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PRESENTATION

Operator

Thank you for standing by, and welcome to the Yum China Fourth Quarter and Fiscal Year 2022 Earnings Conference Call. (Operator Instructions) I would now like to hand the conference over to Ms. Michelle Shen, IR Director. Please go ahead.

Michelle Shen ***Yum China Holdings, Inc. - Director of IR***

Thank you, Zari. Hello, everyone. Thank you for joining Yum China's Fourth Quarter 2022 Earnings Conference Call. On today's call are our CEO, Ms. Joey Wat; and our CFO, Mr. Andy Yeung.

Before we get started, I'd like to remind you that our earnings call and investor materials contain forward-looking statements, which are subject to future events and uncertainties. Our actual results may differ materially from these forward-looking statements. All forward-looking statements should be considered in conjunction with the cautionary statements in our earnings release and 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. Today's call includes 3 sections. Joey will talk about our journey in the past 3 years and discuss fourth quarter performance. Andy will then cover the financial performance and outlook in greater detail. Finally, we will open the call to questions. You can find the webcast of this call and the PowerPoint presentation which contains operational and financial highlights on our IR website.

Finally, we plan to host our 2023 Investor Day in Shanghai this September. We look forward to sharing more details about this event with you in due course. Now I would like to turn the call over to Ms. Joey Wat, CEO of Yum China. Joey?

Joey Wat ***Yum China Holdings, Inc. - CEO & Director***

Thank you, Michelle. I want to wish everyone joining us today a happy and healthy Chinese New Year.

Before looking at the fourth quarter and full year, I would like to reflect upon our journey these past 3 years with COVID, some of our key learnings and how we have grown. First, I'm incredibly grateful to the entire Yum China team for their agility, creativity and tenacity during this difficult time. Together, we became a more resilient, nimble business, better positioned for long-term growth.

During the past 3 years, we quickly pivoted when dine in traffic came under pressure. Delivery doubled from just 20% sales mix in 2019 to 39% in 2022. Our hybrid delivery model and dedicated riders enabled us to capture the increase in demand. Combined with takeaway, off-premise sales reached almost 2/3 in the fourth quarter of 2022. Digital ordering also rocketed from 55% of sales in 2019 to now 89%. That's over USD 20 billion in digital sales in 3 years.

We maintained our rapid growth. Our store portfolio expanded by nearly 40%, a total of 3,800 net new stores. KFC and Pizza Hut stores maintained a healthy payback of 2 to 3 years, respectively. The first year profitability of new stores also improved. Strong new store performance was driven by our flexible store models. We optimized store size and secured more favorable lease terms. For new stores opened in 2022, more than half were in smaller formats. Such flexibility allow us to continue to increase density in higher-tier cities which is particularly useful and helpful for delivery and capture white space in lower-tier cities.

We enhanced the coverage and agility of our world-class supply chain to support business growth. We expanded from 29 to 33 logistics centers for better self-sufficiency in each province. During extended lockdowns, we added rail and sea freight to move our inventory apart from our traditional trucks.

Our store inventory visibility system allows real-time sales forecasting and smart inventory replenishment. These capabilities helped mitigate severe disruption even during lockdown and minimize wastage. Our agile supply chain also supported product innovation by securing supply at scale. Apart from our classic offerings, we launched over 500 new or upgraded menu items last year from regional offers to national launches.

We invested in digital and automation to improve operating transparency and efficiency. For example, we are rolling out smart order system, (Ding Dan Zhi Neng Jiao Fu) at KFC. The AI-powered system more accurately predicts demand and recommends food preparation plan to minimize stock outs and wastage and also reduce waiting time for customers. It also enhances customer experience by reducing wait time and providing real-time order update.

And recently, we added robotic servers at 1/3 of our Pizza Hut restaurants, (Chuan Cai Ji Qi Ren) freeing up crews to serve customers. We remain profitable each and every quarter since the beginning of the pandemic in 2020. By rebasing cost structures and implementing austerity measures, we cushioned shocks created by the volatile market situation. In the past 3 years, we were able to generate USD 1.9 billion in free cash flow and returned over USD 1 billion to shareholders.

Notably, I'm proud to say we did this while also protecting the jobs of our employees. We have had no staff layoff since the pandemic began.

Looking back over this period, we seized opportunities and proved our ability to operate in good times and bad times. Looking forward, our anti-fragile operations will enable us to shine and drive long-term growth in China.

Now let me provide some highlights for the fourth quarter and full year. 2022 was filled with unprecedented challenges. In just 12 months, we managed sporadic COVID outbreaks, entire city lockdowns, nationwide infections and the sudden lifting of COVID-related restrictions. In October and November, COVID infection quickly evolved into major regional outbreaks, leading to tightened COVID-related restrictions.

In December, as China entered a new phase of COVID response, we faced brand new challenges. With surging infection rates, a significant portion of our employees and riders became infected, resulting in labor shortage. Thousands of our stores were temporarily closed or only provide limited services. Many residents also opted to stay at home to avoid infection or recover from symptoms. Dine-in traffic fell sharply.

During this time, as always, the health and safety of our employees and customers remained our top priority. We moved quickly and support our employees with relief medicines and antigen test kits. Mandated daily testing for all crews and riders to minimize infections, and organized informative health talk and a consultation hotline for our employees.

At the same time, we took immediate steps to address the labor shortage. We simplified the menus, shortened operating hours and optimized labor shifts. We reallocated crew resources among stores, prioritizing stores with stronger demand, and we adjusted delivery operations, encouraged customers to pick up orders and promoted packaged food products.

I'm thankful for our team's nimble actions and amazing execution. Even in this challenging quarter, we delivered substantial year-over-year restaurant margin expansion despite lower sales. This was achieved by our extensive scenario planning, operational efficiency improvement, cost rebasing initiatives and temporary relief. We were also able to open a record 538 net new stores in the fourth quarter, or 1,159 net new stores in the full year.

