

YUM BRANDS INC  
Form 10-Q  
October 16, 2007

---

**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 September 8, 2007

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one): Large accelerated filer:  Accelerated filer:  Non-accelerated filer:

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 10, 2007 was 508,607,691 shares.

---

**YUM! BRANDS, INC.**

**INDEX**

	Page No.
Part I. Financial Information	
Item 1 - Financial Statements	
Condensed Consolidated Statements of Income    Quarters and Years to date	
ended September 8, 2007 and September 9, 2006	3
Condensed Consolidated Statements of Cash Flows    Years to date ended	
September 8, 2007 and September 9, 2006	4
Condensed Consolidated Balance Sheets    September 8, 2007	
and December 30, 2006	5
Notes to Condensed Consolidated Financial Statements	6
Item 2 - Management's Discussion and Analysis of Financial Condition	
and Results of Operations	21
Item 3 - Quantitative and Qualitative Disclosures about Market Risk	39
Item 4 - Controls and Procedures	39
Report of Independent Registered Public Accounting Firm	41
Part II. Other Information and Signatures	
Item 1    Legal Proceedings	42
Item 1A    Risk Factors	42
Item 2    Unregistered Sales of Equity Securities and Use of Proceeds	43
Item 6    Exhibits	43
Signatures	45



**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 9/8/07	9/9/06	Year to date 9/8/07	9/9/06
<b>Revenues</b>				
Company sales	\$2,243	\$1,989	\$6,258	\$5,720
Franchise and license fees	321	289	896	825
Total revenues	2,564	2,278	7,154	6,545
<b>Costs and Expenses, Net</b>				
Company restaurants				
Food and paper	700	606	1,924	1,746
Payroll and employee benefits	544	492	1,585	1,461
Occupancy and other operating expenses	646	570	1,798	1,607
	1,890	1,668	5,307	4,814
General and administrative expenses	281	271	830	789
Franchise and license expenses	12	7	30	24
Closures and impairment (income) expenses	(1 )	1	12	25
Refranchising (gain) loss		4	(5 )	(7 )
Other (income) expense	(19 )	(17 )	(47 )	(33 )
Total costs and expenses, net	2,163	1,934	6,127	5,612
<b>Operating Profit</b>	401	344	1,027	933
Interest expense, net	38	34	112	105
<b>Income Before Income Taxes</b>	363	310	915	828
Income tax provision	93	80	237	236
<b>Net Income</b>	\$270	\$230	\$678	\$592
<b>Basic Earnings Per Common Share</b>	\$0.52	\$0.43	\$1.28	\$1.09
<b>Diluted Earnings Per Common Share</b>	\$0.50	\$0.42	\$1.24	\$1.05
<b>Dividends Declared Per Common Share</b>	\$	\$	\$0.15	\$0.1325

See accompanying Notes to Condensed Consolidated Financial Statements.



**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)**

## YUM! BRANDS, INC. AND SUBSIDIARIES

(in millions)

