REFINITIV STREETEVENTS

EDITED TRANSCRIPT

YUMC.N - Q1 2024 Yum China Holdings Inc Earnings Call

EVENT DATE/TIME: APRIL 30, 2024 / 12:00AM GMT

CORPORATE PARTICIPANTS

Florence Lip *Yum China Holdings, Inc. - Senior Director of IR*

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

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

CONFERENCE CALL PARTICIPANTS

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

Chen Luo *BofA Securities, Research Division - MD*

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

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

Michelle Cheng *Goldman Sachs Group, Inc., Research Division - Co-head of Asia Consumer Research*

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

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

PRESENTATION

Operator

Thank you for standing by, and welcome to the Yum China First Quarter 2024 Earnings Conference Call. (Operator Instructions) I would now like to hand the conference over to Florence Lip, Investor Relations Senior Director. Please go ahead.

Florence Lip - *Yum China Holdings, Inc. - Senior Director of IR*

Thank you, operator. Hello, everyone. Thank you for joining Yum China's First Quarter 2024 Earnings Conference Call.

On today's call are our CEO, Ms. Joey Wat; and our CFO, Mr. Andy Yeung.

I'd like to remind everyone that our earnings call and investment 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. You can find the webcast of this call and a 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. - CEO & Executive Director*

Hello, everyone, and thank you for joining us today. I'm proud to share that we turned in a solid performance in the first quarter.

System sales grew 6% year-over-year on top of 17% growth last year. Our revenue reached USD 3 billion in the quarter, an all-time high. Core operating profit improved to USD 396 million from a high base of $392 million last year. Adjusted operating profit in quarter 1 of last year was the highest in the 30 quarters since our spin-off. This quarter was the second highest. We achieved these results in a challenging and competitive environment thanks to our resilient business model and our team's agility and hard work. We demonstrated once again our ability to adjust to changing conditions and deliver solid results.

We continued to invest to accelerate growth, adding a record number of stores. We reached and surpassed the milestone of 15,000 stores. At the same time, we returned a record amount of cash to our shareholders through share repurchases and cash dividends totaling USD 745 million.

Let me start with our store opening strategy. We remain bullish on China. We see the China market as offering us white space for years to come. We intend to fill in by expanding our store portfolio.

In quarter 1, we passed the 15,000-store milestone, opening 378 net new stores. I am proud of how we have been able to accelerate. It took us 25 years to build the first 5,000 stores in China, 8 years to build the next 5,000 stores and just 4 years for the last 5,000 stores. We are well on our way to another 5,000 stores by 2026.

Contrary to select recent reports, China continues to develop rapidly with hundreds of new shopping malls, residential complexes and commercial developments opening every year. Urbanization and long-term consumption upgrades in Tier 2 cities and below present a particularly attractive opportunity for us. Housing and living costs are more affordable there. Tremendous consumption potential has yet to be unleashed. We expect roughly 30% of our new stores this year to be in new cities or strategic locations such as transportation and tourist locations.

Our flexible store models and franchise partnerships give us the tools to capitalize on every opportunity. Taking a closer look at each of these: Our flexible store models enable us to expand across city tiers and penetrate further. In quarter 1, 2/3 of new store openings were in smaller store formats. On average, our new store now takes just RMB 1.2 million to RMB 1.5 million CapEx to build and we are always pushing for even lower CapEx and innovating new formats.

KFC has recently developed a small-town mini model for lower-tier cities, with a simplified menu and optimized equipment, per store CapEx can get as low as RMB 0.5 million. Pizza Hut has just 3,400 stores and holds significant potential for further expansion. We have developed a compact model. It is smaller than our standard stores but features more dining space and menu choices than our satellite model. These promising new models enable us to add store density and enter smaller cities more flexibly and profitably.

Transportation and tourist locations represent just single digits of our store mix right now, but they are key to capturing the spike in travel volume during holiday periods. Same-store sales at these locations grew around 20% during Chinese New Year. We are opening more stores at highway service centers in over 20 provinces, capitalizing on the opportunity presented by the rising car ownership.

Some of our stores will be opened through franchising. In fact, partnering with franchisees is key to unlocking opportunities in lower tiers, remote areas and other strategic locations. At our Investor Day last year, we estimated about 15% to 20% of our net new stores in the next 3 years will come from franchising. In quarter 1, this mix has reached 19% at KFC. A disciplined approach backs our accelerated expansion.

Payback periods have remained consistent at 2 years for KFC and improved from 3 years to 2 to 3 years for Pizza Hut. We track these KPIs very closely to help ensure we open high-quality new stores.

Let's now spend some time on our brand strategy. We have devised robust strategies to meet diverse demands in China. We satisfy our customers' taste buds with delicious innovative food. And we build an emotional bond with them. Through a combination of premium and affordable options, we make sure there's something for everyone. We recorded over 460 million transactions in the first quarter alone, representing a 15% increase year-over-year.