Let's move on to the brands. By brand, KFC and Pizza Hut continue to introduce delicious food and exciting campaigns to delight our customers. At KFC, new categories grew with solid momentum. Juicy whole chicken, (Mi Zhi Quan Ji), and Beef Burger, (Niu rou han bao), doubled in sales in 2022. Combined, they generated around 5% of KFC sales mix in the fourth quarter, nearly equal to our Original Recipe chicken. We continued to introduce more flavors in these categories, such as the Spicy Whole Chicken, (La Lu Feng Wei Quan Ji) launched during Chinese New Year. Following the success of Pokemon Psyduck in quarter 2, (Ke Da Ya) our toys in the fourth quarter also generated huge social buzz. These include Bouncy Chicken, (Beng Beng Ji) and Fluffy Chicken popcorn, (Ji Mi Hua), both were originally designed as pet toys or toys for your cat, but quickly became very popular with all customers and drove traffic.

At Pizza Hut, pizza sales grew nicely for the year, reaching almost 40% of sales. We sold over 100 million pizzas in 2022, that's nearly 7 pizzas per second. Apart from our signature pan, hand-tossed and crispy pizzas, we have added stuffed-crust pizzas. Customer can choose fillings like double cheese, sausage and meat floss(Rou Song). These new launches encouraged the trade ups and lifted effective price.

We continue to offer stunning value for money. Our signature value campaign at KFC, Crazy Thursday, (Feng Kuang Xing Qi Si) attract excellent traffic, generating over 50% more sales on Thursdays compared with other weekdays. Sunday Buy More Save More (Zhou Ri Feng Kuang Pin) continues to spur weekend sales. Customers love the option to mix and match and the sizable discount. At Pizza Hut, we brought back the wildly popular 2 pizza for CNY 59 promotion in November. The amazing value drove great traffic and sales uplift.

New retail packaged foods provided us flexibility during lockdown and when we were short of staff. In 2022, packaged food sales grew 50% (corrected by company after the call) and reached nearly CNY 900 million. We continue to broaden our offerings, adding some of the classics such as Egg tart and popcorn chicken(Ji Mi Hua)

Now moving on to our emerging brands. We have solid management teams and strategies in place. While it will take time to fine-tune and test the business models, we are making solid progress-- Lavazza continues to execute its 4-pillar strategy, which includes brand building, menu innovation, digital and delivery, and store development. Throughout the year, we introduced new coffers flavors such as orange bufala latte with buffalo milk, (Chen Guang Si Rong Na Tie). We also introduced sweet and savory food with -- that pair well with coffee, such as Cube Cornetto, which is a fluffy lave croissant(Gao Bai Qian Ceng Ke Song).

Loyalty members more than double to 1 million in 2022, continue -- contributing to over 40% of sales. We enhanced operational efficiency and optimized new store designs, lowering upfront investment. Although COVID disruptions have delayed store openings, Lavazza reached 85 stores by the end of quarter 4.

Taco Bell doubled its store count in 2022 to 91stores. We continue to localize the menu for Chinese customers. For example, Crispy Wonton taco, (Ya Xiao Su),uses duck and a wonton wrapper in place of a tortilla. Why not? We also continue to improve the value proposition, customer experience and unit economics.

Little Sheep and Huang Ji Huang were acutely impacted by COVID due to their dine-in focus. We used 2022 to refine their business models and strengthen fundamentals from menu, marketing, store models, supply chain to digital initiatives. Huang Ji Huang also continued to generate operating profit.

To wrap up, with a new chapter opening in 2023, we are excited to see positive momentum in the Chinese New Year season. We took decisive action to ensure operational efficiency and capture sales. At KFC, we brought back our signature golden bucket, (Jin Tong) which is a holiday favorite. At Pizza Hut, we introduced a holiday-themed pizza with Wagyu Beef and seafood. It's called (Xian Tiao Qiang He Niu) Pizza, which is inspired by a popular game. It's gratifying to see how our delicious food play an important part in our customers' celebration during the holiday.

Yet COVID remains a reality, and many challenges still lay ahead, including cautious consumer spending post the holiday. While we anticipate the road to recovery will be gradual and uneven, I'm optimistic that brighter days are ahead. We will continue to execute our proven RGM strategy which stand for resiliency, growth and strategic moat to capture the growth opportunity and deliver shareholder value.

With that, I will turn the call over to Andy. Andy?

Ka Wai Yeung ***Yum China Holdings, Inc. - CFO***

Thank you, Joey. And belated Happy Chinese New Year to everyone. Let me share with you our fourth quarter performance.

As Joey mentioned, we faced an extremely fluid and challenging fourth quarter as there were substantial changes in COVID conditions and related policies. In late November, due to rising infections and strict COVID-related health measures, the number of stores that were either temporarily closed or offered only takeaway and delivery services, reached a peak of over 4,300 stores.

In December, we faced a different situation when most of the COVID measures were lifted. Due to labor shortage, we had to temporarily close or provide limited services at over 1,300 stores on average. In such a volatile environment, we took quickly action to capture the off-premise demand. Furthermore, we controlled costs, limited wastage and enhanced productivity despite lower sales. Our team did a wonderful job improving restaurant margins by almost 3 percentage points despite very difficult circumstances.

Let us now go through the financials. Unless noted otherwise, all percentage changes are before the effect of foreign exchange. Foreign exchange had a negative impact of approximately 11% in the quarter.

Fourth quarter total revenue declined 9% year-over-year in reported currency to $2.1 billion. In constant currency, total revenues grew 2%. The contribution of new units and the consolidation of Hangzhou KFC were partially offset by same-store sales decline and temporary store closures. System sales and same-store sales both declined 4% year-over-year. By brand, KFC same-store sales were 97% of the prior year's level, with same-store traffic at 84%. Ticket average grew 16% due to the rise in delivery mix, which has a higher ticket average than dine-in.

Pizza Hut same-store sales were 92% of prior year level. Same-store traffic was at 98%. Ticket average was at 95%, driven by lower ticket average of delivery orders and smaller party size due to the pandemic.

Restaurant margin was 10.4%, 290 basis points higher than the prior year. The year-over-year increase was mainly driven by labor productivity, operational efficiency and temporary relief. These were partially offset by the sales deleveraging impact, which includes temporary store closures as well as higher rider costs due to higher delivery volume.

We also faced inflationary headwinds in commodity and labor costs. Our team worked hard to protect margins during the fourth quarter, which is seasonally low quarter in terms of sales and profits.