	Year to date	
	9/8/07	9/9/06
<b>Cash Flows Operating Activities</b>		
Net income	\$ 678	\$ 592
Depreciation and amortization	362	319
Closures and impairment expenses	12	25
Refranchising (gain) loss	(5 )	(7 )
Contributions to defined benefit pension plans		(41 )
Deferred income taxes	(32 )	(47 )
Equity income from investments in unconsolidated affiliates	(40 )	(37 )
Distributions of income received from unconsolidated affiliates	28	26
Excess tax benefits from share-based compensation	(40 )	(40 )
Share-based compensation expense	43	46
Changes in accounts and notes receivable	(19 )	22
Changes in inventories	(1 )	7
Changes in prepaid expenses and other current assets	4	(10 )
Changes in accounts payable and other current liabilities	39	(31 )
Changes in income taxes payable	82	69
Other non-cash charges and credits, net	58	114
<b>Net Cash Provided by Operating Activities</b>	<b>1,169</b>	<b>1,007</b>
<b>Cash Flows Investing Activities</b>		
Capital spending	(391 )	(323 )
Proceeds from refranchising of restaurants	83	96
Acquisition of restaurants from franchisees		(11 )
Short-term investments	5	(79 )
Sales of property, plant and equipment	42	33
Other, net	5	(16 )
<b>Net Cash Used in Investing Activities</b>	<b>(256 )</b>	<b>(300 )</b>
<b>Cash Flows Financing Activities</b>		
Proceeds from long-term debt		300
Repayments of long-term debt	(11 )	(207 )
Revolving credit facilities, three months or less, net	315	(26 )
Short-term borrowings by original maturity		
More than three months - proceeds	1	164
More than three months - payments	(184 )	(2 )
Three months or less, net	(3 )	
Repurchase shares of Common Stock	(774 )	(853 )
Excess tax benefits from share-based compensation	40	40
Employee stock option proceeds	78	93
Dividends paid on Common Stock	(196 )	(104 )
Other, net		(2 )
<b>Net Cash Used in Financing Activities</b>	<b>(734 )</b>	<b>(597 )</b>
<b>Effect of Exchange Rates on Cash and Cash Equivalents</b>	<b>9</b>	<b>3</b>
<b>Net Increase in Cash and Cash Equivalents</b>	<b>188</b>	<b>113</b>
<b>Cash and Cash Equivalents - Beginning of Period</b>	<b>319</b>	<b>158</b>
<b>Cash and Cash Equivalents - End of Period</b>	<b>\$ 507</b>	<b>\$ 271</b>

See accompanying Notes to Condensed Consolidated Financial Statements.

**CONDENSED CONSOLIDATED BALANCE SHEETS**

## YUM! BRANDS, INC. AND SUBSIDIARIES

(in millions)

	(Unaudited) 9/8/07	12/30/06
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$507	\$319
Accounts and notes receivable, less allowance: \$22 in 2007 and \$18 in 2006	250	220
Inventories	96	93
Prepaid expenses and other current assets	139	138
Deferred income taxes	97	57
Advertising cooperative assets, restricted	76	74
<b>Total Current Assets</b>	<b>1,165</b>	<b>901</b>
Property, plant and equipment, net of accumulated depreciation and amortization of \$3,261 in 2007 and \$3,146 in 2006	3,600	3,631
Goodwill	675	662
Intangible assets, net	336	347
Investments in unconsolidated affiliates	140	138
Other assets	388	369
Deferred income taxes	294	305
<b>Total Assets</b>	<b>\$6,598</b>	<b>\$6,353</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
<b>Current Liabilities</b>		
Accounts payable and other current liabilities	\$1,400	\$1,386
Income taxes payable	99	37
Short-term borrowings	291	227
Advertising cooperative liabilities	76	74
<b>Total Current Liabilities</b>	<b>1,866</b>	<b>1,724</b>
Long-term debt	2,124	2,045
Other liabilities and deferred credits	1,186	1,147
<b>Total Liabilities</b>	<b>5,176</b>	<b>4,916</b>
<b>Shareholders Equity</b>		
Preferred stock, no par value, zero shares and 250 shares authorized in 2007 and 2006, respectively; no shares issued		
Common stock, no par value, 750 shares authorized; 512 shares and 530 shares issued in 2007 and 2006, respectively		
Retained earnings	1,541	1,593
Accumulated other comprehensive loss	(119 )	(156 )
<b>Total Shareholders Equity</b>	<b>1,422</b>	<b>1,437</b>
<b>Total Liabilities and Shareholders Equity</b>	<b>\$6,598</b>	<b>\$6,353</b>

See accompanying Notes to Condensed Consolidated Financial Statements.





**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

(Tabular amounts in millions, except per share data)

**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 United States ( U.S. ) generally accepted accounting principles 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 30, 2006 ( 2006 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 2006 Form 10-K.

