YUM BRANDS INC
Form 10-Q
May 09, 2018

false--12-31Q120182018-03-310001041061YesLarge Accelerated FilerYUM BRANDS INCNoYes456000000007500000007500000003320000003270000002025-04-032020-06-122021-07-27000032432065 0001041061 2018-01-01 2018-03-31 0001041061 2018-05-02 0001041061 2017-01-01 2017-03-31 0001041061 2016-12-31 0001041061 2017-03-31 0001041061 2018-01-01 0001041061 2018-03-31 0001041061 2017-12-31 0001041061 us-gaap:OtherAssetsMember 2018-01-01 0001041061 yum:KFCGlobalDivisionMember country:US 2018-01-01 2018-03-31 0001041061 country:US 2018-01-01 2018-03-31 0001041061 yum:PizzaHutGlobalDivisionMember country:CN 2018-01-01 2018-03-31 0001041061 yum:KFCGlobalDivisionMember 2018-01-01 2018-03-31 0001041061 yum:OtherOutsidetheU.S.andChinaMember 2018-01-01 2018-03-31 0001041061 yum:TacoBellGlobalDivisionMember country:US 2018-01-01 2018-03-31 0001041061 yum:PizzaHutGlobalDivisionMember yum:OtherOutsidetheU.S.andChinaMember 2018-01-01 2018-03-31 0001041061 yum:TacoBellGlobalDivisionMember 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2018-03-31 yum:days yum:weeks xbrli:shares xbrli:pure yum:operating_segments yum:Months yum:restaurants yum:countries_and_territiories iso4217:USD iso4217:USD xbrli:shares utreg:Rate

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

____

FORM 10-Q

(Mark One)
[ ] **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934** for the quarterly period ended March 31, 2018

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer" "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer:	[ü]	Accelerated filer:	[ ]
Non-accelerated filer:	[ ] (Do not check if a smaller reporting company)	Smaller reporting company:	[ ]

Emerging growth company: [ ]

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. [ ]

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

The number of shares outstanding of the Registrant's Common Stock as of May 2, 2018 was323,217,129 shares.

YUM! BRANDS, INC.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

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

	Quarter ended	
Revenues	3/31/2018	3/31/2017
Company sales	$ 512	$ 902
Franchise and property revenues	584	515
Franchise contributions for advertising and other services	275	—
Total revenues	1,371	1,417
Costs and Expenses, Net		
Company restaurant expenses	438	758
General and administrative expenses	219	237
Franchise and property expenses	47	46
Franchise advertising and other services expense	272	—
Refranchising (gain) loss	(156)	(111)
Other (income) expense	(2)	3
Total costs and expenses, net	818	933
Operating Profit	553	484
Investment (income) expense, net	(66)	(1)
Other pension (income) expense	3	28
Interest expense, net	107	110
Income before income taxes	509	347
Income tax provision	76	67
Net Income	$ 433	$ 280
Basic Earnings Per Common Share	$ 1.30	$ 0.78
Diluted Earnings Per Common Share	$ 1.27	$ 0.77
Dividends Declared Per Common Share	$ 0.36	$ 0.30

See accompanying Notes to Condensed Consolidated Financial Statements.

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

	Quarter ended	
	3/31/2018	3/31/2017
Net Income	$433	$ 280
Other comprehensive income (loss), net of tax		
Translation adjustments and gains (losses) from intra-entity transactions of a long-term investment nature		
Adjustments and gains (losses) arising during the period	46	50
	46	50
Tax (expense) benefit	(6)	(1)
	40	49
Changes in pension and post-retirement benefits		
Unrealized gains (losses) arising during the period	—	5
Reclassification of (gains) losses into Net Income	6	30
	6	35
Tax (expense) benefit	(1)	(12)
	5	23
Changes in derivative instruments		
Unrealized gains (losses) arising during the period	2	(3)
Reclassification of (gains) losses into Net Income	11	7
	13	4
Tax (expense) benefit	(4)	(1)
	9	3
Other comprehensive income (loss), net of tax	54	75
Comprehensive Income	$487	$ 355

See accompanying Notes to Condensed Consolidated Financial Statements.