Let me go through the key items and highlight the actions we took. Cost of sales was 31.9%, 60 basis points lower than prior year. We kept commodity inflation relatively modest by strategically locking in prices and innovating the menu. We also carefully planned promotional activities and reduced wastage. Cost of labor was 28.8%, 90 basis points higher than prior year. This was mainly due to increased rider cost from higher delivery sales mix, low single-digit wage inflation and sales deleveraging. This was partially offset by better labor productivities and temporary relief of $14 million. Occupancy and other was 28.9%, 320 basis points lower than prior year despite sales deleveraging. This was mainly due to lower rental expense and other cost-saving initiatives. Rental expense as a percentage of sales benefited from rental relief of $12 million, store portfolio optimization and more favorable lease terms.

G&A expenses increased 2% year-over-year, mainly due to increased compensation and benefit expenses as well as the consolidation of Hangzhou KFC. The increase was partially offset by cost control initiatives. Operating profit was $41 million compared to $633 million in the prior year period. In the fourth quarter of 2021, we recorded a noncash gain of $618 million from the remeasurement of our previously held equity interest in Hangzhou KFC. By excluding the remeasurement gain, adjusted operating profit increased 189% year-over-year from $16 million to $40 million. The net contribution from Hangzhou KFC consolidation was 12% of operating profits in the quarter. It included the last quarter of amortization of intangible assets acquired, which was roughly $15 million.

Effective tax rate was 29.9%, 480 basis points higher than prior year, due to lower pretax income and Hangzhou KFC consolidation. Prior to consolidation, the equity income from JVs was not subject to tax, resulting in a lower tax rate. Net income was $53 million. Adjusted net income was $52 million. Excluding the $4 million mark-to-market net gain on our equity investment in Meituan in the quarter and a $9 million net loss in the prior year period, adjusted net income grew 154%.

Due to -- diluted EPS and adjusted EPS were at $0.13, the mark-to-market gain in Meituan increased diluted EPS by $0.01. In December, we acquired an additional 20% stake in Suzhou KFC JV for approximately $115 million. This increased our total ownership in the JV from 72% to 92%.

For the full year 2022, we generated free cash flow of $734 million. We returned over $668 million to shareholders in cash dividends and share repurchases.

Cash, cash and short-term investments was $3.2 billion, down from $4 billion in the third quarter. The reduction in cash and short-term investments was mainly due to the reclassification of around $600 million from short-term investments to long-term time deposits. We invested in longer-term bank deposits to benefit from better interest rates.

Let's now turn to our outlook for 2023. In January, most of the temporarily closed stores resumed normal services. Our same-store sales for the comparable Chinese New Year holiday season were up mid-single digits year-over-year, but remained below pre-pandemic levels. Same-store sales benefited from pent-up demand as the relaxation of COVID policy coincided with the Chinese New Year holiday. However, the real test will be the sales trajectory after the holiday as we face more cautious customer spending and macroeconomic uncertainties.

Looking ahead, we are encouraged by the new COVID policy. The future indeed looks bright. But we must keep a level head and recognize that uncertainties and challenges still lie ahead. Other countries have shown that further outbreaks in the emergence of new COVID variants are real possibility after COVID restrictions are lifted. We also face some macroeconomic headwinds such as elevated commodity and wage inflation as well as softening global economic conditions. These factors may impact our operations and consumer spending in China.

Now at the risk of sounding like a broken record, we continue to expect recovery to take time and be nonlinear and uneven.

For 2023, our top priority is to drive sales. At the same time, we will remain agile. One of the lessons we learned in the recent years is the importance of planning and preparing for a wide range of scenarios, both to capitalize on growth opportunities and to mitigate risks when needed.

On store development, we are targeting to open 1,100 to 1,300 new stores. We expect capital expenditure of $700 million to $900 million to support organic growth remodeling, digital, supply chain and other infrastructure development. As always, the quality of growth is what matters to us the most, not just the quantity. So we will continue our systematic and disciplined approach to investment and growth.

Finally, we remain committed to returning capital to shareholders. The Board has approved to raise the cash dividend from $0.12 per share to $0.13 per share. This is supported by our healthy balance sheet and strong cash flow.

With that, I will pass you back to Michelle to start the Q&A. Michelle?

Michelle Shen ***Yum China Holdings, Inc. - Director of IR***

Thanks, Andy. We'll now open the call for questions. (Operator Instructions) Zari, please start the Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from Brian Bittner from Oppenheimer & Co.

Brian John Bittner ***Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst***

My question is on the new stores that you've built since COVID began. You've built a significant amount of new stores over the last 3 years, over 3,700 of these new stores. And I know the payback on these stores are still very strong despite operating in the pandemic, which is incredibly impressive. But Andy, can you talk about where the sales productivity and the margins on this class of stores that have been built since COVID, where it currently stands relative to the rest of the asset base, so we can kind of understand how to think about the model moving forward?

Ka Wai Yeung ***Yum China Holdings, Inc. - CFO***

Thank you, Brian. If we look at our store opening for the past 3 years, as Joey has mentioned, we have been opening almost -- increased our store count by almost 40% right? And -- but nevertheless, I think if you look at the new store performance, the payback period was very consistent, very good. For KFC, it's about 3 years or -- sorry, for KFC, it's about 2 years, and for Pizza Hut, it's about 2 to 3 years.

And Pizza Hut is -- the reason why it's 2 to 3 years because if you look at a satellite store model, which is the new model that we have, the performance is on par with KFC, which is about 2 years. And then obviously, there's more standard models, their payback period is a little bit longer. And if you look at overall for this year and last year, the new store that we opened, their unit economics continue to perform very well. If we look at the store that opened recently, they're -- the breakeven -- most of them are breakeven within 3 months of time even with this very challenging environment.

So if you look at our new store portfolio, the difference with our existing store is that over the past couple of years, we did increase penetration in lower tier cities, where is the white space. And then we also increased density in the urban area, especially with smaller model, satellite store model or KFC smaller model.

We need to cater to consumers' demand for convenience and delivery and takeaway services. The new stores, generally, are smaller. So the throughput, the sales throughput, generally, are less than their existing portfolio, roughly about 2/3 of the sales compared to portfolio average.

