.

And in quarter three, obviously, we had 4% system sales growth for the quarter and also seven consecutive quarters of same-store transaction growth going forward because between the TA and TC, I think you can see over the long term, we focus on transaction growth, which really is the most important -- one of the most important drivers for a business like ours. Not to mention the growth is also supported by 10 years of delivery growth.

Second, and this is related to your margin question, we have dual focus on operational efficiency and innovation. I certainly believe that any good company who wants to survive, needs to do both. So, for Q3 alone, this year, we delivered 18% core operating profit growth through multiple margin improvement projects like Project Fresh Eye and Project Red Eye. And then we reinvest our savings into multiple innovations, such as food innovation and then value for money and then some breakthrough model innovations such as KCOFFEE and Pizza Hut.

And with this kind of operational efficiency and innovation, both our KCOFFEE cafe model and 150 Pizza Hut WOW stores right now, they broaden our addressable market and capture new customer demand to grow the business.

Third, we have dual focus on opening equity stores and accelerating franchisee development, and that helps, obviously, manage our capital return. And so far this year, we opened 1,200-plus new stores in the first nine months, and we are on the track to reach our full year target.

Payback is good and 80% of the new stores turned profitable within three months, as mentioned in the earlier remarks. So at the same time, we are accelerating the franchisee opening to unlock opportunities in strategic locations, remote or lower-tier cities.

Last but not least, the dual focus on investing in business growth and returning capital to shareholders are also happening at the same time. So with the sales with the product at the end, we are growing the business and returning capital at the same time.

So to summarize, in each of the above four areas, we do our best to avoid unnecessary compromises. And we use all our energy, our capabilities and creativity to get both same-store sales and system sales. Thank you, Xiaopo.

Operator

Lillian Lou, Morgan Stanley.

Lillian Lou Morgan Stanley - Analyst

Hey, thank you. Good evening, Joey, and congrats again, Adrian, for your new position. And also congrats for the very good results. My question is more on the near term because I think, Joey, you have been very clear on the long-term strategy. I think in the third quarter, I noticed that for KFC, our pricing actually recovered pretty nicely compared to the previous quarter's trend.

And I just want to check the thinking behind, i.e., do we see some elevated competition that make us less pressed by on pricing? Or have we done anything to really kind of support the pricing? So related to that, any thinking about the pricing strategy in the next couple of quarters? Thank you.

Joey Wat Yum China Holdings Inc - Chief Executive Officer & Executive Director

Thank you, Lillian. So in terms of competition, we certainly see the restaurant industry continue to grow. And then the global players are still trying to invest aggressively into the China market and the current players are going deeper to lower Tier cities. And we also see some players rationalized promotional intensity in recent quarters and some aggressive players slowed down their store openings this year.

Our strategy for KFC pricing and pizza pricing, actually, in the short term, long term, it's relatively transparent. For KFC, we try to have stable pricing. Our quarter -- this quarter is 38, I think. So that short term, it's slightly higher than the previous quarter, and it's higher than 2019 (corrected by company after the call). So, it's relatively stable.

For Pizza Hut's pricing strategy, we are very clear from 2017 onward. We try to be a bit more mass market driven. So we have continued to lower the pricing. So that is more accessible. So in the short term, long term, that's pretty much our strategy in terms of pricing.

Lillian Lou Morgan Stanley - Analyst

Thank you, Joey.

Operator

Ethan Wang, CLSA.

Ethan Wang CLSA Limited - Analyst

Thank you. Hello, Joey. Hello, Adrian. So my question is on the franchising model. I think I remember back in the Investor Day, we mentioned in the future, KFC franchisee store will be 15% to 20% of new stores. But obviously, we are now having a higher hope for the franchising model. So what makes this change? And if we expect more franchising model in the future, does that also mean we should expect lower CapEx spending going forward as well? Thank you.