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

	Quarter ended	
	3/31/2018	3/31/2017
Cash Flows – Operating Activities		
Net Income	$433	$ 280
Depreciation and amortization	37	70
Refranchising (gain) loss	(156)	(111)
Investment (income) expense, net	(66)	(1)
Contributions to defined benefit pension plans	(3)	(7)
Deferred income taxes	(1)	20
Share-based compensation expense	17	17
Changes in accounts and notes receivable	4	18
Changes in prepaid expenses and other current assets	(22)	(1)
Changes in accounts payable and other current liabilities	(99)	(48)
Changes in income taxes payable	13	12
Other, net	32	39
Net Cash Provided by Operating Activities	189	288
Cash Flows – Investing Activities		
Capital spending	(42)	(76)
Proceeds from refranchising of restaurants	205	185
Other, net	1	(5)
Net Cash Provided by Investing Activities	164	104
Cash Flows – Financing Activities		
Proceeds from long-term debt	—	192
Repayments of long-term debt	(332)	(200)
Revolving credit facilities, three months or less, net	—	—
Short-term borrowings by original maturity		
More than three months - proceeds	12	—
More than three months - payments	(7)	—
Three months or less, net	—	—
Repurchase shares of Common Stock	(498)	(461)
Dividends paid on Common Stock	(120)	(106)
Debt issuance costs	—	(18)
Other, net	(31)	(36)
Net Cash Used in Financing Activities	(976)	(629)
Effect of Exchange Rates on Cash and Cash Equivalents	38	17
Net Decrease in Cash and Cash Equivalents, Restricted Cash and Restricted Cash Equivalents	(585)	(220)
Cash, Cash Equivalents, Restricted Cash and Restricted Cash Equivalents - Beginning of Period	1,668	831
Cash, Cash Equivalents, Restricted Cash and Restricted Cash Equivalents - End of Period	$1,083	$ 611

See accompanying Notes to Condensed Consolidated Financial Statements.

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

	(Unaudited) 3/31/2018	12/31/2017
ASSETS		
Current Assets		
Cash and cash equivalents	$ 982	$ 1,522
Accounts and notes receivable, net	501	400
Prepaid expenses and other current assets	406	384
Advertising cooperative assets, restricted	—	201
Total Current Assets	1,889	2,507
Property, plant and equipment, net	1,651	1,697
Goodwill	514	512
Intangible assets, net	105	110
Other assets	490	346
Deferred income taxes	187	139
Total Assets	$ 4,836	$ 5,311
LIABILITIES AND SHAREHOLDERS' DEFICIT		
Current Liabilities		
Accounts payable and other current liabilities	$ 924	$ 813
Income taxes payable	124	123
Short-term borrowings	61	375
Advertising cooperative liabilities	—	201
Total Current Liabilities	1,109	1,512
Long-term debt	9,419	9,429
Other liabilities and deferred credits	1,062	704
Total Liabilities	11,590	11,645
Shareholders' Deficit		
Common Stock, no par value, 750 shares authorized; 327 and 332 shares issued in 2018 and 2017, respectively	—	—
Accumulated deficit	(6,539)	(6,063)
Accumulated other comprehensive loss	(215)	(271)
Total Shareholders' Deficit	(6,754)	(6,334)
Total Liabilities and Shareholders' Deficit	$ 4,836	$ 5,311

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 in the United States (“GAAP”) for complete financial statements. Therefore, we suggest that the accompanying Financial Statements be read in conjunction with the Consolidated Financial Statements included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017 (“2017 Form 10-K”).

YUM! Brands, Inc. and its Subsidiaries (collectively referred to herein as “YUM” or the “Company”) comprise the worldwide operations of KFC, Pizza Hut and Taco Bell (collectively the “Concepts”). YUM has over 45,000 units in more than 135 countries and territories, of which 60% are located outside the U.S. YUM was created as an independent, publicly-owned company on October 6, 1997 via a tax-free distribution by our former parent, PepsiCo, Inc., of our Common Stock to its shareholders. References to YUM throughout these Financial Statements are made using the first person notations of “we,” “us” or “our.”

As of March 31, 2018, YUM consisted of three operating segments:

- The KFC Division which includes our worldwide operations of the KFC concept
- The Pizza Hut Division which includes our worldwide operations of the Pizza Hut concept
- The Taco Bell Division which includes our worldwide operations of the Taco Bell concept

YUM's fiscal year begins on January 1 and ends December 31 of each year, with each quarter comprised of three months. Our U.S. subsidiaries and certain international subsidiaries operate on a weekly periodic calendar where the first three quarters of each fiscal year consists 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 preparation of the accompanying Financial Statements in conformity with 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 these estimates.