Our Financial Statements include YUM! Brands, Inc. and its wholly-owned subsidiaries (collectively referred to as YUM or the Company ). The Financial Statements include 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.

Our preparation of the accompanying Financial Statements in conformity with U.S. generally accepted accounting principles 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. The Company has previously taken, and continues to take, the position that we do not believe it is more likely than not that deferred tax assets arising from certain foreign tax credit carryforwards will be realized and have established a valuation allowance accordingly. These deferred tax assets totaled approximately \$90 million at September 8, 2007. The Company is currently undertaking a review of our international operations that could impact our ability to utilize these foreign tax credit carryforwards. Additionally, future decisions to repatriate foreign earnings to the United States may allow us to utilize these foreign tax credits, offsetting some or all of the incremental United States tax we might be required to provide on those earnings. As a result, we believe it is reasonably possible within the next twelve months that some amounts of these valuation allowances will be reversed upon a determination that it is more likely than not such deferred tax assets will be realized. We are currently not able to estimate the amount, if any, of these valuation allowances that might be reversed nor are we able to estimate any resulting net impact on our recorded income tax provision.

In our opinion, the accompanying Financial Statements include all normal and recurring adjustments considered necessary to present fairly, when read in conjunction with our 2006 Form 10-K, our financial position as of September 8, 2007, and the results of our operations for the quarters and years to date ended September 8, 2007 and September 9, 2006 and cash flows for the years to date ended September 8, 2007 and September 9, 2006. Our results of operations 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.

We have reclassified certain items in the accompanying Financial Statements and Notes to the Financial Statements in order to be comparable with the current classifications. These reclassifications had no effect on previously reported net income.



## 2. Two-for-One Common Stock Split

On May 17, 2007, the Company announced that its Board of Directors approved a two-for-one split of the Company's outstanding shares of Common Stock. The stock split was effected in the form of a stock dividend and entitled each shareholder of record at the close of business on June 1, 2007 to receive one additional share for every outstanding share of Common Stock held. The stock dividend was distributed on June 26, 2007, with approximately 261 million shares of Common Stock distributed. All per share and share amounts in the accompanying Financial Statements and Notes to the Financial Statements have been adjusted to reflect the stock split.

## 3. Earnings Per Common Share ("EPS")

	Quarter		Year to date	
	9/8/07	9/9/06	9/8/07	9/9/06
Net income	\$270	\$230	\$678	\$592
Weighted-average common shares outstanding (for basic calculation)	523	537	528	544
Effect of dilutive share-based employee compensation	18	18	18	19
Weighted-average common and dilutive potential common shares outstanding (for diluted calculation)	541	555	546	563
Basic EPS	\$0.52	\$0.43	\$1.28	\$1.09
Diluted EPS	\$0.50	\$0.42	\$1.24	\$1.05
Unexercised employee stock options and stock appreciation rights (in millions) excluded from the diluted EPS computation <sup>(a)</sup>	7.1	17.1	8.1	16.1

(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.

## 4. Shareholders' Equity

We had dividends payable of zero and \$119 million at September 8, 2007 and December 30, 2006, respectively. Subsequent to the third quarter, we declared a cash dividend on September 20, 2007 of \$0.15 per share of Common Stock to be distributed on November 2, 2007 to shareholders of record at the close of business on October 12, 2007.

Under the authority of our Board of Directors, we repurchased shares of our Common Stock during the years to date ended September 8, 2007 and September 9, 2006 as indicated below. All amounts exclude applicable transaction fees.