Now the profitability of those new stores are better. As we mentioned, we have lower upfront investment for the small store. If you look at it historically, we probably spent about RMB2.5 million (corrected by company after the call) for our new store opening. And then now like we are spending on average, about RMB 2 million. And then for the small model, it's close to RMB 1.5 million.

And so -- and then also, we have obviously improved the efficiencies throughout this pandemic. As you look at the restaurant margin, for example, last year -- in 2022, despite the fairly volatile environment throughout the year and sales deleveraging, we managed to improve restaurant margins, especially at KFC. So I think we're pretty confident that we have the right format and resources to grow our store network at a healthy pace and also maintain a very robust payback for our investment.

Joey Wat ***Yum China Holdings, Inc. - CEO & Director***

Brian, I'll just to add some color to your question. The theme here of the aggressive new store openings is resiliency because while we emphasize how many stores we have opened in the last 3 years, how many - over 3,700 net new store, but actually 4,800 gross new -- stores. At the same time, what we did not talk about but also important is how many stores we have retired. So when we open the more productive new store, we, at the same time, retire the less productive assets. And thus, the quality of our assets for Yum China has improved in the last 3 years.

So just have a bit of highlight here. For the new store we open, right now, we are talking about 90% of the stores have -- the new stores have flexible rent, which make us more resilient. Andy talked about lower CapEx. Even more, if you think about our CapEx, roughly 40%-60%. 40% is equipment, which we can move around, 60% is sunk cost. So the reduction of the CapEx in terms of sunk cost is even more than just the total reduction of the CapEx. And the size is smaller. So the productivity of the new store is better actually. And the location of the stores matter, too, because they're both in higher tier cities and lower tier cities, it's about 40-60 split, too. So for lower-tier city, 60% new stores, and they're very, very effective in entering new cities. For KFC, 2022, we actually entered 200 new cities. And these are white space. And you can imagine, it's a pretty good market to grow.

For higher-tier cities, our focus is on filling the gap or the distance between the stores to increase the density of our store in high-tier city, which is incredibly important if you think about our focus on our delivery business. So I hope that gives you some flavor about the new stores in terms of the quality and in terms of the resiliency for their business.

Operator

Your next question comes from Chen Luo from Bank of America.

Chen Luo *BofA Securities, Research Division - MD*

Happy Chinese New Year. So before I raise my question, I'd like to highlight 3 things, if I may. First, out of the 12 quarters during the pandemic period, for 5 quarters, we actually reported restaurant margins better than the pre-pandemic level. And despite the fact that for the 4 quarters, we had same store sales like mid- to high single-digit same-store sales decline versus 2019. Whereas for Q3 last year, we actually saw more than 10% same-store sales decline over the same period in 2019.

Apart from the one-time cost relief, we have significantly rebased our cost structure and innovated store formats, as Joey and Andy just elaborated on. And meanwhile, we also consolidate Hangzhou and Suzhou KFC in the past 3 years. Supposedly, this portion of business carries higher margins than the group average. So I think the market, in general, would expect pretty meaningful margin recovery of expansion going forward once sales start to recover.

And for point number two, I also noticed that our priority this year is to drive sales. But meanwhile, the market generally believes that the company is very good at balancing top line and margins. And point number three, just now, we also highlight that we will be planning for multiple scenarios in a very fluid situation.

So after highlighting all these 3 points, now let's come to my question. Sorry if it's a bit long. So I understand the situation is very fluid, but let's assume that for 2023, our macro environment is kind of okay so that the momentum could be similar to that of second half of 2020 and first half of 2021, so that we might see some pretty okay same-store recovery but may not be fully back to the 2019 level. And under that scenario, is it fair to say that we can actually bring our restaurant margin to a level largely similar to 2019 or even a bit higher than that. So that's my question. Thank you.

Ka Wai Yeung *Yum China Holdings, Inc. - CFO*

Chen Luo, thank you for the summary and also -- summary, takeaway and also the question about restaurant margin potential. As we have always said, like when there's -- same-store sales decline, generally, that will put pressure on restaurant margins, overall margins. But when there is recovery on sales, we also expect some operational leverage, too.

Now obviously, as you mentioned, we are quite encouraged by the relaxation of the COVID policy, I think, which will give us a little bit more certainty about the business environment and for operations and then also the Chinese New Year trading period. So in general, I think, we are cautiously optimistic.

The reason we mentioned a couple -- in terms of the market conditions and also the COVID still being a reality is really -- the reality is that we need to keep a level head. I think if you look at the operational improvement, labor productivity improvement and then some of this margin improvement, as we mentioned before, which we expect most of them or some of them would continue. As we have mentioned, we did a lot of work to rebase our cost structure over the past few years. And so if you think about some of our labor structure, our restaurant management versus crew, part-time versus full time all that, and then also, if you think about, as we mentioned, the rental expenses, where we also got some favorable lease term, et cetera, I think those will carry forward.

Now obviously, over the past couple of years because the COVID situation in the fourth quarter and this year, too, right? So in the fourth quarter alone, we received about $26 million of rental relief and other type of relief. And then for the full year, we received about $86 million in total. So those are likely to go away. As you mentioned, if things become more normalized, and so that would also have an impact.

The other one is that we're looking in the commodity prices and labor inflation. I think, obviously, for the past year, because of the COVID and also the overall economic conditions, they have been relatively modest in China in 2022. Cost of sales -- commodity price inflation was about low single digits and same for labor cost inflation. Now we feel -- if you look at the -- commodity prices, for example, for chicken prices, they have been rising since the second half of last year. And so we do expect probably low single-digit commodity price inflation next year, at least in the first half this year, in 2023. And then we also expect cost of labor inflation to return to more normal pace. As we mentioned, low single digit is not the normal. Mid- to high single digit is the norm. So we expect that to actually return to a more normal pace of inflationary pressure there. So that's how we generally look at the sort of like the margins and the cost environment as we move into 2023.

And thank you.

