YUM BRANDS INC
Form 10-Q
October 12, 2010

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

FORM 10-Q

(Mark One)
[ü] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the quarterly period ended September 4, 2010

OR

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

For the transition period from ____________ to _________________

Commission file number 1-13163

YUM! BRANDS, INC.
(Exact name of registrant as specified in its charter)

North Carolina (State or other jurisdiction of incorporation or organization)	13-3951308 (I.R.S. Employer Identification No.)
1441 Gardiner Lane, Louisville, Kentucky (Address of principal executive offices)	40213 (Zip Code)

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

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

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

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

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

The number of shares outstanding of the Registrant's Common Stock as of October 4, 2010 was 468,583,606 shares.

YUM! BRANDS, INC.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (Unaudited)
YUM! BRANDS, INC. AND SUBSIDIARIES
(in millions, except per share data)

	Quarter		Year to date	
Revenues	9/4/10	9/5/09	9/4/10	9/5/09
Company sales	$ 2,496	$ 2,432	$ 6,712	$ 6,502
Franchise and license fees and income	366	346	1,069	969
Total revenues	2,862	2,778	7,781	7,471
Costs and Expenses, Net				
Company restaurants				
Food and paper	788	777	2,112	2,081
Payroll and employee benefits	516	523	1,480	1,485
Occupancy and other operating expenses	713	707	1,935	1,879
Company restaurant expenses	2,017	2,007	5,527	5,445
General and administrative expenses	285	276	813	812
Franchise and license expenses	24	29	71	74
Closures and impairment (income) expenses	5	5	21	31
Refranchising (gain) loss	(2)	4	51	(9)
Other (income) expense	(11)	(13)	(31)	(97)
Total costs and expenses, net	2,318	2,308	6,452	6,256
Operating Profit	544	470	1,329	1,215
Interest expense, net	38	42	121	138
Income Before Income Taxes	506	428	1,208	1,077
Income tax provision	139	88	307	212
Net Income – including noncontrolling interest	367	340	901	865
Net Income – noncontrolling interest	10	6	17	10
Net Income – YUM! Brands, Inc.	$ 357	$ 334	$ 884	$ 855
Basic Earnings Per Common Share	$ 0.76	$ 0.71	$ 1.87	$ 1.82
Diluted Earnings Per Common Share	$ 0.74	$ 0.69	$ 1.82	$ 1.77
Dividends Declared Per Common Share	$ —	$ —	$ 0.42	$ 0.38

See accompanying Notes to Condensed Consolidated Financial Statements.

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

	Year to date	
	9/4/10	9/5/09
Cash Flows – Operating Activities		
Net Income – including noncontrolling interest	$ 901	$ 865
Depreciation and amortization	383	385
Closures and impairment (income) expenses	21	31
Refranchising (gain) loss	51	(9)
Contributions to defined benefit pension plans	(22)	(96)
Gain upon consolidation of a former unconsolidated affiliate in China	—	(68)
Deferred income taxes	(130)	59
Equity income from investments in unconsolidated affiliates	(34)	(29)
Distributions of income received from unconsolidated affiliates	34	29
Excess tax benefits from share-based compensation	(46)	(48)
Share-based compensation expense	37	39
Changes in accounts and notes receivable	(6)	11
Changes in inventories	(30)	34
Changes in prepaid expenses and other current assets	15	(26)
Changes in accounts payable and other current liabilities	94	2
Changes in income taxes payable	118	(87)
Other, net	111	43
Net Cash Provided by Operating Activities	1,497	1,135
Cash Flows – Investing Activities		
Capital spending	(490)	(505)
Proceeds from refranchising of restaurants	106	91
Acquisitions and investments	(62)	(99)
Sales of property, plant and equipment	21	16
Other, net	(10)	(8)
Net Cash Used in Investing Activities	(435)	(505)
Cash Flows – Financing Activities		
Proceeds from long-term debt	350	499
Repayments of long-term debt	(20)	(522)
Revolving credit facilities, three months or less, net	12	(289)
Short-term borrowings by original maturity		
More than three months - proceeds	—	—
More than three months - payments	—	—
Three months or less, net	5	5
Repurchase shares of Common Stock	(283)	—
Excess tax benefits from share-based compensation	46	48
Employee stock option proceeds	64	91
Dividends paid on Common Stock	(295)	(263)
Other, net	(30)	(8)
Net Cash Used in Financing Activities	(151)	(439)
Effect of Exchange Rates on Cash and Cash Equivalents	10	—
Net Increase in Cash and Cash Equivalents	921	191