The accompanying Financial Statements include all normal and recurring adjustments considered necessary to present fairly, when read in conjunction with our 2017 Form 10-K, our financial position as of March 31, 2018, and the results of our operations, comprehensive income and cash flows for the quarters ended March 31, 2018 and 2017. Our results of operations, comprehensive income 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 advertising and marketing costs, generally in proportion to revenue, and the recognition of income taxes using an estimated annual effective tax rate.

In January 2016, the Financial Accounting Standards Board ("FASB") issued a standard that updates certain aspects of recognition, measurement, presentation and disclosure of financial instruments. We adopted this standard beginning with the quarter ended March 31, 2018. While the adoption of this standard did not have a material impact on our Financial Statements the standard will require our investment in Grubhub Inc. ("Grubhub") common shares, which was consummated in April 2018 (see Note 12), to be remeasured to fair value in each future reporting period with corresponding changes recorded in our Consolidated Statement of Income.

In October 2016, the FASB issued a standard that requires the recognition of the income tax consequences of an intra-entity transfer of an asset, other than inventory, when the transfer occurs. As required, we adopted this standard in the quarter ended March 31, 2018 and recorded a cumulative adjustment to retained earnings at the beginning of our first quarter 2018. As a result, we recognized a reduction in Other assets of $34 million to write-off the unamortized tax consequences of certain historical intra-entity transfers of assets with an offsetting increase to our Accumulated deficit.

In August 2017, the FASB issued a standard that refines and expands existing hedge accounting guidance. We adopted this standard beginning with the quarter ended March 31, 2018. The adoption of this standard did not have a material impact on the Financial Statements.

In February 2018, the FASB issued a standard that allows a reclassification to retained earnings for stranded tax effects within accumulated other comprehensive (income) loss ("AOCI") subsequent to the accounting in the fourth quarter of 2017 necessary as a result of the enactment of the Tax Cuts and Jobs Act of 2017 (“Tax Act”). We adopted this standard during the quarter ended March 31, 2018 and reclassified stranded tax effects of $19 million from AOCI with a corresponding decrease to Accumulated deficit at the beginning of our first quarter 2018. These stranded tax effects primarily related to the remeasurement of deferred tax assets associated with pension losses within AOCI.

From 2014 through 2017 the FASB issued standards to provide principles within a single framework for revenue recognition of transactions involving contracts with customers across all industries ("Topic 606"). We adopted these standards beginning with the quarter ended March 31, 2018, using the modified retrospective method. See Notes 2 and 5.

We have reclassified certain other items in the Financial Statements for the prior periods to be comparable with the classification for the quarter ended March 31, 2018. These reclassifications had no effect on previously reported Net Income.

Note 2 - Revenue Recognition Accounting Policy

We adopted Topic 606 at the beginning of the quarter ended March 31, 2018. Below is a discussion of how our revenues are earned, our accounting policies pertaining to revenue recognition prior to adopting Topic 606 ("Legacy GAAP"), our accounting policies pertaining to revenue recognition subsequent to adopting Topic 606 and other required disclosures. Refer to Note 5 for information regarding the cumulative effect adjustment recorded to Accumulated deficit as of the beginning of the quarter ended March 31, 2018 to reflect the adoption of Topic 606. Also included in Note 5 is disclosure of the amount by which each balance sheet and income statement line item was affected in the current reporting period as compared to Legacy GAAP.

Company Sales

Revenues from the sale of food items by Company-owned restaurants are recognized as Company sales when a customer purchases the food, which is when our obligation to perform is satisfied. The timing and amount of revenue recognized related to Company sales was not impacted by the adoption of Topic 606.

Franchise and Property Revenues

Our most significant source of revenues arises from the operation of our Concept stores by our franchisees. Our franchise agreements require that the franchisee remit continuing fees to us as a percentage of the applicable restaurant’s sales in exchange for the license of the intellectual property associated with our Concepts' brands (the “franchise right”). Continuing fees represent the substantial majority of the consideration we receive under our franchise agreements. Franchise rights may be granted through store-level franchise agreements or through a master franchise agreement. Continuing fees are typically billed and paid monthly and are usually 4%-6% for store-level franchise agreements. Master franchise agreements transfer exclusive master franchise rights and administrative obligations, including control of advertising contributions, to master franchisees in certain regions who in turn grant sub-franchising rights to sub-franchisees. As a result of transferring administrative obligations to a master franchisee the percentage of a master franchisee’s restaurants’ sales that we receive as a continuing fee is less than the percentage we receive for restaurants operating under a store-level franchise agreement. Our franchise agreements also typically require certain, less significant, upfront franchise fees such as fees paid upon opening of a store, fees paid to renew the term of the franchise right and fees paid in the event the franchise agreement is transferred to another franchisee. Upfront franchise fees are typically billed and paid when the new franchise agreement becomes effective or when the agreement is transferred to another franchisee.