It was not easy. While our restaurants remained open this year and last year, there were a lot more other restaurants opening during the holiday this year. But our customers responded well to our offerings. The strong transaction growth also reflects our successful strategy to spread our price points expanding into lower ticket orders, and that will allow us to capture more market shares.

Now let me spend some time on each brand, beginning with KFC, our primary growth engine. Delicious, innovative food and amazing value have been the keys to our success. Our high ticket average products sold very well in quarter 1. KFC's beef burger and whole chicken sales grew double digit. We take a holistic approach to drive traffic while protecting our ticket average. We launched the super juicy pineapple Beef burger (foreign language). The combination of pineapple and beef taste is exotic and customers like it.

At the same time, we added entry price beef burgers into our weekday value combo. So we have both value and premium options to meet diverse consumer needs. Our 6-year old signature Crazy Thursdays continue to drive major traffic to KFC. Thursdays now even outperform weekends. Leveraging full chicken utilization, we offer great value to customers at sustainable costs.

Our delivery business remains strong. Delivery sales have grown double digits every year for the past decade. We identified smaller orders as an area of opportunity. To tap it, KFC reduced its delivery fee and expand one-person meal options in late February. The initiatives attracted strong incremental traffic, capturing more market share especially in lower-tier cities.

To offset the lower delivery fee, we have taken actions to reduce our overall operating cost for riders. This includes introducing platform riders at select locations where their quality actually matches our dedicated riders. We can serve more customers while maintaining service quality and sustainable margins.

We are constantly searching for new growth pillars. K-Coffee continues to grow nicely, achieving a 30% increase in cups sold in quarter 1. We are excited about further penetrating this segment of a growing coffee market. To this end, we have developed a side-by-side K-Coffee model. We call it (foreign language). Its distinct storefront and dining area cultivates a cafe ambiance surrounded by coffee aroma. These shops are connected to KFC stores, so that we can share a kitchen to keep the investment and operating costs down. Using KFC equipment, we can serve unique products like coffee floats, (Xue Ding Coffee) and sparkling coffee, (foreign language) without additional investment in equipment.

Summer is coming. So we really encourage our friends to try this very refreshing sparkling coffee. It's indeed one of our best-selling coffee already. We see initial success of 100 side-by-side stores across 80 cities already, and we intend to roll this model out aggressively.

Next is Pizza Hut, which now has over 3,400 stores only and is ready for accelerated growth. In the past 12 months, Pizza Hut added over 400 stores and increased city coverage by 10% to over 750 cities. We aim to broaden its addressable market with a strong value proposition for mass-market appeal. Our strategy emphasizes widening price points, expanding into new categories and delivering emotional value to consumers.

First, we are widening price points. We enriched our entry price pizza offerings. Sales from below RMB 50 pieces grew double digit in quarter 1. Our Bolognese pizza (foreign language) pizza priced at RMB 39 has quickly become one of our top 5 best-selling pizzas. It's a familiar taste inspired by our spaghetti -- well, actually, our signature dish for the past 30 years, and it has become a customer favorite.

These results give us confidence that we are on the right track. Our higher-ticket offerings also offer abundant value. We brought back our popular All-you-can-eat deal at RMB 178 for 5 days with Beef Wellington, Durian pizza, Crayfish and other very delicious options to choose from. This campaign generated a lot of social buzz and became a strong sales driver, particularly for those people who love to indulge themselves with the All-you-can-eat deal.

We are also expanding offerings to capture our share of growing 1 person meal occasions. Just last week, we launched the Pizza Dough Burger [Bi Sa Bao] in around 2,000 stores with existing ingredients. This made to order burger features pizza dough buns, freshly baked in-store on a daily basis. The inspiration actually comes from Chinese bun.

So our pizza dough bun is chewy and fluffy, it's very unique and it's very different. It perfectly complements our juicy beef and chicken patties. The result is good. And we are confident that will unlock incremental sales. We aim to offer emotional value to our customers beyond delicious food. In quarter 1, we more than doubled the number of IP collaborations with top animations and games. These campaigns attracted a wave of young customers eager to join the fun.

Let's turn to Lavazza. Lavazza's dual growth engines, coffee shop and retail, are making good progress in driving synergies. We further reduced the CapEx of our latest small store formats and improved store economics. Our retail business expanded to premium outlets such as Five Star Hotels and Michelin star restaurants. By growing the 2 businesses, we are building the Lavazza brand in China.

Looking forward, Lavazza Group and we are planning to partner with a local roastery for fresher beans, more competitive cost and smoother operations.