Edgar Filing: YUM BRANDS INC - Form 10-Q

Authorization Date	Shares Repurchased		Dollar Value of	
	(thousands)		Shares Repurchased	
	2007	2006	2007	2006
March 2007	10,249		\$ 335	\$
September 2006	15,274		469	
March 2006		16,538		398
November 2005		19,128		469
Total	25,523	35,666	\$ 804 <sup>(a)</sup>	\$ 867 <sup>(b)</sup>

(a) Amount includes the effect of \$47 million in share repurchases (1.5 million shares) with trade dates prior to September 8, 2007 but settlement dates subsequent to September 8, 2007. Additionally, amount excludes the effect of \$17 million in share repurchases (0.6 million shares) with trade dates prior to December 30, 2006 but settlement dates subsequent to December 30, 2006.

(b) Amount includes the effect of \$14 million in share repurchases (0.6 million shares) with trade dates prior to September 9, 2006 but cash settlement dates subsequent to September 9, 2006.

As of September 8, 2007, we have \$165 million available for future repurchases (includes the impact of shares repurchased but not yet cash settled as described above) under our March 2007 share repurchase authorization. On October 8, 2007, our Board of Directors authorized additional share repurchases allowing us to repurchase, through October 2008, up to \$1.25 billion (excluding applicable transaction fees) of our outstanding Common Stock. Based on market conditions and other factors, repurchases may be made from time to time in the open market or through privately negotiated transactions at the discretion of the Company.

Comprehensive income was as follows:

	Quarter		Year to date	
	9/8/07	9/9/06	9/8/07	9/9/06
Net income	\$270	\$230	\$678	\$592
Foreign currency translation adjustment arising during the period	20	8	46	31
Foreign currency translation adjustment included in net income			1	
Changes in fair value of derivatives, net of tax <sup>(a)</sup>	(24 )	(1 )	(22 )	9
Reclassification of pension actuarial losses to net income, net of tax	4		12	
Reclassification of derivative (gains) losses to net income, net of tax	3	2		(4 )
Total comprehensive income	\$273	\$239	\$715	\$628

(a) In anticipation of issuing fixed-rate debt in the fourth quarter of 2007, we entered into forward starting interest rate swaps ( interest rate swaps ) during the quarter ended September 8, 2007. These interest rate swaps had an aggregate notional amount of \$400 million and were designated as hedges of the risk of changes in future interest payments attributable to changes in the London Interbank Offered Rate prior to the issuance of the debt. As of September 8, 2007, the fair values of these interest rate swaps were in a liability position of \$33 million. As the ineffective portion of these interest rate swaps recognized in our Condensed Consolidated Statement of Income for the quarter

ended September 8, 2007 was not significant, the offset to this liability was almost entirely recognized in Accumulated Other Comprehensive Loss at September 8, 2007. Upon the issuance of the debt and the settlement of the interest rate swaps, any gain or loss on the interest rate swaps at that time not previously recognized in our Condensed Consolidated Statement of Income will be amortized over the life of the anticipated debt issuance as a decrease or an increase, respectively, in interest expense.

## 5. Recently Adopted Accounting Pronouncements

Effective December 31, 2006, we adopted Financial Accounting Standards Board ( FASB ) Interpretation No. 48, Accounting for Uncertainty in Income Taxes ( FIN 48 ), an interpretation of Statement of Financial Accounting Standards ( SFAS ) No. 109, Accounting for Income Taxes. FIN 48 requires that a position taken or expected to be taken in a tax return be recognized in the financial statements when it is more likely than not (i.e., a likelihood of more than fifty percent) that the position would be sustained upon examination by tax authorities. A recognized tax position is then measured at the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. Upon adoption, we recognized an additional \$13 million for unrecognized tax benefits, which was accounted for as a reduction to our opening balance of retained earnings on December 31, 2006. Subsequent to this adjustment, we had \$283 million of unrecognized tax benefits at December 31, 2006, \$185 million of which, if recognized, would affect the effective income tax rate.

FIN 48 also requires that changes in judgment that result in subsequent recognition, derecognition or change in a measurement of a tax position taken in a prior annual period (including any related interest and penalties) be recognized as a discrete item in the period in which the change occurs. Prior to the adoption of FIN 48, we recorded such changes in judgment, including audit settlements, as a component of our annual effective rate. This change will not impact the manner in which we record income taxes on an annual basis.