Change in Cash and Cash Equivalents due to consolidation of an entity in China		—		17
Cash and Cash Equivalents - Beginning of Period		353		216
Cash and Cash Equivalents - End of Period	$	1,274	$	424

See accompanying Notes to Condensed Consolidated Financial Statements.

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

	(Unaudited) 9/4/10	12/26/09
ASSETS		
Current Assets		
Cash and cash equivalents	$ 1,274	$ 353
Accounts and notes receivable, net	249	239
Inventories	149	122
Prepaid expenses and other current assets	313	314
Deferred income taxes	81	81
Advertising cooperative assets, restricted	109	99
Total Current Assets	2,175	1,208
Property, plant and equipment, net	3,770	3,899
Goodwill	700	640
Intangible assets, net	440	462
Investments in unconsolidated affiliates	145	144
Other assets	529	544
Deferred income taxes	329	251
Total Assets	$ 8,088	$ 7,148
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Accounts payable and other current liabilities	$ 1,374	$ 1,413
Income taxes payable	94	82
Short-term borrowings	724	59
Advertising cooperative liabilities	109	99
Total Current Liabilities	2,301	1,653
Long-term debt	2,905	3,207
Other liabilities and deferred credits	1,239	1,174
Total Liabilities	6,445	6,034
Shareholders' Equity		
Common Stock, no par value, 750 shares authorized; 468 shares and 469 shares issued in 2010 and 2009, respectively	112	253
Retained earnings	1,681	996
Accumulated other comprehensive income (loss)	(237)	(224)
Total Shareholders' Equity – YUM! Brands, Inc.	1,556	1,025
Noncontrolling interest	87	89
Total Shareholders' Equity	1,643	1,114
Total Liabilities and Shareholders' Equity	$ 8,088	$ 7,148

See accompanying Notes to Condensed Consolidated Financial Statements.

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

Note 1 - Financial Statement Presentation

We have prepared our accompanying unaudited Condensed Consolidated Financial Statements ("Financial Statements") in accordance with the rules and regulations of the Securities and Exchange Commission ("SEC") for interim financial information. Accordingly, they do not include all of the information and footnotes required by Generally Accepted Accounting Principles ("GAAP") in the United States ("U.S.") for complete financial statements. Therefore, we suggest that the accompanying Financial Statements be read in conjunction with the Consolidated Financial Statements and Notes thereto included in our annual report on Form 10-K for the fiscal year ended December 26, 2009 ("2009 Form 10-K"). Except as disclosed herein, there has been no material change in the information disclosed in the Notes to our Consolidated Financial Statements included in the 2009 Form 10-K.

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

YUM's business consists of three reporting segments: YUM Restaurants China ("China Division"), YUM Restaurants International ("YRI" or "International Division") and United States. The China Division includes mainland China ("China") and YRI includes the remainder of our international operations.

At the beginning of 2010 we began reporting information for our Thailand and KFC Taiwan businesses within our International Division as a result of changes to our management reporting structure. These businesses now report to the President of YRI, whereas previously they reported to the President of the China Division. While this reporting change did not impact our consolidated results, segment information for previous periods has been restated to be consistent with the current period presentation throughout the Financial Statements and Notes thereto. For the quarter and year to date ended September 5, 2009 this restatement resulted in a decrease in Company sales of $68 million and $179 million, respectively, for the China Division. For the quarter and year to date ended September 5, 2009, this restatement resulted in a decrease to operating profit of $1 million and $4 million, respectively, for the China Division. Any impact of the restatement on the China Division reported figures was offset by the impact to the International Division reported figures.

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

As discussed in Note 4, in the quarter ended June 13, 2009 we began consolidating the entity that operates the KFCs in Shanghai, China. The increase in cash related to the consolidation of this entity's cash balance ($17 million) is presented as a single line item on our Condensed Consolidated Statement of Cash Flows.