Under Legacy GAAP, continuing fees from franchisees were recognized as the related sales occurred. The timing and amount of revenue recognized related to continuing fees was not impacted by the adoption of Topic 606 based on the application of the sales-based royalty exception within Topic 606. Under Legacy GAAP, revenue related to initial fees was recognized upon store opening and renewal and transfer fees were recognized when the related agreement became effective. Upon adopting Topic 606, we have determined that the services we provide in exchange for these upfront franchise fees are highly interrelated with the franchise right and are not distinct from the ongoing services we provide to our franchisees. As a result, upon adopting Topic 606 upfront franchise fees are recognized as revenue over the term of each respective franchise agreement. Revenues for these upfront franchise fees are recognized on a straight-line basis, which is consistent with the franchisee’s right to use and benefit from the intellectual property. Revenue from continuing fees and upfront franchise fees is presented within Franchise and property revenues in our Condensed Consolidated Statements of Income.

Additionally, from time-to-time we provide non-refundable consideration to franchisees in the form of cash or other incentives (e.g. cash payments to incent new unit openings and free or subsidized equipment). The Company’s intent in providing such consideration is to drive new unit development or same-store sales growth that will result in higher future revenues for the Company. Under Legacy GAAP, these payments were recognized when we were obligated to make the payment and were presented as either a reduction to Franchise and property revenues, if cash was provided directly to the franchisee, or as Franchise and property expenses, if cash was not provided directly to the franchisee. Upon adopting Topic 606, such payments are capitalized as assets and amortized as a reduction in Franchise and property revenues over the period of expected cash flows from the franchise agreements to which the payment relates.

Revenues from franchisees related to their rental of restaurants we lease or sublease to them is recognized as it is earned. Rental income is billed and paid on a monthly basis. Revenues from rental agreements with franchisees are presented within Franchise and property revenues within our Condensed Consolidated Statements of Income. The timing and amount of revenue recognized related to the rental of restaurants we lease or sublease was not impacted by the adoption of Topic 606.

Franchise Contributions for Advertising and Other Services

We participate in various advertising cooperatives with our franchisees established to collect and administer funds contributed for use in advertising and promotional programs designed to increase sales and enhance the reputation of the Company and its franchise owners, typically within a particular country. Contributions to the advertising cooperatives are required for both Company-owned and franchise restaurants and are generally based on a percentage of restaurant sales. Revenues for these services are billed and paid typically on a monthly basis. Under Legacy GAAP, receipts and expenditures related to advertising cooperatives we were required to consolidate were presented on a net basis in our Condensed Consolidated Statements of Income. Upon adopting the requirements of Topic 606 we act as a principal in the transaction based on our responsibility to define the nature of the goods or services and/or our responsibility to define which franchisees receive the benefit of the goods or services. Additionally, we have determined the advertising services provided to franchisees are highly interrelated with the franchise right and therefore not distinct. Franchisees remit to us a percentage of restaurant sales as consideration for providing the advertising services. As a result, revenues for advertising services are recognized when the related sales occur and are presented as Franchise contributions for advertising and other services. Expenses incurred to provide these services are presented as Franchise advertising and other services expense.

On a much more limited basis, we provide goods or services to certain franchisees that are distinct from the franchise right. Such arrangements typically relate to supply chain, quality assurance and information technology services that are provided by a third party at our direction and that do not require integration with other goods or services we provide. The extent to which we provide such goods or services varies by brand, geographic region and, in some instances, franchisee. Similar to advertising services, receipts and expenditures related to these other services were presented on a net basis under Legacy GAAP. Upon adoption of Topic 606, revenues from the goods or services described above are presented as Franchise contributions for advertising and other services within our Condensed Consolidated Statements of Income. Expenses related to the provisioning of these goods and services are recorded in Franchise advertising and other services expense. Revenues are recognized as the goods or services are transferred to the franchisee and related expenses are recognized as incurred.