Joey Wat ***Yum China Holdings, Inc. - CEO & Director***

Let me add some color here. The way that the management think about all these core costs and margins is as follows. If you look at our numbers historically, cost of sales and cost of labor, going forward, even in 2023, I think for your modeling purpose, we can expect cost of sales and cost of labor, we -- our management team will try to keep it relatively stable if we could because we have to manage inflation for cost of sales. But at the same time, it won't be too low either. For 2022, it's about 31% (corrected by company after the call). If you go all the way back to 2016, when we start to get listed, it's also about 29%, 30%.

But the big delta is Pizza Hut. Actually, Pizza Hut, at that time -- right now, Pizza Hut is 31.5%. At that time, Pizza Hut was only 26%. And that was a problem because when the cost of sales is too low means the value for money is not good enough for customers, and that's very dangerous. So our goal is to keep it relatively stable.

Cost of labor. The fact is it just keeps increasing. And our job is to manage it at a reasonable level. But we have to pay our staff at a competitive price -- competitive wages. Otherwise, we won't get good staff. The area that, over the years, which we have improved quite a bit, I would say, is occupancy and other operating expenses such as rent, semi, AMP depreciation, amortization, et cetera, et cetera.

So 2022 is 28.6%, and 2016 is 34.2%, a massive 5.6% delta. Now that shows management team's consistency and focus on reducing the rent, which is always the right thing to do, I would like to believe, and also depreciation, which is from reduced CapEx. So that has been our focus.

But when we -- and that's true for both KFC and Pizza Hut, by the way, 5% to 6% improvement for both brands over these many years. However, one thing I would like to emphasize again and again, when we save all this money, we don't just -- let it flow-through to the margin. We always, always, always pass on some savings back to the customer. That's the way that we build long-term business. So I hope that helps you to think about management focus for the margin and various key cost items in our P&L.

Chen Luo ***BofA Securities, Research Division - MD***

That's very helpful. By the way, your Bouncy chicken(Beng beng ji) toy is really cute. And also, I'm very amazed by the newly launched Mao xue wang type of products. So I'm looking forward to have a try.

Joey Wat ***Yum China Holdings, Inc. - CEO & Director***

You must. You must cross the border and try it.

Operator

Your next question comes from Wei Xiaopo from Citi.

Xiaopo Wei ***Citigroup Inc., Research Division - Director & Head of Asia-Pacific Consumer Research***

Happy New Year, Gong xi fa cai. I have a long-term question. We had appreciated the great rundown of Joey's opening remarks, showing us the journey over the past 3 years, how you build your agility and also keep the growth in the long-term target. So my question is, in the past 3 years, your agility is very visible, which will protect your margin, will capture the digital and delivery. But when China reopens, the market will be more dynamic.

I just want to get a sense that whether Joey and team will be more offensive or a little bit aggressive than before in terms of demand activation because you always stay ahead of competition. You stay ahead of competition to reserve your cost and protect margin during the bad time. Will you be a little bit offensive in market share gains looking for upon China reopening?

Joey Wat ***Yum China Holdings, Inc. - CEO & Director***

Thank you, Xiaopo. I think I would like to address the narrative that whether -- in the past 3 years, whether we have been offensive or defensive. I think we have been very aggressive in the last 3 years, if you consider what we just talked about earlier with Brian's question. We have expanded the footprint by as much as 40% within 3 years. So our view is we shall take advantage of the crisis and adversity. And I think we did.

So we -- when we look forward from 2023 and beyond, I think we'll continue our pace, which have been rather aggressive, I would say. But the focus is to -- the focus and priority is to drive sales, focus on delicious food, new product, value, exciting campaign, while at the same time, continue our disciplined approach to capture more growth. If you think about the last 3 years, our biggest constraint actually was on the sales side due to disruptions of the pandemic.

So going forward, we will focus even more on driving sales, and then continue the disciplined approach, which includes accelerating store growth, Andy talked about targeting 1,100 to 1,300 net new stores in 2023. Secondly, optimize the store format because there's still a lot to be done.

We have done, I think, a pretty decent job with KFC and Pizza Hut. But let's not forget, in the last 3 years, the smaller brands actually had more challenging time to test, to try their store format, their sales, the different bits and pieces of store models, and we are certainly looking forward to the -- a bit more supportive environment for the smaller brands to grow.

And third, to invest, to strengthen our strategic moat in terms of supply chain, digital, et cetera. So I hope that gives you a sense about our focus. Our focus is still on resiliency, growth and strategic moat, and our anti-fragile operations, which have improved in the past 3 years, will continue with strong focus on sales. Thank you.

Ka Wai Yeung ***Yum China Holdings, Inc. - CFO***

Let me add another point, which is when we look at our store network expansion, I think we have been very disciplined in order to -- since the spin off, right? And so we're very consistent about that.

Within that very consistent approach, very systematic and disciplined approach is a built in a mechanism, right, to accelerate growth, when the unit economics have perform well and decelerate when the unit economics is not performing as well.

As we mentioned before, if you think about us, when times are better and the store formats are right and performing really well, the store manager themselves or the market manager themselves will propose more stores and then more stores will be approved by our model. Now vice versa, right? And so this is a classic example. If you look at Pizza Hut, right, Pizza Hut even before the pandemic it was in a rejuvenation program. And you see there is store unit economic at that time -- new store unit economic at that time was partially constrained. And therefore, you see limited net new store growth for Pizza Hut.

And then with the success of the satellite store model, you see a pretty significant acceleration for the store development there. And so I think our model and our approach is -- while it's disciplined and systematic, it also reflects very much the current economic conditions and our unit economics which will accelerate and decelerate according to store performance. Thank you, Xiaopo.

Operator

Your next question comes from Michelle Cheng from Goldman Sachs.

Michelle Cheng ***Goldman Sachs Group, Inc., Research Division - Executive Director***

So my question is about the promotion activities and the competition landscape. We know in the past few years, the smaller players have been squeezed out significantly, and this actually benefited our business. So going forward, in the new, like, reopening world, how should we think about the competitive landscape changes? And also, on the other side, we know the consumption power has been pretty challenging these days. So what is your strategy to drive traffic back leveraging those promotion activities?