Our preparation of the accompanying Financial Statements in conformity with U.S. GAAP requires us to make estimates and assumptions that affect reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the Financial Statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from the estimates.

In our opinion, the accompanying Financial Statements include all normal and recurring adjustments considered necessary to present fairly, when read in conjunction with our 2009 Form 10-K, our financial position as of September 4, 2010, and the results of our operations for the quarters and years to date ended September 4, 2010 and September 5, 2009 and cash flows for the years to date ended September 4, 2010 and September 5, 2009. Our results of operations and cash flows for these interim periods are not necessarily indicative of the results to be expected for the full year.

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

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

	Quarter ended		Year to date	
	9/4/10	9/5/09	9/4/10	9/5/09
Net Income – YUM! Brands, Inc.	$ 357	$ 334	$ 884	$ 855
Weighted-average common shares outstanding (for basic calculation)	473	472	473	469
Effect of dilutive share-based employee compensation	11	13	12	13
Weighted-average common and dilutive potential common shares outstanding (for diluted calculation)	484	485	485	482
Basic EPS	$ 0.76	$ 0.71	$ 1.87	$ 1.82
Diluted EPS	$ 0.74	$ 0.69	$ 1.82	$ 1.77
Unexercised employee stock options and stock appreciation rights (in millions) excluded from the diluted EPS computation(a)	0.2	12.3	3.2	13.8

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

Note 3 - Shareholders’ Equity

Under the authority of our Board of Directors, we repurchased shares of our Common Stock during the year to date ended September 4, 2010, as indicated below. All amounts exclude applicable transaction fees. We had no share repurchases in the year to date ended September 5, 2009.

		Shares Repurchased (thousands)	Dollar Value of Shares Repurchased	Remaining Dollar Value of Shares that may be Repurchased
Authorization Date	Authorization Expiration Date	2010	2010	2010
September 2009	September 2010	7,598	$ 283	$ 17
March 2010	March 2011	—	—	300
Total		7,598	$ 283	$ 317

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Comprehensive income was as follows:

	Quarter ended		Year to date	
	9/4/10	9/5/09	9/4/10	9/5/09
Net Income – YUM! Brands, Inc.	$ 357	$ 334	$ 884	$ 855
Foreign currency translation adjustment	20	61	(27)	126
Changes in fair value of derivatives, net of tax	(6)	(16)	23	(14)
Reclassification of derivative (gains) losses to Net Income, net of tax	8	13	(22)	19
Reclassification of pension actuarial losses to Net Income, net of tax	4	3	13	8
Total comprehensive income	$ 383	$ 395	$ 871	$ 994

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

Noncontrolling interest as of December 26, 2009	$ 89
Net Income – noncontrolling interest	17
Dividends declared	(19)
Noncontrolling interest as of September 4, 2010	$ 87

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

U.S. Business Transformation

As part of our plan to transform our U.S. business we took several measures in 2010 and 2009 ("the U.S. business transformation measures"). These measures include: expansion of our U.S. refranchising; charges relating to General and Administrative ("G&A") productivity initiatives and realignment of resources (primarily severance and early retirement costs); and investments in our U.S. Brands made on behalf of our franchisees such as equipment purchases.

In the year to date ended September 4, 2010, we recorded a pre-tax refranchising loss of $51 million in the U.S. The loss recorded in the year to date ended September 4, 2010 is the net result of gains from 98 restaurants sold and non-cash impairment charges related to our offers to refranchise restaurants in the U.S., principally a substantial portion of our Company operated KFC restaurants in the quarter ended March 20, 2010. See the Facility Actions section for further detail. In the quarter and year to date ended September 5, 2009, we recorded pre-tax gains of $8 million and $23 million, respectively, from refranchising in the U.S.

In connection with our G&A productivity initiatives and realignment of resources we recorded pre-tax charges of $5 million and $9 million in the years to date ended September 4, 2010 and September 5, 2009, respectively. The unpaid current liability for the severance portion of these charges was $1 million as of September 4, 2010. Severance payments in the quarter and year to date ended September 4, 2010 totaled approximately $1 million and $5 million, respectively.