The Company recognizes interest and penalties accrued related to unrecognized tax benefits and penalties as components of its Income tax provision. The Company had approximately \$74 million for the payment of interest and penalties accrued at December 31, 2006.

The major jurisdictions in which the Company files income tax returns include the U.S. federal jurisdiction, China, the United Kingdom, Mexico and Australia. Upon adoption of FIN 48, the earliest years that the Company was subject to examination in these jurisdictions were 1999 in the U.S., 2003 in China, 2000 in the United Kingdom, 2001 in Mexico and 2001 in Australia. In addition, the Company is subject to various U.S. state income tax examinations, for which, in the aggregate, we had significant unrecognized tax benefits at December 31, 2006. We anticipate that our recorded uncertain tax benefits for certain tax positions we have taken may increase or decrease during the remainder of 2007 as a result of the continuation of these and other examinations. However, given the status of these examinations we cannot reliably estimate a range of a potential change at this time. Upon completion of audit examinations and the expiration of certain statutes of limitation during the quarter ended June 16, 2007, the Company's aggregate, unrecognized tax benefits recorded at December 31, 2006 were reduced by \$8 million and the amount accrued for payment of interest and penalties for unrecognized tax benefits was reduced by \$21 million. As a result of these reductions, our recorded Income tax provision was \$18 million lower for the year to date ended September 8, 2007.

In June 2006, the FASB ratified the Emerging Issues Task Force ( EITF ) issue 06-3, How Taxes Collected From Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is Gross Versus Net Presentation) ( EITF 06-3 ). EITF 06-3 addresses income statement presentation and disclosure requirements for taxes assessed by a governmental authority that are directly imposed on and concurrent with a revenue-producing transaction between a seller and a customer, including sales, use, value-added and some excise taxes. EITF 06-3 permits such taxes to be

## Edgar Filing: YUM BRANDS INC - Form 10-Q

presented on either a gross basis (included in revenues and costs) or on a net basis (excluded from revenues). The Company has historically presented and will continue to present such taxes on a net basis.

### 6. New Accounting Pronouncements Not Yet Adopted

In September 2006, the FASB issued SFAS No. 157, Fair Value Measures ( SFAS 157 ). SFAS 157 defines fair value, establishes a framework for measuring fair value and enhances disclosures about fair value measures required under other accounting pronouncements, but does not change existing guidance as to whether or not an instrument is carried at fair value. SFAS 157 is effective for fiscal years beginning after November 15, 2007, the year beginning December 30, 2007 for the Company. We are currently reviewing the provisions of SFAS 157 to determine the impact for the Company.

In September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, ( SFAS 158 ). SFAS 158 amends SFAS No. 87, Employers Accounting for Pensions, SFAS No. 88, Employers Accounting for Settlements and Curtailments of Defined Benefit Plans and for Termination Benefits, SFAS No. 106, Employers Accounting for Postretirement Benefits Other Than Pensions and SFAS No. 132(R), Employers Disclosures about Pensions and Other Postretirement Benefits. In the fourth quarter of 2006, we adopted the recognition and disclosure provisions of SFAS 158 as described in our 2006 Form 10-K. Additionally, SFAS 158 requires measurement of the funded status of pension and postretirement plans as of the date of a company s fiscal year ending after December 15, 2008 (the year ended December 27, 2008 for the Company). Certain of our plans currently have measurement dates that do not coincide with our fiscal year end and thus we will be required to change their measurement dates in 2008. At this time, we have not yet determined which of the two approaches permitted by SFAS 158 we will use in transitioning to a fiscal year-end measurement date. Under both approaches the impact of the transition, including the net periodic benefit cost computed for the period between our previous measurement date and our fiscal year end, as well as changes in the fair value of plan assets and benefit obligations during the same period, will be recorded directly to Shareholders Equity. We do not currently anticipate any such amount will materially impact our financial condition.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities ( SFAS 159 ). SFAS 159 provides companies with an option to report selected financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings at each subsequent reporting date. SFAS 159 is effective for fiscal years beginning after November 15, 2007, the year beginning December 30, 2007 for the Company. While we continue to review the provisions of SFAS 159, we have not yet identified any assets or liabilities for which we currently believe we will elect the fair value reporting option.