Adrian Ding Yum China Holdings Inc - Acting Chief Financial Officer

Thank you, Ethan. I guess, firstly, on your question regarding what made the change, right? I think the key reason is we're ready. For instance, for KFC, we have the new store model, KFC small town Mini. As we communicated previously, the capital expenditure for that store model is lower than RMB0.5 million or roughly 1/3 of our regular KFC store.

And for instance, for the newly rolled out Pizza Hut WOW, that model could have good potential in lower-tier cities as well, and be good for franchising. Obviously, within recent years, the franchisee quality in China has improved meaningfully as well. So overall, the store model readiness, our QA readiness, digital capabilities, and the readiness of the franchisees, is enabling us to speed up the franchise openings here in China.

As we mentioned during the prepared remarks, for KFC, we aim to gradually increase our net new open percentage in franchise to 40% to 50% down the road over the next few years. For Pizza Hut, it takes a bit longer. But overall, we hope to achieve 20% to 30% of net new openings for Pizza Hut being franchise model over the next few years.

And speaking of franchise unit economics, obviously, we want to remind everyone here that for each \$100 of system sales generated by our franchisees, we recognized \$40 to \$45 as our revenue. That breakdown includes 6% to 7% of the 100 being our royalty fee collected and initial fee collected. Also the other \$35 to \$36 out of the \$100 being the transaction with franchisees, the revenue from transaction with franchisees. That's mainly in the areas of COS and other services, including AMP and others.

And in terms of our cost, franchise expense, 3% of the license fee will need to be paid to Yum brands. And our expense for transaction with franchise fees is incurred around our costs. But in the future, there's a potential for us to retain certain margin in the services with franchisees because we have savings from Project Red Eye and Project Fresh Eye.

And lastly to your question whether that will lower our capital expenditure and in terms of our, I guess, ROIC, that's a real question. Over the long term, we do expect that will help enhance our ROIC, but in the near term, the impact will be immaterial because, as we mentioned, the overall pacing of step-up in franchising will be gradual over the next few years. Thank you, Ethan.

Ethan Wang *CLSA Limited - Analyst*

Thank you, Adrian. And congratulations on the results. Thank you.

Adrian Ding *Yum China Holdings Inc - Acting Chief Financial Officer*

Thank you.

Operator

Michelle Cheng, Goldman Sachs.

Michelle Cheng *Goldman Sachs Group Inc - Analyst*

Hi, Joey, Adrian. Thanks for having the time to ask question. So my question is still more on the short term. I think, Adrian, you earlier mentioned that quarter-to-date, we didn't see a significant changes yet, even we are positive on stimulus. But considering last fourth quarter, the base supposedly should be easier. So are we still seeing like incremental sequential improvement in fourth quarter trend?

And also, looking ahead, when we consider both KFC and Pizza Hut, you look at KFC, the same-store sales is still much more resilient than compared with the pre-COVID levels still much closer. So when we look for same-store sales growth going forward, are we seeing that Pizza Hut's pricing trend will be gradually stabilized and KFC actually have room to see the pricing improvement next year? Thank you.

Adrian Ding *Yum China Holdings Inc - Acting Chief Financial Officer*

Thank you, Michelle, for your question. As I mentioned in the prepared remarks, we are quite encouraged by the stimulus policies. Obviously, it will take time to influence consumer behavior and impact businesses like ours. I'd like to give some more color into the quarter four performance, especially in the top line. So entering quarter four, as I mentioned in the prepared remarks, we've not observed significant changes in consumer sentiment nor in the macro situation.

In terms of the October Golden Week holiday, our SSSG slightly improved year-over-year during the Golden Week. However, consumer spending remained cautious post-holiday. I think that's a common phenomenon we observed for this year after a long holiday, that consumer spending returned to be cautious for some time after the long holiday.

Overall, speaking to quarter four, we still face some top-line pressure, but we are confident in our ability to outperform peers in both the good times and bad. And we are also reasonably confident that our quarter four same-store transaction index will continue to be positive for another quarter.