Now let's briefly touch on our Chinese dining brand. Little Sheep and Huang Ji Huang had a strong recovery last year. Huang Ji Huang remains a very resilient model with strong growth potential. Little Sheep has made good progress with their new 1-person hot pot module. We achieved initial success with the pilot stores in Shanghai, resulting in a robust pipeline with our franchisees. We are also expanding internationally, such as reentering the U.S. with a new Little Sheep store in New Jersey.

As we expand to serve more customers and capture incremental traffic, we are pursuing greater operational efficiency to make our business even more resilient. In the spirit of our restaurant general manager #1 or RGM #1 philosophy, we launched Project Fresh Eye to assess our operational processes through the fresh eyes of our RGM. Our goal is to empower our RGMs, supporting them better and faster. The scope covers all aspects: from our restaurants to supply chain and back office. We aim to improve efficiency, enhance agility and drive cost effectiveness. We are streamlining processes and integrating resources to promote synergies across regions and functions.

Technology will continue to play a big role in driving efficiency. We are starting to use generative AI to develop creative marketing and facilitate our recruiting processes. In addition, we benchmark against the industry to identify areas of opportunities and develop targeted strategies. We aim to be best-in-class and best-in-cost, passing on any cost savings to our customers and other stakeholders.

Our ability to address our consumers' ever-evolving needs allows us to connect with them emotionally and continually. Our pioneering digital capabilities, proprietary supply chain management and unmatched operational efficiency enable us to do this on a massive scale. These qualities set us apart from our competition and help us drive sustainable growth in this dynamic market.

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

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

Thank you, Joey, and hello, everyone. We delivered solid results in the first quarter, driving sales, core operating profit and EPS growth despite a higher base.

During the action-packed first quarter, we launched an exciting offering and took bold strategic actions to expand our addressable market. At the same time, we are pressing on with our cost structure rebasing, driving operational efficiency to support long-term sustainable growth.

Let's now look at our first quarter performance in more detail. System sales increased 6% year-over-year, led by 8% net new unit contribution. Same-store sales were at 97% of prior year levels against a very strong performance last year.

By brand, KFC system sales increased 7% year-over-year, driven by net new store contribution. KFC's portfolio reached 10,603 stores, adding 307 net new stores in the quarter. Same-store sales were at 98% of prior year levels, with 4% same-store traffic growth and a 6% lower ticket average.

Putting this into perspective, our ticket average in the quarter was RMB 42. This is sequentially higher than RMB 39 in the fourth quarter last year due to holiday impact. And it is also higher than RMB 39 in the first quarter 2019.

Now, in line with our strategy to drive incremental traffic, we offer higher ticket average products like whole chicken and beef burger while enriching entry-level combos. We also lowered our delivery fees to capture smaller ticket orders. And we had a nice rebound in breakfast, coffee and ice cream sales, which have a lower ticket average.

Pizza Hut's system sales increased 4% year-over-year driven by net new unit contribution. Pizza Hut's portfolio reached 3,425 stores with record first quarter net new stores of 113. Same-store sales were at 95% of the prior year level, led by strong traffic growth of 8% and a 12% lower ticket average.

As Joey mentioned, we are strategically enriching our entry price pizza, steaks, smaller party-size options and one-person meals at Pizza Hut. This helps Pizza Hut tap into underserved customer segments and roll out to more locations, capturing incremental traffic.

Operating profit was $374 million. Our operating margin as a percentage of revenue was 12.6%. We're delighted that our core operating profit was not only stable but also grew by 1% on top of the very strong performance last year. As a reminder, core operating profit excludes foreign exchange impact, special items and other items affecting comparability.

Our proactive savings in G&A expenses partially offset the year-over-year low restaurant margin. As Joey mentioned, we have challenged ourselves to strive for higher efficiency so that we can drive sustainable growth.

Now let's go through our restaurant margins and key cost items.

Our restaurant margin was 17.6%, 230 basis points lower than last year or 130 basis points lower on a comparable basis. The year-over-year difference was mainly due to higher cost of sales and cost of labor while our occupancy and other costs continued to improve.

Cost of Sales was 32.1%, 200 basis points higher year-over-year, or 170 basis points higher on a comparable basis. We increased value for money offerings. Favorable commodity costs, superb procurement and efficiency gains from Project Fresh Eye allow us to pass the savings back to customers.

Cost of labor was 25.4%, 80 basis points higher year-over-year, or 60 basis points higher on a comparable basis. This was mainly due to last year's wage increases for frontline staff and higher rider costs as the delivery mix went up. We improved our labor productivity, which more than offset the sales deleveraging impact.

Occupancy and other was 24.9%, 10 basis points lower year-over-year, or 60 basis points lower on a comparable basis. This improvement came from lower rent expenses as well as lower marketing and advertising expenses.

Our G&A expenses decreased 10% year-over-year because of operational efficiency gains across the organization and lower performance-based compensation this year. G&A expenses as a percentage of revenue was 4.7% in the quarter, improving from 5.6% a year ago. Obviously, the ratio would fluctuate with seasonality in sales. But for the full year, we aim to keep G&A ratio to be around 5%.