Joey Wat ***Yum China Holdings, Inc. - CEO & Director***

Hi, Michelle, for the competitive landscape, I'm happy to report that I think we have been doing quite all right. I mean, from 2019 to 2022, the overall market in our business has dropped by mid-single digits. But Yum China, ourselves, we hold up there. So that means our market share has increased a little bit. So I think we have done something right.

Going forward, regarding your question on promotion and sales momentum, we always look at the promotion, product, operation all in a holistic view. How to drive sales? Well, the focus of driving sales, we always prioritize traffic and then ticket average, and we want kind of both. So how to get both? We will have the -- a series of initiatives that form the promotion and sales strategy. We always have fantastic product because it's really not very healthy just to only focus on promotion without amazing products. So product comes first.

Therefore, even during the 3 years, pandemic, every year, we are still able to launch about 500 new products, with or without the help of traditional marketing because we have now over 410 million members(corrected by company after the call). We can always market the new products to our members.

And then with the new product, we have really effective promotions. And that's now becoming more effective over time because we have less promotion campaign, but more effective promotion campaign. And for example, as I mentioned earlier, in the first part of the call, Crazy Thursday, amazing. But it took 4 years to make -- to produce or to come to amazing Crazy Thursday promotion. And that worked really well for work days. But for weekend, our business has been quite challenging because of reduced social activities in the last 3 years.

So for 2022, we pushed Sunday Buy More Save More (Zhou ri feng kuang ping) for KFC. And then for Pizza Hut, that is like the value promotion for the 2 pizza for CNY 59. So fewer but more effective promotion. That drives sales, but that also protect the margin for our shareholders.

Now you think about -- you probably have the hidden question here is about price increase. It is also within our plan, but we do it, hopefully, in a clever way. We expand the range of price. We have lower entry price point product, and we also have some very high-end products to please the customer who will want to treat themselves. Our favorite example is the Wagyu Beef Burger for KFC, which is always a very interesting idea for traditional KFC lovers. So with the combination of multiple initiatives, we hopefully can both drive traffic, maintain the margin and also produce the sales for our shareholders. Thank you.

Michelle Cheng ***Goldman Sachs Group, Inc., Research Division - Executive Director***

Yes. Thank you Joey and thank you for the comment on the pricing.

Operator

Your next question comes from Anne Ling from Jefferies.

Kin Shun Ling ***Jefferies LLC, Research Division - Equity Analyst***

A couple of questions here. First of all, regarding the company's disclosure, that 5% same-store sales growth -- sorry, mid-single-digit same-store sales growth during Chinese New Year. Would you share with us, like, how -- is it, like, more or less similar for both KFC and

Pizza Hut? And how does it differ in terms of the pace of recovery? What we should be expecting? And then also, if we take a look at, like, both brands, we have an increase of the delivery business versus year 2019. So how would it change when we have the reopening? Will we see more stabilization on this part?

Joey Wat ***Yum China Holdings, Inc. - CEO & Director***

Anne, for the Chinese New Year same-store sales, the mid-single-digit number, KFC did better, slightly better than Pizza Hut, because of the transportation hub stores performed very well. As we mentioned in the earnings release this morning, it's even better than the government statistics. So that helps a lot.

And in terms of the regional difference. And all regions performed quite well across all regions, and lower tier cities performed better, actually. But I have to mention is we need to be prudent to look at the number because this year, Chinese New Year is very early. So the comparison is rather difficult. We shall look at the Chinese New Year number, including January and February. So that will -- that picture would be more complete.

And in terms of delivery business, the increase is good between 2019 to 2022, it moved from 20% to 40% for Yum China. However, I would also like to mention that as the management look at this business, we also look at off-premise business as a whole because delivery business is still outperformed -- still outperformed compared to dine-in.

But the question is, where's the ceiling? I mean, I would just like to highlight the off-premise sales right now for our business is about 2/3, which I mentioned earlier. And that's incredibly important in our analysis because it's about the resiliency of our business. That is something the management team has worked very hard to achieve. And that's also the reason why we have -- we have done okay in the last 3 years because when the off-premise business is as high as 2/3, it helps protect the business.

Think about what's our breakeven sales. That's how we think about it. What's the breakeven sales for our business? It's right now, you can work out the number, is we only need less than 80% of the sales or same-store sales to breakeven to achieve breakeven. That means even during the pandemic, when a significant portion of our store was shut, we can still achieve breakeven sales because there's sales transfer from dine-in to delivery and off-premise even during the lockdown.

So that's the way that we look at the business, and I hope you would -- you guys will also look at the business in this way as well. And that 20% increase, therefore, from 2019 to 2022 is incredibly important. If I mention one more slight point is if you look at our number during quarter 4 2022, KFC did better than Pizza Hut. One reason is KFC's off-premise business is much higher than Pizza Hut. So protect the downside much better. Thank you, Anne.

Operator

Your next question comes from Lillian Lou from Morgan Stanley.

Lillian Lou ***Morgan Stanley, Research Division - Executive Director***

Just a very quick follow-on question because that's exactly what Joey just mentioned that KFC versus Pizza Hut recovery pace. Given this current new volatile situation and in the meanwhile, we are seeing improvement in off-premise traffic. So like for Jan and Feb and even for 2023, are we seeing -- like is it fair that we can expect the KFC's momentum in terms of the pickup trend will be stronger than Pizza Hut?

And especially, how this delivery portion may be normalized down a bit versus last year. How does that kind of impact our forecast for same-store sales growth? I believe traffic will offset some downward pressure on ticket size for KFC and opposite situation for Pizza Hut. So basically, how do we picture the dynamics in the next couple of months and also 2023?

Joey Wat ***Yum China Holdings, Inc. - CEO & Director***

For KFC and Pizza Hut, they are very different business in a way, right? One is QSR, very clear QSR. And the other one has a very big portion in dine-in and casual dining, which is very, very unique. So they will be different. And we talked quite a lot about the KFC already, so I'm going to focus on Pizza Hut in response to your question, Lillian.

Pizza Hut we started the turnaround back in 2017. And our focus has been drive the traffic first and then drive the sales. Once we get the sales under control, we move on to make it more profitable. Sales first, profit later. I presume you guys all still remember. But after we get the profit under control, then we work on the store expansion and resiliency.