### 7. Facility Actions

For the year to date ended September 8, 2007, the Company refranchised 285 stores including 94 in the quarter ended September 8, 2007.

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

	Quarter ended September 8, 2007			
	U.S.	International	China	Worldwide
Refranchising (gain) loss <sup>(a)</sup>	\$ (1 )	\$ 2	\$(1 )	\$
Store closure (income) costs <sup>(b)</sup>	\$ (4 )	\$ (2 )	\$	\$(6 )
Store impairment charges		3	2	5
Closure and impairment (income) expenses	\$ (4 )	\$ 1	\$2	\$(1 )



Edgar Filing: YUM BRANDS INC - Form 10-Q

	Quarter ended September 9, 2006			
	U.S.	International		China
		Division	Division	Worldwide
Refranchising (gain) loss <sup>(a)</sup>	\$ 6	\$ (2 )	\$	\$4
Store closure (income) costs <sup>(b)</sup>	\$ (3 )	\$	\$(1 )	\$(4 )
Store impairment charges	3	1	1	5
Closure and impairment (income) expenses	\$	\$ 1	\$	\$1

	Year to date ended September 8, 2007			
	U.S.	International		China
		Division	Division	Worldwide
Refranchising (gain) loss <sup>(a)</sup>	\$(3 )	\$	\$(2 )	\$(5 )
Store closure (income) costs <sup>(b)</sup>	\$(10 )	\$(2 )	\$	\$(12 )
Store impairment charges	10	10	4	24
Closure and impairment (income) expenses	\$	\$8	\$4	\$12

	Year to date ended September 9, 2006			
	U.S.	International		China
		Division	Division	Worldwide
Refranchising (gain) loss <sup>(a)</sup>	\$(4 )	\$(3 )	\$	\$(7 )
Store closure (income) costs <sup>(b)</sup>	\$(1 )	\$1	\$(1 )	\$(1 )
Store impairment charges	16	7	3	26
Closure and impairment (income) expenses	\$15	\$8	\$2	\$25

(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.



**8. Other (Income) Expense**

	Quarter		Year to date	
	9/8/07	9/9/06	9/8/07	9/9/06
Equity income from investments in unconsolidated affiliates	\$(19 )	\$(16 )	\$(40 )	\$(37 )
Gain upon sale of investment in unconsolidated affiliate <sup>(a)</sup>	(1 )	(2 )	(6 )	(2 )
Contract termination charge <sup>(b)</sup>				8
Foreign exchange net (gain) loss and other	1	1	(1 )	(2 )
Other (income) expense	\$(19 )	\$(17 )	\$(47 )	\$(33 )

(a) Reflects recognition of income associated with receipt of payments for a note receivable arising from the 2005 sale of our fifty percent interest in the entity that operated almost all KFCs and Pizza Huts in Poland and the Czech Republic to our then partner in the entity.

(b) Reflects an \$8 million charge associated with the termination of a beverage agreement in the United States segment.