Our effective tax rate was 26.9% in the first quarter. The lower tax rate on a year-over-year basis was due mainly to less non-tax deductible expenses. We expect the full year effective tax rate to be in the high 20s.

Diluted EPS was $0.71, growing 10% year-over-year.

Moving on to our second quarter outlook. As a reminder, the second quarter of last year was a phenomenal quarter. System sales increased 32% year-on-year in the second quarter last year. Operating profit last year was the highest among all second quarters. We also benefited from strong demand around Labor Day and Children's Day holidays last year. We recorded around $12 million in temporary relief and VAT deduction benefit, which is not expected to recur this year. So all these would again form a high base for comparison.

Looking ahead to the second quarter of this year, we expect the tide to remain choppy. This will test our ability to adapt. We'll continue to execute on our strategy to drive incremental traffic with great value for money offerings. Consumers are indeed more rational in their spending in the new normal, but they do respond well to our exciting offerings and campaigns.

On the operational side, we will continue to work hard to improve the efficiency across the organization and pass along the savings to customers.

For the full year, with a strong store pipeline, we are expecting to open 1,500 to 1,700 net new stores. In addition to investing for growth, we also returned a record $745 million to shareholders in the first quarter, including buying back 16.6 million shares, which is equivalent to more than 4% of our share outstanding. Our strong cash flow generation and a healthy cash position are what made this possible. At the end of the quarter, we had $3.1 billion in net cash. We are committed to return $1.5 billion to shareholders in 2024 and continue to drive our long-term sustainable growth.

With that, I will pass it back to Florence. Florence?

Florence Lip - *Yum China Holdings, Inc. - Senior Director of IR*

Thanks, Andy. Now we will open the call for questions.

(Operator Instructions) Operator, please start the Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question today comes from Michelle Cheng from Goldman Sachs.

Michelle Cheng - *Goldman Sachs Group, Inc., Research Division - Co-head of Asia Consumer Research*

Congrats for the still very resilient results on a very tough comp. My question is about the same-store sales and consumption trend. Given we know the offline traffic has been very bad year-to-date, but on same-store sales, especially KFC is still pretty healthy. And you shared the higher ticket size items going by like a double-digit and transportation hub growth still Chinese are pretty strong at 20%. I'm wondering whether you can share more color about the different performance including like tier of cities, day parts, consumer cohorts or holiday versus post-holiday sales?

And is there any color on month-to-date trend and how we should expect into second quarter and Labor Day even? Andy just mentioned that we had -- we also had a tough comp last year. So wondering how we should look at the second quarter same-store sales.

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

Thank you, Michelle. I would recap a little bit of the Chinese New Year and then go through the quarter to what we are seeing right now.

So as mentioned on the quarter 4 earnings release call last time, we anticipate a tough Chinese New Year because it was very high base. The situation was unique last year with the reopening and then there's pent-up demand on traveling and then also, we are a bit more well prepared with the new store -- with the store openings than our peers. And yet, we delivered 6% system sales growth on top of 17% growth last year's quarter 1. And mainly leading -- led by the robust transaction growth and that's very encouraging. And from the growth of the total 15% transaction growth, we see a few things.

For the 2024 Chinese New Year, we see the return to normal trading with more stores available for consumer. Trading was robust and at the transportation hub, et cetera, the business was booming. And then we also see diverse demand, which I mentioned in my prepared remarks. On the one hand, customer like the value for money for the high-ticket items, but at the same time, the functional needs with lower ticket average is equally appreciated and that's a very strong recovery of the smaller ticket items from delivery all the way to coffee, breakfast, ice cream, et cetera. So all these are good.

And then we also see the trend -- continue to see the trend of consumer behavior during holidays. So during holidays, they splurge and then after the holidays, they tighten up the belt a little bit. But the trading in March sequentially improved.

And then if we move to the next trend, it's about the region, city tier, location, et cetera. We see the regional recovery from the North recovered the best because that was lapping on a lower base the year before. In Eastern China, Eastern part of China continue to be very resilient, which is brilliant. And then, of course, all regions across China grew system sales.

By city tier, as we have mentioned a few times before, the Tier 2 still performed the best and lower tier city lapping strong CNY last year. And the Tier 2 cities with regional hubs such as Chengdu, et cetera, continue to do really well because, as I mentioned again, in the prepared remarks, the living costs and housing price there are lower. So the trading is very robust, which is good.

By location, sales at shopping mall where we have more stores have surpassed the 2019 level and the trading is robust, and that's also very encouraging because it's not reported widely, but China last year actually added about 400 shopping malls to the base of about 6,000 shopping mall that we are tracking. And I don't think that many countries are still building that many shopping malls. And for 2024, that trend will continue. We estimate to have a few more hundred shopping malls coming to China.