Lastly, but importantly, we really focus on things within our control. So, we continue to execute on our strategy, which has proven to be quite effective to capture incremental traffic and protect our margins. We believe we are well positioned to continue to capture consumer needs with our flagship products, stunning value, deliver strategy and breakthrough models.

I think to your second part of the question relates to the difference between KFC and Pizza Hut. Obviously, given the consumers are more rationalized in their spending, Pizza Hut, with their higher per-person spending, currently is facing a little bit of bigger headwinds compared to KFC, which really has a super robust resilient model. However, I think we're doing all the right things for Pizza Hut, lowering the TAs, lowering the per person spending and also developing new store models such as Pizza Hut WOW, which is even more accessible.

And as we mentioned in the prepared remarks, for both this quarter and the previous quarter, that we do see some initial encouraging results for WOW. But particularly on the dine-in side, we see a meaningful increase in SSSG there for WOW.

Obviously, it's only been five months since we converted the first WOW store back in May. So, we're still kind of iterating a development store model. Hopefully, over a steady pace, the Pizza Hut WOW model will enable Pizza Hut to get to a different and much larger total addressable market.

And I think the final part of your question is more on the midterm for next year on the TA for Pizza Hut and KFC. As we mentioned, for KFC, we looked at the TA. We expect the TA to be steady over the mid-to-long run, although there might be some short-term fluctuations depending on macro and competitive dynamics.

For Pizza Hut, it's our strategy to lower the TA and we have been doing that reasonably effectively with positive transaction growth over the past quarters. And we look to continue that strategy down the road as well. Thank you, Michelle.

Joey Wat Yum China Holdings Inc - Chief Executive Officer & Executive Director

Thank you, Adrian. I'll just add some color about the Pizza Hut same-store sales. So, the Pizza Hut WOW model, its making good progress, but one step at a time. As Adrian mentioned, we see very nice improvement in the dine-in same-store sales.

And out of the 150 Pizza WOW stores, actually 1/3, so 50 stores, are in Guangdong in the South. And because of the scale of Pizza Hut WOW stores relative to Guangdong total store, we have seen some meaningful improvement of the Guangdong same-store sales, which is exciting.

But again, we have over 3,600 stores Pizza Hut stores around the country right now. So, it will take some time. But the progress is good. Last but not least, quarter four is a small quarter. So, a lot of the numbers could swing either way. Thank you so much.

Michelle Cheng Goldman Sachs Group Inc - Analyst

Thank you, Joey, Adrian, for the details.

Adrian Ding Yum China Holdings Inc - Acting Chief Financial Officer

Thank you.

Operator

Sijie Lin, CICC.

Sijie Lin China International Capital Corporation Limited - Analyst

Thank you, Joey and Adrian. Congrats on another strong quarter and generous shareholder returns. I have one question. So, we have seen some food safety cases overseas. So how do we balance on one hand the cost control, and on the other hand, the quality of the product and service? Thank you.

Joey Wat Yum China Holdings Inc - Chief Executive Officer & Executive Director

Thank you, Sijie. Well, first of all, I presume you refer to food safety cases overseas that's caused by raw onions. First of all, we only use cooked onions, so that should not have any similar implications on our business. When it comes to the overall food safety versus cost control, it's always our strong philosophy and operation that we put food safety at the most important position. We are fully compliant with regulations. And also, if there's any issue, it's reported directly to myself, and then we also report it to our Board. We have a food safety committee on this one.

So we absolutely treat it with the highest importance and priority. And it's reflected in a holistic quality assurance system and our comprehensive food safety process within our entire value chain from suppliers to logistics all the way to our stores.

And last, but not least, I just want to reassure you that our investment in our digital supply chain in the last many years have paid off. We have very good visibility, which means digital visibility of our food safety without inventory. And to the point that stock replenishment to the stores is automatic. So, it's absolutely important.