So for this year, 2022, let's not forget Pizza Hut opened a lot of stores this year. This is the record opening store year for Pizza Hut. Over 300 stores. That's -- well, at least we are very happy about it. So I hope the shareholders are happy about it, too.

So what is next for Pizza Hut is open more stores by increasing the scale. But one very important topic for Pizza Hut going forward is their resiliency. And I think, as I mentioned earlier, in the last question from Anne, right now, KFC's resilience is slightly better than Pizza Hut. And therefore, our focus on Pizza Hut going forward is more store and better resiliency.

How to do better resiliency? The satellite store, other than all the operational improvement will continue, the satellite store. The satellite store is fabulous. I mean, right now, between the satellite store and the other smaller store, we have about 20% of the portfolio, about 600 stores in this category, satellite stores are 350 stores. So these are very low investment store but with very good sales productivity. And the payback is two years for the satellite store.

For total new store for Pizza Hut, the payback is 3 years. 2-years payback for the Satellite store (added by company after the call). Well, after 30-some years of Pizza Hut business, this is the best payback store model for Pizza Hut. So you can imagine, we're going to open more of these. When we open more of the satellite or small store, you can also imagine the delivery business will also benefit as well.

So I think -- I hope that you can see our focus for the business is very clear. We know what we are doing, and we do it in our own pace. It's like running a marathon. At the beginning, it takes some time. But once we are at certain speed, we'll run it at a certain speed because we can. Thank you.

Operator

Your next question comes from Lin Sijie from CICC.

Sijie Lin ***China International Capital Corporation Limited, Research Division - Analyst***

Congrats for another resilient quarter. So I have one question, which is more about the whole picture. So regarding the recovery of Chinese consumption, we find that the recent recovery even, after the Chinese New Year, of the shopping mall traffic and restaurant sales is really good in some cities, like maybe Chengdu, Chongqing, Changsha, but I'm not sure if it's a common situation nationwide. So since we have extensive layout in most regions and most city tiers, what is our opinion? You may wonder will there remain difference for recovery among regions and city tiers in the future?

Joey Wat ***Yum China Holdings, Inc. - CEO & Director***

Sijie, thank you. As I mentioned earlier, the Chinese New Year recovery is encouraging. The momentum is good. And we also saw good recovery across the region. And in particular, in some Tier 2 city like Chengdu or Xi'an or Changsha because Pizza Hut is a tourist destination for domestic traveling. So they benefit from the CNY. And then our lower-tier city stores also benefit because people have not been able to go home for 3 years. So we're happy to see that. But our caution is on post-Chinese New Year trading because while all these happy improvements are happening, we are also cautious that the value for money, the cautious spending is also happening. So therefore, while we are happy to see the traffic coming back, we still focus a lot on value promotion to get our customers through the door.

Going forward, we -- our focus right now is look at the post-Chinese New Year trading because particularly when they are concerned about economy and macro situation, the customer spending post-big holiday might be cautious. And that's not only specific to Chinese. I spent 10 years in U.K., and I think that consumer behavior is consistent across all countries or everywhere. It's just natural human behavior. So therefore, we have that cautious optimistic preparation towards the January and February trading as the holistic trading period, instead of just January.

Ka Wai Yeung ***Yum China Holdings, Inc. - CFO***

Yes. Sijie, And I just want to add a little bit to Joey's comments. I think in general, we are very encouraged, obviously, by the new COVID policy and then also the Chinese New Year trading period. And so we are optimistic for the year. I think things are looking brighter. But I think what we're trying to say is that we do not take sales or growth for granted. We believe that likely still, there's going to be uncertainty and challenge ahead, and we'll work hard to drive that sales growth and then be disciplined about our store expansion. And so that's the old saying would say, we plan for the best and prepare for the worst. And so that has been in the last couple of years our strategy and we'll continue that. So plan for different scenarios. Thank you, Sijie.

Operator

Thank you. Your next question comes from Ethan Wang from CLSA.

Yushen Wang ***CLSA Limited, Research Division - Research Analyst***

My question is on supply chain, which is very important to our business, both during COVID and post-COVID, but largely ignored by market some time. So we noticed that we have made a very strong commitment to reduce our carbon footprint Scope 3 that may apply to our supply chain as well. So I was just wondering, does that mean we may make some changes in regard to our supply chain choice? Or we may make some investment to our supply chain partners to achieve that goal and how that's going to affect our business going forward?

Ka Wai Yeung ***Yum China Holdings, Inc. - CFO***

Ethan, thank you for your questions. In terms of supply chain, I think, obviously, continues to be a very important advantage for us. And it's very important to our long-term sustainable growth. And so for supply chain, we will -- in the next couple of years, we'll continue our -- as we mentioned in the previous Investor Day, we will step up investments in supply chain and other infrastructure. Obviously, we'll be expanding our footprint in terms of our store for our supply chain centers and then also including automation, but also investment to reduce carbon footprint, as you mentioned.

Now obviously, it's very important for us to work with our supplier base, our supplier partner to work to that goal. I think if you look at the climate change initiative, it's still relatively new. We are learning it. We have planned for it, and we have submitted the Science-Based Target initiatives for our plan. We are committed to achieving net-zero emission by 2050. And so that's a commitment that not only require us internally to make investment and improve our operations, but also work very closely with our supplier. And then in the future, we will also work very closely with our consumer, too. Because to make a sustainable environment to require everyone's involvement. So it's not that we would necessarily change, but we will work together and obviously study and encourage our supplier base to also work toward that goal with us as well. And so that's how generally we think about our supply chain initiative versus the ESG initiatives, especially climate change.

Joey Wat ***Yum China Holdings, Inc. - CEO & Director***

I have 2 points to add Ethan. One is when we talk about investment in supply chain responding to ESG, some people naturally think that, oh, that means margin impact, that means additional investments. I have to emphasize that in Yum China's philosophy, that means that the investment must have a desired payback. It does not mean that we just justify the additional investment because it's the right thing to do. It has to be the right thing to do now and in the future, it has to be sustainable for the business as well.