Taxes assessed by a governmental authority that are both imposed on and concurrent with a specific revenue transaction and collected from a customer are excluded from revenue under both Legacy GAAP and Topic 606.

The following table disaggregates revenue by Concept and our most significant markets based on Operating Profit. We believe this disaggregation best reflects how the nature, amount, timing and uncertainty of our revenues and cash flows are impacted by economic factors.

	Quarter ended 3/31/2018			
	KFC Division	Pizza Hut Division	Taco Bell Division	Total
U.S.				
Company sales	$ 17	$ 14	$ 242	$273
Franchise and property revenues	44	70	122	236
Franchise contributions for advertising and other services	2	65	91	158
China				
Franchise and property revenues	54	16	—	70
Other				
Company sales	228	10	1	239
Franchise and property revenues	209	63	6	278
Franchise contributions for advertising and other services	104	13	—	117
	$ 658	$ 251	$ 462	$1,371

Our contract liabilities are comprised of unamortized upfront fees received from franchisees. A summary of significant changes to the contract liability balance during the first quarter of 2018 is presented below.

	Deferred Franchise Fees
Balance at January 1, 2018	$ 392
Revenue recognized that was included in unamortized upfront fees received from franchisees at the beginning of the period	(17)
Increases due to cash received, excluding amounts recognized as revenue during the period	20
Balance at March 31, 2018	$ 395

We expect to recognize contract liabilities as revenue over the remaining term of the associated franchise agreement as follows:

Less than 1 year	$56
1 - 2 years	53
2 - 3 years	49
3 - 4 years	45
4 - 5 years	40
Thereafter	152
Total	$395

We have applied the optional exemption, as provided for under Topic 606, which allows us to not disclose the transaction price allocated to unsatisfied performance obligations when the transaction price is a sales-based royalty.

Note 3 - Earnings Per Common Share (“EPS”)

	Quarter ended	
	2018	2017
Net Income	$433	$280
Weighted-average common shares outstanding (for basic calculation)	332	357
Effect of dilutive share-based employee compensation	8	7
Weighted-average common and dilutive potential common shares outstanding (for diluted calculation)	340	364
Basic EPS	$1.30	$0.78
Diluted EPS	$1.27	$0.77
Unexercised employee stock options and stock appreciation rights (in millions) excluded from the diluted EPS computation[(a)]	2.3	1.7

(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 4 - Shareholders’ Deficit

Under the authority of our Board of Directors, we repurchased shares of our Common Stock during the quarters ended March 31, 2018 and 2017 as indicated below. All amounts exclude applicable transaction fees.

	Shares Repurchased (thousands)		Dollar Value of Shares Repurchased		Remaining Dollar Value of Shares that may be Repurchased
Authorization Date	2018	2017	2018	2017	2018
November 2016	—	6,849	$—	$442	$ —
November 2017	6,507	—	528	—	972
Total	6,507[(a)]	6,849[(b)]	$528[(a)]	$442[(b)]	$ 972

(a) Includes the effect of $30 million in share repurchases (0.4 million shares) with trade dates prior to March 31, 2018, but cash settlement dates subsequent to March 31, 2018.

(b) Includes the effect of $26 million in share repurchases (0.4 million shares) with trade dates on, or prior to, March 31, 2017, but cash settlement dates subsequent to March 31, 2017 and excludes the effect of $45 million in share purchases (0.7 million shares) with trades dates prior to December 31, 2016, but cash settlement dates subsequent to December 31, 2016.

Changes in AOCI are presented below.

	Translation Adjustments and Gains (Losses) From Intra-Entity Transactions of a Long-Term Nature	Pension and Post-Retirement Benefits	Derivative Instruments	Total
Balance at December 31, 2017, net of tax	$ (174)	$ (106)	$ 9	$(271)
Adoption of accounting standards	21 (a)	(17) (b)	(2) (b)	2
Gains (losses) arising during the period classified into AOCI, net of tax	39	—	(2)	37
(Gains) losses reclassified from AOCI, net of tax	1	5	11	17
OCI, net of tax	61	(12)	7	56
Balance at March 31, 2018, net of tax	$ (113)	$ (118)	$ 16	$(215)

(a) Represents the impact of foreign currency translation from the adoption of Topic 606. See Notes 2 and 5.