Last but not least, we have more than 300-plus QA employees spread across China, focusing on this important matter in addition to the technology that we have invested to monitor this particular important priority. Thank you so much.

Sijie Lin China International Capital Corporation Limited - Analyst

Thank you, Joey.

Operator

Anne Ling, Jefferies.

Anne Ling Jefferies Group LLC - Analyst

Hey, hi, thank you, management team. Just a question on KCOFFEE. Now with 500 stores, what we hear on the ground is that it's been doing amazingly good. So I just want to check whether you can share with us the incremental benefit because it's a side-by-side store with your existing KFC. So maybe would you share with us what is the incremental same-store benefit? And also, in terms of profitability, if there's anything that you can share with us?

Joey Wat Yum China Holdings Inc - Chief Executive Officer & Executive Director

Thank you, Anne. Well, long story short. We have observed the incremental sales uplift to the store is a single-digit sales uplift, and it does produce incremental profit because of our very unique operating model. So that is the short answer.

In terms of a longer answer, we are indeed very excited. And today actually, we opened our 500th stores in Shanghai, right next to our headquarters and in a very prime area in Xu Jia Hui, Shanghai. The increase of the sales, or the number of cups, is 30% plus, roughly. And this is very exciting, especially when we take the background of the overall market same-store sales in coffee as the background. And the opportunity here is a significant majority of our Yum China members have yet to try a KCOFFEE.

And in our side-by-side model, the cross-sales from KFC to KCOFFEE is amazing. So, we are excited about it. And, it took us 10 years from selling coffee to build the first KCOFFEE cafe, but we are seeing really good progress. We had 100 stores in March. And now we have 500 stores, and then by year-end we expect to exceed 600-plus stores.

And we are expanding to campuses and transportation locations as well. The food is good. We have very distinctive coffee -- sparkling coffee, the float and then the egg tart or the gigantic egg tart. So, things are looking very exciting and positive. Thank you,

Anne.

Anne Ling Jefferies Group LLC - Analyst

Thank you.

Operator

Walter Woo, CMBI.

Wing Woo CMB International Securities Limited - Analyst

Hello, Joey and Adrian, can you hear me?

Joey Wat Yum China Holdings Inc - Chief Executive Officer & Executive Director

Yes.

Wing Woo CMB International Securities Limited - Analyst

Okay. Thank you. Congratulations on your resilient results, and thanks again for all the efforts. So my question is about the Pizza WOW store format. So, can you comment on the sales and margin performance of the Pizza WOW stores and also the midterm room for potential growth? And are they suitable for all the regions in China?

And also, I remember the last time when I dined in the WOW stores, the menu looked really appealing and there were lots of choices and the prices are cheap. However, when I really ordered, many of the items were just not available. So this disappointed me a little bit.

Do you think this is a problem? And how do you see the WOW store format now and going forward? And also, we are also heard of your new store format called KPRO. Are there any infos that you are ready to share? Thank you.

Joey Wat Yum China Holdings Inc - Chief Executive Officer & Executive Director

Thank you. For Pizza WOW, I mean, let's take a step back. It's really an innovation that happened only five months ago. So, I think our speed of going out is very fast already. We are at about 150 stores. And the breakthrough model is very exciting. As I mentioned in the prepared remarks, the impact on the dine-in same store sales is very exciting. There's more work to be done for the delivery side.

And then in terms of the profit, we continue to work on it. Well, let me just bring back our dual focus. Innovations and operational efficiency. Operational efficiency and innovation. It goes both ways. So, for our core business, we achieve operational efficiency, and we take the savings and we invest in innovation.

For Pizza WOW, we have the innovation first, and that is reflected in exciting sales. But the operational efficiency will come later, which I hope addresses your disappointment of the product because it does not happen automatically.