And -- so -- and one other trend is delivery continues to do very well. And as you can see, KFC delivery sales actually increased by 14%, which is massive. 14% that is a consistent growth for a decade in this delivery business. And it's driven by the smaller order delivery, which is something that we again mentioned in the previous quarter earnings release, that was our part of our strategy and it worked really well. And going to the quarter 2, I think Andy can make a few comments about the quarter 2. Yes.

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

Thanks, Michelle, for the questions. So I think for quarter 2, as we mentioned, we are committed to delivering compelling value to consumers. And again, the strategy worked really well. We will introduce more products and then try to execute some more engaging marketing campaign to drive sales.

As in our prepared remarks, we have mentioned we continue to see consumers to be more rational in spending, but they do respond positively to our new product introductions, our value propositions and also some of the fun marketing campaigns as well. So that's what we're going to do more.

And in terms of like a quarter for this year, just remind everyone, we have a very high base last year. Last year, we actually have seen a 32% increase in our system sales and then also record profit last year in the second quarter which was helped by some very strong performance during the Labor Day and Children's Day holiday sales. As well as last year, we also had some one time-- about $12 million which we're not expecting that to occur this year.

So all in all, we will have a high base. But despite these challenges we mentioned, we focus on our strategy, our values, new product introduction, campaigns, that resonate well with consumers. And then we also have mentioned in the prepared remarks, we have a Project Fresh Eye and to further boost our efficiency. And again, as we mentioned, we will try to find more savings so that we can pass on to the customer. And we do plan to continue to improve our G&A expenses. Obviously, that would fluctuate quarter-by-quarter the ratio. But for the full year, we intend to keep it around 5%. So yes, so this is sort of the plan there.

But a couple of things I want to mention that is worth keeping in mind. One is that our new store contributions, the revenue structure is changing as we increase the mix of smaller store and also franchise store, right, which would change the mix between franchise income versus company sales. And also foreign exchange. Our operating currency is RMB, and our reporting currency is U.S. dollar. So we will continue to be impacted by the currency exchange fluctuation.

Operator

The next question comes from Brian Bittner from Oppenheimer.

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

As it relates to the operating environment, I realize it's a very competitive and promotional environment, which I think is driving a lot of the pressure to your average check. But at the same time, it is also helping you drive traffic growth. Your same-store traffic was up 4% in the quarter, which is impressive. And I'm curious where this traffic is coming from? Is it new customers? Or is it coming from loyalty customers? Just more frequency from existing customers? Can you unpack where the traffic growth is coming from? And Andy, as it relates to the average check declines, how long do you expect average check to be a headwind to your same-store sales?

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

So I will take these questions. First of all, I would like to point out that the overall ticket average aligns really well with our strategic goal, which is to drive incremental traffic to our store.

As you mentioned, we have seen pretty impressive same-store transaction growth, both at KFC and Pizza Hut, which demonstrates that our strategy is working and the strength of our business. If you look at KFC for example, we experienced a 4% increase in same-store traffic and Pizza Hut, 8%. So that's good.

Now when we talk about TA, the ticket average, it's very important for us to look at the yearly comparisons, are influenced by a mix of factors including delivery mix, product mix and also order size in the post-COVID recovery. So -- however, I think it's worthwhile to look at the longer trends -- long-term trends because it will provide a clear perspective on our strategy there.

For example, for KFC the overall TA was RMB 42 in the quarter, very healthy. With -- that is a sequential increase from RMB 39 in the fourth quarter due to holiday impact obviously. It's also higher than the RMB 39 in the first quarter 2019. And so again, like we are committed to manage the TA at KFC through a balanced approach over the long term. Our strategy has been focusing on value for money, introducing new products and also launching promotional campaigns to meet customer demand.

Now we also have reduced the delivery fees to capture more smaller-ticket size delivery order. And also after the pandemic reopening, we definitely see some strong rebound in our sales in breakfast, coffee and ice cream items as we have mentioned before. At the same time, we also have mentioned our high-ticket items like whole chicken, beef burger continued to do well growing -- the sales at double-digit rates in the quarter. So this is a balanced approach, positions us well to enhance customer value and then also expand our market reach.

Now on Pizza Hut side, as the brand continued to grow its network beyond 3,000 stores. we are transforming the business from a remarkably premium casual dining business into a more mass-market operation. So we are realigning our market positioning with our pricing at Pizza Hut. We have expanded both our price range and also product mix, offering more pizzas and other items below RMB 50. We are also providing more options for consumers, such as our recently launched burger, making Pizza Hut products more suitable for smaller party size.