Additionally, the Company recognized a reduction to Franchise and license fees and income of $1 million and $32 million in the quarter and year to date ended September 5, 2009, respectively, related to investments in our U.S. Brands. These investments reflect our reimbursements to KFC franchisees for installation costs of ovens for the national launch of Kentucky Grilled Chicken. The reimbursements were recorded as a reduction to Franchise and license fees and income as we would not have provided the reimbursements absent the ongoing franchise relationship.

We are not including the impacts of these U.S. business transformation measures in our U.S. segment for performance reporting purposes as we do not believe they are indicative of our ongoing operations. Additionally , we are not including the depreciation reduction of $2 million and $5 million for the quarter and year to date ended September 4, 2010, respectively, arising from the impairment of the KFCs offered for sale in the quarter ended March 20, 2010 within our U.S. segment for performance reporting purposes. Rather, we are recording such reduction as a credit within unallocated Occupancy and other operating expenses resulting in depreciation expense for these restaurants continuing to be recorded in the U.S. segment at the rate at which it was prior to the impairment charge being recorded.

Russia Acquisition

On July 1, 2010, we completed the exercise of our option with our Russian partner to purchase their interest in the co-branded KFC-Rostik's restaurants across Russia and the Commonwealth of Independent States ("CIS"). As a result, we acquired company ownership of 50 restaurants and gained full rights and responsibilities as franchisor of 81 restaurants, which our partner previously managed as master franchisor. Upon exercise of our option, we paid cash of $56 million, net of settlement of a long-term note receivable of $11 million, and assumed long-term debt of $10 million. The remaining balance of the purchase price, anticipated to be $11 million, will be paid in cash in July 2012. The impact of consolidating this business on all line items within our Condensed Consolidated Income Statement was insignificant for the quarter ended September 4, 2010 for our International Division. While we have not yet completed our allocation of the purchase price, our Condensed Consolidated Balance Sheet at September 4, 2010 reflects the consolidation of this entity using preliminary amounts including $74 million of goodwill. We anticipate that the preliminary amount allocated to the International Division's goodwill will be retroactively reduced upon completion of the determination of all identifiable assets acquired and liabilities assumed.

The pro forma impact on our results of operations if the acquisition had been completed as of the beginning of 2010 or 2009 would not have been significant.

Consolidation of a Former Unconsolidated Affiliate in China

On May 4, 2009 we acquired an additional 7% ownership in the entity that operates more than 200 KFCs in Shanghai, China for $12 million, increasing our ownership to 58%. The acquisition was driven by our desire to increase our management control over the entity and further integrate the business with the remainder of our KFC operations in China. Prior to our acquisition of this additional interest this entity was accounted for as an unconsolidated affiliate under the equity method of accounting due to the effective participation of our partners in the significant decisions of the entity that were made in the ordinary course of business. Concurrent with the acquisition we received additional rights in the governance of the entity, and thus we began consolidating the entity upon acquisition. As required by GAAP, we remeasured our previously held 51% ownership in the entity, which had a recorded value of $17 million at the date of acquisition, at fair value and recognized a gain of $68 million accordingly. This gain, which resulted in no related income tax expense, was recorded in Other (income) expense on our Condensed Consolidated Statements of Income during the quarter ended June 13, 2009 and was not allocated to any segment for performance reporting purposes.

Under the equity method of accounting, we previously reported our 51% share of the net income of the unconsolidated affiliate (after interest expense and income taxes) as Other (income) expense in the Condensed Consolidated Statements of Income. We also recorded a franchise fee for the royalty received from the stores owned by the unconsolidated affiliate. From the date of the acquisition we have reported the results of operations for the entity in the appropriate line items of our Condensed Consolidated Statements of Income. We no longer recorded franchise fee income for these restaurants nor did we report Other (income) expense as we did under the equity method of accounting. Net income attributable to our partner's ownership percentage is recorded in Net Income – noncontrolling interest. For the year to date ended September 4, 2010 the consolidation of the existing restaurants upon acquisition increased Company sales by $98 million and decreased Franchise and license fees and income by $6 million. For the year to date ended September 4, 2010, the consolidation of the existing restaurants upon acquisition increased Operating Profit by $3 million. The impact on Net Income – YUM! Brands, Inc. was not significant to the year to date ended September 4, 2010. As the existing restaurants were consolidated for all of both the quarters ended September 4, 2010 and September 5, 2009, the consolidation of these restaurants did not impact comparability for the quarter.