So one example is we invest in little measurement meters in the store to measure the usage of energy. Well, the original -- the little cute equipment is very expensive. It does not justify our payback because our overall -- if you think about store economics, 2 years, 3 years, well, we have to work towards that direction. So what did our teams do? We worked with the suppliers of that little cute equipment, get rid of the bells and whistles. So it's very affordable. And we install them in our stores. And the saving is enough to justify the investment. So the payback is still protected. So that's one discipline. And we also share whatever we learn with our supplier to help them. So that's point one.

Point two, is supply chain. I'm personally very excited about this area, and my team is very, very passionate about it, too, because there are some really fun and exciting innovations happening in the last few years here. And I can share one with you. During the Shanghai lockdown, we have 1 warehouse -- while we have 33 logistic centers to supply the chicken to different province, we have 1 warehouse to supply the package, the paper box, the bags, et cetera, for our stores. But that warehouse, what happened, was in Shanghai. And Shanghai was completely lockdown. And that is the serious business, right? How can we keep our stores open without the packaging paper, the wrapping paper?

Well, our team, which is a brilliant team, when we are faced with such challenges, we came up with even more brilliant solution. That's when we started to build a logistics site in the most nearby port within a week, and we started to ship these packaging materials through sea freight. One direction went to the north, to Tianjin, and then distribute from Tianjin to cover the entire northern part of China. One, went down to Guangzhou, it covers the southern part of China. Well, what happened to the middle part of China there? Well, there's railway. The railway can stop everywhere without the problem of lockdown. So some part of these packaging materials get on the train and went to Chengdu and Wuhan, everywhere. And we are okay. So now you can imagine in the past, when we opened a logistics center, we looked at the trucks route, now we look at the trucks, the rail and the sea freight, everything. I love it. I think that's the way that we shall do our business, in the past few years and going forward. It's fun. Thank you.

Operator

Your next question comes from Rap Tse from CIMB.

Rap Tse *CIMB*

So the question I would like to ask is about your new store target. And I'm just wondering if you guys think your new target is a bit too conservative because obviously, you guys have done really well last year on opening more than 1,100 stores last year with COVID. And without COVID, do you think the numbers could be a bit more higher this year? And also, since your CapEx spend last year is much lower than your previous expectations, and then perhaps the per store CapEx, it's much lower now. And also the level of rent is still lower than the pre-COVID level. And why should we take more advantage of that? And also, do you mind breaking down the number of store openings for the smaller brands like Lavazza and TacoBell as well. Thank you.

Ka Wai Yeung *Yum China Holdings, Inc. - CFO*

Rap, thank you for your questions about our new store opening target. So I just want to echo a little bit about our previous comments, which is for last year, we opened more than 1,800 stores. The more than 1,100 store is the net new store that was increased. As Joey mentioned, obviously, we're very disciplined, and our new stores' performance is very good. So we have been opening new stores quite aggressively even during the pandemic period.

We also aggressively optimized and improved our portfolio of brand and also our store network. And so that's why you see the net number is 1,100 plus for last year. Now this year, and as I have mentioned before, obviously, the target that we set up is 1,100 to 1,300 new stores this year. But I would emphasize that for our company, the quality of growth is more important than the quantity of growth.

And when -- so we generally do not give like a quantitative dictate or number to our staff and say, hey, this year, you're going to open x thousands of stores. That's not the way we do it. We do it in a very disciplined way, right? What we look at is like what's a reasonable sort of range of new store. And then -- but ultimately, how many stores will be open is really depending on the market conditions, right, the unit economics.

As I mentioned, when the store economics, they perform really well, the market is booming, be sure our market manager, they will be promoting store opening and propose more stores for opening. And the unit economics is good, more store will be approved. And so there will be acceleration automatically that builds our process.

But our process is not based on a person's or a particular point of view, it is really based on a consistent, disciplined approach that reflects both the market conditions and also the unit economics. So we feel confident that if things are doing really, really well, I'm sure like -- we are confident that our store manager -- and they will make the right decision and we'll see very healthy, very strong, robust network expansion.

As we mentioned before, and this year, our focus is on driving sales growth. This is really important because the sales, not only impact top line, but also impact margin. The biggest driver for margin is really sales. And then when we talk about other cost factors. So this will be our focus, and we're confident that if we have -- you look at the number for the last few years, I think we had outperformed the overall market in terms of the restaurant industry, and we're confident that we will be able to do it in the long haul.

Joey Wat ***Yum China Holdings, Inc. - CEO & Director***

Rap, I have one point to add. Analytically or from analyst's point of view, the CapEx, the rent, the sales, all these are important factors to open stores. But operationally, what is not mentioned enough, the most important factor actually is how many good store managers do we have. And good store managers take some time to train, 2 to 3 years. And for us, we don't apologize for that focus because even in our culture, we emphasize on RGM #1. Our store managers are the most important people in our organization. So in order to ensure quality of growth, as Andy mentioned, we need to get all these things under control, CapEx, the rent, the operations, the sales. But the most important job for me and my management team is we make sure we have good store managers to run the store. Thank you.

Ka Wai Yeung ***Yum China Holdings, Inc. - CFO***

In terms of by brand, I think like, obviously, KFC remains the largest brand for store opening, and you've seen Pizza Hut have accelerated store opening, as Joey mentioned, a record number in probably recent years -- with a number of years, even before pandemic. And then you -- we are continuing to see very robust expansion for Lavazza, right? So Lavazza now is more than 85 stores already, and still growing very rapidly. And you think about it compared to last year is multiple fold increase.

And then Taco Bell also happened to increase store network expansion. In terms of the Chinese cuisine business, we'll work very closely with our franchisee. We will likely see the network increase in 2023 for the Chinese cuisine business, both which include Little Sheep and Huang Ji Huang.

Operator

Thank you. There are no further questions at this time. I'll now hand back to Michelle for closing remarks.

Michelle Shen ***Yum China Holdings, Inc. - Director of IR***

Thanks, Zari. Thank you all for joining the call today. We look forward to speaking with you on the next earnings call. If you have further questions, please reach out through the contact information in our earnings release in our website. Have a great day. Thank you.

Ka Wai Yeung ***Yum China Holdings, Inc. - CFO***

Thank you, everyone.

Joey Wat ***Yum China Holdings, Inc. - CEO & Director***

Thank you.

Operator

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