Now this approach, I think, should help us to expand our addressable market segment. We are glad to see that our strategic pricing strategy has been successful in driving store transaction growth in the quarter. So -- but while we are driving the ticket average lower at Pizza Hut, our focus remains the same: driving incremental sales and protecting profits and margins.

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

I mean our KFC and Pizza business both are very big. So I just find it helpful maybe to highlight one or two things in the category to show the growth. Although when it translates to total number, it might not be that big, because our base is big.

So Brian, to give you an example, other than what Andy just said, our coffee business for KFC, K-Coffee, number of cups of coffee actually grew by 30%. I mean it does not show it in a big number, but for coffee, it's brilliant. So we sold about 50 million cups of coffee for the quarter 1 alone, 30%

growth. Brilliant, very promising category. And we only have 100 or so side-by-side store right now. And as I mentioned earlier, we intend to grow it very aggressively.

And Pizza Hut. One highlight here is the lower priced pizza, which is something that we mentioned in the previous quarter earning release. The pizza price below RMB 50. We have 7 choices in that category for the price lower than RMB 50 now. And this small group of pizzas -- and we, of course, intend to launch more at this price point. It gave us double-digit sales growth for Pizza Hut.

Well, the TC growth, which is the question you asked, of course, it's even better. So that gives you a sense of how focused we are on driving the transactional growth.

Operator

The next question comes from Chen Luo from BofA.

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

My question is on the competition side. So in the past 2 quarters, competition has always been a key investor concern. So we also noticed that in the recent few months, our promotional intensity has increased. So based on our observation, compared with our last earnings call, do we think competition has actually further intensified or still largely stable at the moment?

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

Well, honestly, competition has always been very intense throughout decades. We will continue to learn and evolve and grow with our competitors. But I just want to highlight again and again that it's good to see competitors up their game and increase the investment in the industry.

Last year, 2023, the industry actually grew at 20%, although it was barely reported in the mass media. And then for this year, or the year before 2023, the industry always grew at a very nice number, like double digit or much faster than the GDP growth of 5% or whatever the GDP growth is. So naturally, it attracts both domestic and international investors to continue to invest in this industry. So it's really not a bad thing at all.

I think what is important, Luo Chen, is we have to remain quite open minded and continue to relearn and reconnect with our consumer. And that's exactly what we have been doing, and we'll continue to do that. And we -- in the last few years, you can see that we learned from local players who launched Chinese burger, we learned from other players about the possibility of the whole chicken. We learned from other competitors in pizza category, the focus on the lower-priced pizza. And that's how we compete in this market, and we'll continue to stay agile.

And the market will always be choppy, but that's okay. We are here to stay, and it will continue to test our ability to compete. And our strategy is always very consistent. For KFC, the trick is about in the long term, we make sure that our ticket average is relatively stable by having high ticket average item, such as beef burger or whole chicken, and then have the entry priced product to grow the transaction and et cetera.

And then for Pizza Hut, again, is very consistent, it's to drive down the TA actually. 2017, our TA was 132. Now it's 90. We'll continue to drive it down because that TA TC strategy has to be consistent with our mass-market store growth strategy. So we'll have the sort of the stable and consistent strategy to compete in this market.

Operator

The next question comes from Lillian Lou from Morgan Stanley.

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

I have a question about Joey's comment on the diversified consumer demand right now, and there has been some widening so-called the holiday effect. And are we seeing actually from store performance as well, given that situation, there is more gap between best performing stores or relatively worse performing stores, or stores in different locations. For example, the heavy traffic hubs, of course, there's more of an underlying bigger gap in terms of the store performance. And I mean, reacting to that, we continue to deliver better efficiency and cost savings. So trying to understand better from this challenge of widening of holiday impact or customer demand, how we manage, keep on saving more. I think Andy and Joey you mentioned a little bit about trying to dig in a little bit better understanding for the ongoing cost saving progress.

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

Well, first of all, I would like to report that for the more diverse demand between the -- sort of the splurge consumption during the holiday and a bit more tightening the belt after the holiday. That is not that unique. I spent 10 years in U.K. Consumer-- they are exactly the same despite the cultural difference or language difference. So we just learn to train our business better and better. So how do we deal with it? How do we meet the diverse demand?

During the holiday, we focused on the high ticket -- high-ticket trading, like the bucket of the whole chicken, beef burger, so that our customer can splurge. But at the same time, we will also drive the TC, like Chinese New Year is a great example.

The location where customers splurge actually is lower tier city and the transportation hub and tourist location. But in Tier 1 city, it's still very functional. And China is a very big country. So we just -- will see what's the trend and then we match and we deliver what customers want. And not being judgmental about it at all.