(b) During the quarter ended March 31, 2018, we adopted a standard that allows for the reclassification from AOCI to Accumulated deficit for stranded tax effects resulting from the Tax Act. See Note 1.

Note 5 - Items Affecting Comparability of Net Income, Financial Position and Cash Flows

Refranchising (Gain) Loss

The Refranchising (gain) loss by reportable segment is presented below. Given the size and volatility of refranchising initiatives, our chief operating decision maker ("CODM") does not consider the impact of Refranchising (gain) loss when assessing segment performance. As such, we do not allocate such gains and losses to our segments for performance reporting purposes.

During the quarter ended March 31, 2018, we refranchised 144 restaurants and received $205 million in pre-tax proceeds. During the quarter ended March 31, 2017, we refranchised 121 restaurants and received $185 million in pre-tax proceeds.

A summary of Refranchising (gain) loss is as follows:

	Quarter ended	
	2018	2017
KFC Division	$(57)	$1
Pizza Hut Division	(2)	2

Taco Bell Division	(97)	(114)
Worldwide	$(156)	$(111)

KFC U.S. Acceleration Agreement

During 2015, we reached an agreement with our KFC U.S. franchisees that gave us brand marketing control as well as an accelerated path to expanded menu offerings, improved assets and enhanced customer experience. In connection with this agreement we are investing approximately $130 million from 2015 through 2018 primarily to fund new back-of-house equipment for franchisees and to provide incentives to accelerate franchisee store remodels. Under Legacy GAAP these amounts were expensed as incurred and included $3 million during the quarter ended March 31, 2017. We recorded total pre-tax charges of $115 million, primarily as Franchise and property expenses, during the three year period ended December 31, 2017 Due to their size and unique and long-term brand building nature, as well as their non-recurring impact on KFC Division's results when expensed upfront, our CODM did not consider the impact of these investments when assessing segment performance from 2015 through 2017. As such, for these years the investments were not allocated to the KFC Division segment operating results for performance reporting purposes.

Upon adoption of Topic 606 in 2018, approximately $100 million of incentives paid to franchisees from 2015 through 2017 were capitalized, net of amortization of $19 million. These capitalized amounts are being amortized as a reduction to Franchise and property revenues over the period of expected cash flows from the franchise agreements to which the payment relates. Amortization related to franchise incentive payments that were capitalized upon the adoption of Topic 606 and franchise incentive payments that will be capitalized going forward will be allocated to KFC segment operating results as the expense is recurring and is not expected to significantly impact the comparability of results in any given period. During the quarter ended March 31, 2018, we recorded a $2 million reduction to KFC Division Franchise and property revenues related to the amortization of these franchise incentive payments.

In addition to the investments above, we agreed to fund $60 million of incremental system advertising from 2015 through 2018. During the quarters ended March 31, 2018 and 2017, we incurred $2 million and $4 million, respectively, in incremental system advertising expense. We funded approximately $50 million of such advertising during the three year period ended December 31, 2017, which included $20 million during 2017. We currently expect to fund approximately $10 million in 2018. All of these advertising amounts were recorded primarily in Franchise and property expenses and have been and will continue to be included in the KFC Division segment operating results.

YUM's Strategic Transformation Initiatives

In October 2016, we announced our strategic transformation plans to drive global expansion of the KFC, Pizza Hut and Taco Bell brands ("YUM's Strategic Transformation Initiatives") following the then anticipated separation of our China business on October 31, 2016. Major features of the Company’s strategic transformation plans involve being more focused on the development of our three brands, increasing our franchise ownership and creating a leaner, more efficient cost structure. During the quarters ended March 31, 2018 and 2017, we recognized pre-tax charges of $1 million and $7 million, respectively, primarily within G&A, related to these initiatives. Due to the scope of the initiatives as well as their significance, our CODM does not consider the impact of these initiatives when assessing segment performance. As such, costs associated with the initiatives are not being allocated to any segment for performance reporting purposes.

Pizza Hut U.S. Transformation Agreement

In May 2017, we reached an agreement with Pizza Hut U.S. franchisees that will improve brand marketing alignment, accelerate enhancements in operations and technology, and that includes a permanent commitment to incremental advertising and digital and technology contributions by franchisees (the “Transformation Agreement”). In connection with the Transformation Agreement we anticipate investing approximately $90 million to upgrade restaurant equipment to improve operations, fund improvements in restaurant technology and enhance digital and ecommerce capabilities. We currently expect the majority of this investment, which will be a mix of both capital and operating investments, to be split between 2017 and 2018.