And that's another reason why whenever we turn around business, KFC or later on Pizza Hut, we always focus on sales first, profit later, one step at a time. So, for Pizza WOW, go back to our framework, we have the innovation first and then operational efficiency later. So, I believe that we are making good progress. And I'm very happy to see what we achieved so far for Pizza WOW, but there is a lot more work to be done. It's only been five months.

Regarding KPRO, we have been opening a small number of KPROs in Hangzhou, Shanghai, Guangzhou. And it's still small right now, and obviously, targets health conscious consumers with products like panini, energy bowls and smoothies, very healthy choices.

And it's still in its pilot stage, by the way. So, there's still a lot to be learned. But that's one thing that we are already doing, which is sharing learning from KCOFFEE again it's a side by side. The new stores are side by side with KFC so that we can share staff. We can share some investment of CapEx, but it's still early days. Okay. Thank you.

Wing Woo CMB International Securities Limited - Analyst

Thank you.

Operator

Linda Huang, Macquarie.

Linda Huang Macquarie - Analyst

Hi, Management, can you hear me? Yes. My question is regarding for our capital allocation. We appreciate that the company stepped up the total return to \$4.5 billion. And please correct me if I wrong because based on your cash flow, right? I found that every single year, our free cash flow will be around \$700 million to \$800 million. But if we return back to \$1.5 billion, that means that probably in three years, we can use up all our cash in our balance sheet.

So I'm just wondering, based on this capital return, does that mean that for the next three years, we will just purely focus on the organic growth, and we never think about anything like a big M&A will happen in the next three years or we can strike the balance. If there is a big deal coming up, and we are willing to take some debt to take any M&A opportunity. So that's my question. Thank you.

Adrian Ding Yum China Holdings Inc - Acting Chief Financial Officer

Thank you, Linda. I guess there are two parts of the question. Firstly, regarding the sustainability of our capital return. Obviously, we're very confident in our ability to generate cash. And as we mentioned, we have a dual focus on our business growth and return to shareholders, a dual focus again. For 2024 to 2026, we plan to step up our return from \$3 billion to \$4.5 billion. That includes the \$1.5 billion for this year 2024.

And as the question regarding the longer term, right, obviously, as you correctly pointed out, we probably cannot do \$1.5 billion every year forever, but I think in terms of our company's philosophy, we have always been shareholder value conscious.

So we'll continue to evaluate how best to deliver long-term shareholder value. And obviously, I will not be surprised down the road, we will be able to return a meaningful portion of our free cash flow generated each year to our shareholders beyond 2026. Obviously, we have no concrete plans yet, but we'll provide some more concrete guidance down the road at the appropriate time.

On your second question regarding M&A and strategic opportunities, we have been very prudent in terms of our M&A approach. Obviously, we prudently and proactively evaluate potential M&A opportunities, both historically as well as in the future. And we'll only go ahead with M&A to the extent that makes sense and creates value for shareholders. So obviously, for each of the M&A, as you know, we actually have a robust discussion with our board as well.

To the extent that a very major M&A comes out and then to the extent, if it makes a lot of sense to Yum China, then we may or may not adjust our capital return plan. Obviously, we may or may not take on debt to fund M&A depending on the size of the M&A. Again, we are very prudent in terms of our M&A approach. We'll only do M&As to the extent that it's sensible to our shareholders. Hopefully, that will address your questions. Thank you, Linda.

Linda Huang Macquarie - Analyst

Okay. Thank you very much.

Operator

There are no further questions at this time. I'll now hand back to Ms. Lip for closing remarks.

Florence Lip Yum China Holdings Inc - Senior Director of Investor Relations

Thank you. Thank you for joining the call today. For further questions, please reach us through the contact information in our earnings release and on our website. Thank you.

Joey Wat Yum China Holdings Inc - Chief Executive Officer & Executive Director

Thank you.

Adrian Ding Yum China Holdings Inc - Acting Chief Financial Officer

Thank you.

Operator

That does conclude our conference for today. Thank you for participating. You may now disconnect.

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