And then in terms of going forward, and you can see in our store opening strategy, we're going to continue to accelerate -- probably further accelerate our store opening in the strategic location like the transportation hub and tourist location and also the mini store model. And these are very, very good models. The mini store model is what I mentioned earlier in the prepared remarks, it's very low-cost investment, RMB 0.5 million. Our normal investment is about RMB 1.2 million to RMB 1.5 million now. So the smallest RMB 0.5 million, is the model we tested, and we are happy with that and that's for KFC. And that's very good for the strategic location because the investment is low and it's also very good for the low-tier city because we see customers are going to more and more low-tier cities right now. So we respond to it, and we are very agile, very fast.

And of course, to make the mini model work, the cost efficiency has to work. And again, to be specific here, the mini store model, the menu is only half of the menu of the normal KFC. And that certainly helps. And then in mini stores, the operating costs, including rent and labor, is lower. Therefore, it works.

And for Pizza Hut, I mentioned it in my prepared remarks, it might not be clear enough. After many years of delivering new store return within 3 years, I hope you guys realize that in this particular quarter, we changed that to 2 to 3 years. So if you remember, when we start the Pizza Hut new store opening, the payback time is more than 3 years, 3 to 4 years. Then we improved to 3 years. And as of this quarter, 2024 quarter 1, Pizza Hut has finally improved to 2 to 3 years, which is brilliant.

So it also means that we are more flexible to open this kind of better payback new store in the strategic location that we want and also with better cost efficiency. We can go through line by line, but the new store payback says it all. Thank you, Lilian.

Operator

The next question comes from Anne Ling from Jefferies.

REFINITIV

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

So regarding the cost side, we noticed that the cost of goods sold, there's actually some increase in terms of the food cost. I'm just wondering like whether it is because of the promotions that we are offering, that results in a higher COS? Or is it because there are some new items, for example, with the lowering of the delivery cost, and then we are also charging this RMB 1 or RMB 2 packaging costs.

And I'm not sure whether this also is reflected in the cost of goods as well. So maybe you can share with us what is the outlook of the food cost, given the fact that if we look at the chicken price, year-to-date, it was actually down 11%. So any chance that we will see some savings on that front?

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

And thank you for your questions. So when we look at the first quarter cost of sales, it's around 32.1%. Around like what we have, what we're targeting about 31% plus minus 1% range. In fact, if you look at KFC it's actually within that and Pizza Hut is a little bit higher. And obviously, both as we have mentioned on the prepared remarks, both brands are focusing on driving store traffic, driving transaction growth in the store. And so we have stepped up value for money campaigns.

We also have new product introductions and other promotional activities. So the result is good. We've seen system sales growth of 6% overall for the company.

Now in terms of the commodity prices, we do have favorable commodity price in the quarter. And for poultry, we also have favorable commodity prices there. We do lock up our supply contracts a quarter or so ahead of time. So we know that in the second quarter, we probably would also have favorable commodity prices as well.

However, because the chicken life cycle or raising the chicken life cycle is about like almost a quarter. And so we cannot provide a longer-term sort of outlook for you.

Now in terms of the gains that we got from those favorable commodity prices and whatnot, as we have mentioned before, that we do intend to pass the savings back to the consumer, so that they can get the good value that they have.

Now for Pizza Hut it's a little bit higher for the quarter because they did run five day All-you-can-eat campaign, which is great consumer demand, but the cost of sales is a bit higher over there. And we'll continue to calibrate obviously, the supply chain and make it more efficient over time, so that we can both drive sales and drive growth and protect profit as well.

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

And one last comment. So the reduction of the delivery fee has rather minimal impact on the margin because we have the 14-plus sales growth in delivery in KFC to offset that. So it's okay. And of course, before we launch it, we test it and we know it's going to be okay.

Operator

The next question comes from Ethan Wang from CLSA.

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

So my question is on the delivery services. So post-COVID, there was some concern that the delivery sales contribution might go down, but actually in the first quarter, it held up pretty well. So has management seen any trend that delivery sales is more resilient than off-line dining? And in that case, is that going to affect our planning on salary expense going forward?

And a related one, because we mentioned that in some cities, we are now cooperating with platforms. So how should we think about this? Is that a deliberate kind of planning in terms of cost controlling? How is that going to help?

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

In terms of delivery as a percent of sales, as I mentioned in the previous question, it has continued to improve and increase in the last 10 years. So the trend is not going away. And KFC right now is about 60-plus percent sales mix is from delivery and takeaway and then about 30% from dining. And our store portfolio emerged to reflect that, right?

Because our store becomes smaller, it become more delivery focused. Same as Pizza Hut, we have the satellite store that is very delivery driven. And for Pizza Hut, the delivery business, of course, is in the high 30s, too. So they will continue to grow.

And there are two things that I would like to mention in our delivery sales going forward. One is we are going for the smaller order size of the delivery business because you will notice that traditionally and historically, our ticket average for delivery business for both KFC and Pizza Hut is very high and probably slightly too high. So for KFC, we have reduced the delivery fee, tested in quarter 4 last year, and we roll it out in quarter 1 this year to encourage and to grow the smaller order delivery business.