We invested $39 million related to the Transformation Agreement in 2017, which included $8 million of investments that we capitalized and $31 million that was expensed primarily as Franchise and property expenses or G&A. The $31 million expense amount included $5 million of franchisee incentive payments that under Legacy GAAP were expensed as incurred. Due to the adoption of Topic 606 in 2018, franchise incentive payments related to the Transformation Agreement, including the $5 million from 2017, are now being capitalized and being amortized as a reduction of Franchise and property revenues.

We invested $7 million in the quarter ended March 31, 2018 related to the Transformation Agreement, primarily consisting of investments that were capitalized.

Due to their unique and long-term brand-building nature as well as their non-recurring impact on Pizza Hut's Division results, the financial impact of operating investments that are part of the Transformation Agreement are not considered by our CODM when assessing segment performance. As a result, these operating investments are not being allocated to the Pizza Hut Division operating segment results for performance reporting purposes. Depreciation on capital investments is being allocated to Pizza Hut segment results as the expense is recurring and is not expected to significantly impact the comparability of results in any given period. For the same reasons, the amortization related to franchise incentive payments that were capitalized upon the adoption of Topic 606 and franchise incentive payments that will be capitalized going forward will be allocated to Pizza Hut segment operating results.

In addition to the investments above, we agreed to fund $37.5 million of incremental system advertising dollars from the second half of 2017 through 2018. During the quarter ended March 31, 2018, we incurred $3 million in related incremental system advertising expense. We funded approximately $25 million of such advertising during 2017, which was expensed in the third and fourth quarters of 2017. We currently expect to fund approximately $12.5 million in 2018. These advertising amounts have been and will continue to be recorded primarily in Franchise and property expenses and are included in Pizza Hut's segment operating results.

Impact of Adopting New Revenue Recognition Standards

As discussed in Note 1, we adopted Topic 606 beginning with the quarter ended March 31, 2018, using the modified retrospective method. Topic 606 was applied to all contracts with customers as of January 1, 2018 and the cumulative effective of this transition was recorded as an adjustment to Accumulated deficit as of this date. As a result, the following adjustments were made to the Condensed Consolidated Balance Sheet as of January 1, 2018:

CONDENSED CONSOLIDATED BALANCE SHEET

	As Reported 12/31/2017	Adjustments		Balances with Adoption of Topic 606 1/1/2018
ASSETS				
Current Assets				
Cash and cash equivalents	$ 1,522	$ 11		$ 1,533
Accounts and notes receivable, net	400	112		512
Prepaid expenses and other current assets	384	76	(a)	460
Advertising cooperative assets, restricted	201	(201)		—
Total Current Assets	2,507	(2)		2,505
Property, plant and equipment, net	1,697	11		1,708
Goodwill	512	—		512
Intangible assets, net	110	—		110
Other assets	346	118		464
Deferred income taxes	139	26		165
Total Assets	$ 5,311	$ 153		$ 5,464
LIABILITIES AND SHAREHOLDERS' DEFICIT				
Current Liabilities				
Accounts payable and other current liabilities	$ 813	$ 220		$ 1,033
Income taxes payable	123	—		123
Short-term borrowings	375	—		375
Advertising cooperative liabilities	201	(201)		—
Total Current Liabilities	1,512	19		1,531
Long-term debt	9,429	—		9,429
Other liabilities and deferred credits	704	353		1,057
Total Liabilities	11,645	372		12,017
Shareholders' Deficit				
Accumulated deficit	(6,063)	(240)		(6,303)
Accumulated other comprehensive loss	(271)	21		(250)
Total Shareholders' Deficit	(6,334)	(219)		(6,553)
Total Liabilities and Shareholders' Deficit	$ 5,311	$ 153		$ 5,464

(a) Includes $58 million of restricted cash related to advertising cooperatives. These balances can only be used to settle obligations of the respective cooperatives.

We recorded an increase in Accounts payable and other current liabilities and Other liabilities and deferred credits of $57 million and $335 million, respectively, as part of our cumulative adjustment related to unamortized upfront franchise fees, with a corresponding $392 million increase in Accumulated deficit. We recorded increases in Prepaid expenses and other current assets and Other assets of $18 million and $118 million, respectively, as part of our cumulative adjustment related to unamortized franchise incentives, with a corresponding $136 million decrease in Accumulated deficit.