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

Issuance of Senior Unsecured Notes

On August 24, 2010, we issued $350 million aggregate principal amount of 3.875% Senior Unsecured Notes that are due on November 1, 2020 (the "2010 Notes"). We will use the net proceeds for general corporate purposes, which may include repayment of indebtedness. Pending the use of the net proceeds for these purposes, we have temporarily invested all or a portion of the net proceeds in short-term, investment grade securities, which are classified as Cash and Cash Equivalents on our Condensed Consolidated Balance Sheet at September 4, 2010.

On August 20, 2009, we issued $250 million aggregate principal amount of 4.25% Senior Unsecured Notes that are due on September 15, 2015 and $250 million aggregate principal amount of 5.30% Senior Unsecured Notes that are due on September 15, 2019.

Facility Actions

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

	Quarter ended September 4, 2010			
	China Division	YRI	U.S.	Worldwide
Refranchising (gain) loss(a)	$ (1)	$ (1)	$ —	$ (2)
Store closure (income) costs(b)	$ (1)	$ 1	$ 1	$ 1
Store impairment charges	1	2	1	4
Closure and impairment (income) expenses	$ —	$ 3	$ 2	$ 5

	Quarter ended September 5, 2009			
	China Division	YRI	U.S.	Worldwide
Refranchising (gain) loss(a) (c)	$ —	$ 12	$ (8)	$ 4
Store closure (income) costs(b)	$ —	$ (1)	$ —	$ (1)
Store impairment charges	2	—	4	6
Closure and impairment (income) expenses	$ 2	$ (1)	$ 4	$ 5

	Year to date ended September 4, 2010			
	China Division	YRI	U.S.	Worldwide
Refranchising (gain) loss(a)(c)(d)	$ (5)	$ 5	$ 51	$ 51
Store closure (income) costs(b)	$ (1)	$ —	$ 2	$ 1
Store impairment charges	6	6	8	20
Closure and impairment (income) expenses	$ 5	$ 6	$ 10	$ 21

	Year to date ended September 5, 2009			
	China Division	YRI	U.S.	Worldwide
Refranchising (gain) loss(a) (c)	$ —	$ 14	$ (23)	$ (9)
Store closure (income) costs(b)	$ —	$ —	$ 3	$ 3
Store impairment charges	6	5	17	28
Closure and impairment (income) expenses	$ 6	$ 5	$ 20	$ 31

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

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

(c) During the quarter ended September 5, 2009 we recognized a $10 million refranchising loss as a result of our decision to offer to refranchise our KFC Taiwan equity market. During the quarter ended March 20, 2010 we refranchised all of our remaining company restaurants in Taiwan, which consisted of 124 KFCs. We included in our March 20, 2010 financial statements a non-cash write-off of $7 million of goodwill in determining the loss on refranchising of Taiwan. Neither of these losses resulted in a related income tax benefit, and neither loss was allocated to any segment for performance reporting purposes. The amount of goodwill write-off was based on the relative fair values of the Taiwan business disposed of and the portion of the business that was retained. The fair value of the business disposed of was determined by reference to the discounted value of the future cash flows expected to be generated by the restaurants and retained by the franchisee, which include a deduction for the anticipated royalties the franchisee will pay the Company associated with the franchise agreement entered into in connection with this refranchising transaction. The fair value of the Taiwan business retained consists of expected, net cash flows to be derived from royalties from franchisees, including the royalties associated with the franchise agreement entered into in connection with this refranchising transaction. We believe the terms of the franchise agreement entered into in connection with the Taiwan refranchising are substantially consistent with market. The remaining carrying value of goodwill related to our Taiwan business of $30 million, after the aforementioned write-off, was determined not to be impaired as the fair value of the Taiwan reporting unit exceeded its carrying amount.