And it worked. Because it's hard for a customer to make the choice when the delivery fee is too high when the order size is smaller. So we'll continue to do it.

And then Pizza Hut has a bit more work to do because we have to have enough 1-person meal choices first to make that happen. So well, look at it in a positive way that's even more opportunity here. So one opportunity is the lower price pizza that helps because that encourages smaller order.

Second is, if you're in China, you will know that we just launched the burger business, which, by the way, is very exciting. I love -- I love the burger from Pizza Hut as well. And I love the burger from KFC. It's very different. The KFC one is more juicy, and then Pizza Hut one is very unique. It's hard to describe how unique it is until you try it. I really encourage you to cross the border to Shenzhen and try it.

The doughgoal is make a pizza -- well, the pizza bread -- pizza bun is made of the pizza dough. So it's freshly baked in the store. And that alone is very unique and the beef itself is brilliant. And other than great product, it's a 1-person meal because the average ticket size for Pizza Hut is more than one person. So with that, we will continue to grow to some of the smaller order for the delivery business. And both are the right thing to do and have quite a bit of margin there.

When it comes to the platform rider, you guys know that for years and years, we insist on using our own delivery rider because of the quality. Although it's slightly higher cost, we know that. However, time has changed. We have learned that when we did, again test it, and so that we know that is the case. In select locations, some platform rider, the quality is very good. So we test them in quarter 4 last year, and then we continue to test it in quarter 1 this year. Why this is important?

Because this is Chinese New Year. When the demand is very robust, and we have to make sure even when the demand is high, the quality is still good. And we are very happy with the test. So for KFC, we'll continue to roll that out in select locations on the condition that the quality is as good. But they are more affordable, so it helps to manage the delivery business margin.

And then Pizza Hut, we have not started the platform rider mix practice yet. So that will be something to be followed. So I will pause here. Thank you so much, Ethan.

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

Sorry, I know we're running out of time. So when we mentioned selected locations, they are currently high-tier cities, I assume.

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

Sorry, I could not hear you. Select location? It's everywhere. Because we evaluate based on the quality. So it could be high tier city or low tier cities.

Operator

The next question comes from Sijie Ling from China International Capital Corporation Limited.

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

Congrats for another solid quarter results under a challenging base. So I have one question on the K-Coffee. We are very happy to see that we already have 100 independent or so-called side-by-side K-Coffee stores in a short time. And could you just add a bit more about the positioning and development strategy of K-Coffee? So like regarding the pricing, the menu design, the store format, the store location, et cetera. What's our similarities and differences compared with the current main coffee players? And how can we give it the full play to our own advantages? What's the plan for the future store expansion?

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

I think the best way to find out is if you come to some of our K-Coffee side-by-side store, then you figure out all of these very quickly. So let me -- I'll mentioned again, for the K-Coffee, the number of cups increased 30% for the quarter 1, which is a very significant number. So we are very grateful for our customers' support.

So right now, we have 100 K-Coffee stores --side by side. Let's start with results, then we'll go through the detail. The result is these are all profitable additions. Even at the price of RMB 9.9 for a lot of coffee, we make our cost structure work. So our shareholders don't have to worry about the impact on the overall margin.

So the way it was is -- despite we sell K-Coffee in all the KFC stores, but we also see the need for a dedicated space for customers. And what defines a coffee store versus the fried chicken store? The K-Coffee store is having this very lovely coffee aroma. It's the smell and the lovely space. So we create that space and at a very small incremental cost because you right now see more of these side-by-side K-Coffee store in the lower-tier cities and top-tier cities. Because we opened so many new stores every year, so we took advantage of that development, and we will have 2 storefronts. One is KFC, next to it is K-Coffee.

And the trick here is we share the kitchen. So there's no incremental investment in kitchen. And you know that within our investment, the biggest portion of the CapEx is actually the kitchen. So that helps. And then the pricing is similar to what we sell in other KFC stores, the coffee is very affordable. The menu -- it has something unique, though. So if you come to our K-Coffee shop, make sure you try our to (foreign language the gigantic egg tart. We sell millions and hundreds of million of egg tart every year. But we also realized that this gigantic egg tart, is a brilliant sell. It's a big portion of our K-Coffee sales right now. So we do have some very unique products with the K-Coffee shop, and we'll continue to do that. And again, as I mentioned in the prepared remarks, our growth strategy of side-by-side K-Coffee shop for 2024 would be aggressive. And what is aggressive? You'll see by the end of the year!

Operator

That does conclude today's Q&A session. I will now hand the conference back to Florence Lip for any closing remarks.

Florence Lip - *Yum China Holdings, Inc. - Senior Director of IR*

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

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

Thank you very much.

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

Thank you.

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

Thank you.