Deferred income taxes increased $26 million as a result of recording the tax effects of the two adjustments noted above, with a corresponding decrease to Accumulated deficit. Accumulated other comprehensive loss decreased $21 million as a result of recognizing the impact of foreign currency translation related to the three adjustments noted above, with a corresponding increase in Accumulated deficit.

The remaining adjustments to our December 31, 2017 Condensed Consolidated Balance Sheet are primarily a result of reclassifying the assets and liabilities of our consolidated advertising cooperates from Advertising cooperative assets, restricted and Advertising cooperative liabilities to the respective balance sheet caption to which the assets and liabilities relate.

The following tables reflect the impact of adopting Topic 606 on our Condensed Consolidated Statement of Income for the quarter ended March 31, 2018 and our Condensed Consolidated Balance Sheet as of March 31, 2018 as well as the amounts as if the guidance that was in effect prior to adoption were applied:

CONDENSED CONSOLIDATED STATEMENT OF INCOME

	Quarter ended 3/31/2018		
Revenues	As Reported	Impact	Balances without Adoption of Topic 606
Company sales	$512	$—	$ 512
Franchise and property revenues	584	5	589
Franchise contributions for advertising and other services	275	(275)	—
Total revenues	1,371	(270)	1,101
Costs and Expenses, Net			
Company restaurant expenses	438	—	438
General and administrative expenses	219	—	219
Franchise and property expenses	47	6	53
Franchise advertising and other services expense	272	(272)	—
Refranchising (gain) loss	(156)	—	(156)
Other (income) expense	(2)	—	(2)
Total costs and expenses, net	818	(266)	552
Operating Profit	553	(4)(a)	549
Investment (income) expense, net	(66)	—	(66)
Other pension (income) expense	3	—	3
Interest expense, net	107	—	107
Income before income taxes	509	(4)	505
Income tax provision	76	(1)	75
Net Income	$433	$(3)	$ 430
Basic Earnings Per Common Share	$1.30	$(0.01)	$ 1.29
Diluted Earnings Per Common Share	$1.27	$(0.01)	$ 1.26

(a) Includes $4 million of franchise incentive payments related to the KFC U.S. Acceleration Agreement and the Pizza Hut U.S. Transformation Agreement that would have been expensed immediately and that we would not have allocated to the KFC Division or the Pizza Hut Division under Legacy GAAP. Upon the adoption of Topic 606, these payments have been capitalized as assets.

Upon adopting Topic 606 the timing and amount of revenue recognized for upfront franchise fees and franchise incentives changed from upfront recognition under Legacy GAAP to recognition over the term of the franchise agreement to which the fees and incentives relate. Also, under Legacy GAAP, amounts reported as Franchise contributions for advertising and other services and Franchise advertising and other services expense were presented on a net basis. Upon the adoption of Topic 606 these amounts require gross presentation in our Condensed Consolidated Statements of Income. Lastly, Legacy GAAP required that certain value-added taxes withheld and remitted on our behalf by our franchisees be reported as revenue and corresponding expense in our Condensed

Consolidated Statements of Income. Upon adoption of Topic 606 these taxes are reported on a net basis as a reduction in Franchise and property revenues.

CONDENSED CONSOLIDATED BALANCE SHEET

	As Reported 3/31/2018	Impact	Balances without Adoption of Topic 606 3/31/2018
ASSETS			
Current Assets			
Cash and cash equivalents	$ 982	$(20)	$ 962
Accounts and notes receivable, net	501	(109)	392
Prepaid expenses and other current assets	406	(71)	335
Advertising cooperative assets, restricted	—	197	197
Total Current Assets	1,889	(3)	1,886
Property, plant and equipment, net	1,651	(13)	1,638
Goodwill	514	—	514
Intangible assets, net	105	—	105
Other assets	490	(118)	372
Deferred income taxes	187	(24)	163
Total Assets	$ 4,836	$(158)	$ 4,678
LIABILITIES AND SHAREHOLDERS' DEFICIT			
Current Liabilities			
Accounts payable and other current liabilities	$ 924	$(235)	$ 689
Income taxes payable	124	—	124
Short-term borrowings	61	—	61
Advertising cooperative liabilities	—	197	197
Total Current Liabilities	1,109	(38)	1,071