**9. Reportable Operating Segments**

The following tables summarize revenue and operating profit for each of our reportable operating segments:

<b>Revenues</b>	Quarter		Year to date	
	9/8/07	9/9/06	9/8/07	9/9/06
United States	\$ 1,224	\$ 1,300	\$ 3,642	\$ 3,969
International Division <sup>(a)</sup>	740	518	2,117	1,476
China Division <sup>(b)</sup>	600	460	1,395	1,100
	\$ 2,564	\$ 2,278	\$ 7,154	\$ 6,545

<b>Operating Profit</b>	Quarter		Year to date	
	9/8/07	9/9/06	9/8/07	9/9/06
United States	\$ 187	\$ 183	\$ 543	\$ 565
International Division <sup>(c)</sup>	127	105	347	288
China Division <sup>(d)</sup>	135	105	276	220
Unallocated and corporate expenses	(48 )	(47 )	(148 )	(151 )
Unallocated other income (expense)		2	4	4
Unallocated franchising gain (loss) <sup>(e)</sup>		(4 )	5	7
Operating profit	401	344	1,027	933
Interest expense, net	(38 )	(34 )	(112 )	(105 )
Income before income taxes	\$ 363	\$ 310	\$ 915	\$ 828

## Edgar Filing: YUM BRANDS INC - Form 10-Q

- (a) Includes revenues of \$312 million and \$122 million for the quarters ended September 8, 2007 and September 9, 2006, respectively, and \$900 million and \$338 million for the years to date ended September 8, 2007 and September 9, 2006, respectively, for entities in the United Kingdom. The increases primarily resulted from our acquisition of the remaining fifty percent ownership of our Pizza Hut United Kingdom unconsolidated affiliate in September 2006.
- (b) Includes revenues of approximately \$533 million and \$397 million for the quarters ended September 8, 2007 and September 9, 2006, respectively, and \$1.2 billion and \$933 million for the years to date ended September 8, 2007 and September 9, 2006, respectively, in mainland China.
- (c) Includes equity income from investment in unconsolidated affiliates of \$1 million for the quarter ended September 9, 2006, and \$4 million and \$8 million for the years to date ended September 8, 2007 and September 9, 2006, respectively, for the International Division.
- (d) Includes equity income from investment in unconsolidated affiliates of \$19 million and \$15 million for the quarters ended September 8, 2007 and September 9, 2006, and \$36 million and \$29 million for the years to date ended September 8, 2007 and September 9, 2006, respectively, for the China Division.
- (e) Unallocated franchising gain (loss) is not allocated to the U.S., International Division or China Division segments for performance reporting purposes.

### 10. Pension Benefits

We sponsor noncontributory defined benefit pension plans covering certain full-time salaried and hourly U.S. employees. The most significant of these plans, the YUM Retirement Plan (the Plan), is funded while benefits from the other U.S. plans are paid by the Company as incurred. During 2001, the plans covering our U.S. salaried employees were amended such that any salaried employee hired or rehired by YUM after September 30, 2001 is not eligible to participate in those plans. We also sponsor various defined benefit pension plans covering certain of our non-U.S. employees, the most significant of which are in the United Kingdom ( U.K. ). Our plans in the U.K. have previously been amended such that new participants are not eligible to participate in these plans.

The components of net periodic benefit cost associated with our U.S. pension plans and significant International pension plans are as follows:

	U.S. Pension Plans		International Pension Plans	
	Quarter		Quarter	
	9/8/07	9/9/06	9/8/07	9/9/06 <sup>(a)</sup>
Service cost	\$8	\$8	\$2	\$2
Interest cost	11	11	2	1
Expected return on plan assets	(12 )	(11 )	(2 )	(1 )
Amortization of prior service cost	1			
Amortization of net loss	6	7		
Net periodic benefit cost	\$14	\$15	\$2	\$2

	U.S. Pension Plans		International Pension Plans	
	Year to date		Year to date	
	9/8/07	9/9/06	9/8/07	9/9/06 <sup>(a)</sup>
Service cost	\$23	\$24	\$6	\$4
Interest cost	35	32	5	3
Expected return on plan assets	(35 )	(33 )	(6 )	(3 )
Amortization of prior service cost	1	2		

Edgar Filing: YUM BRANDS INC - Form 10-Q

Amortization of net loss	17	21	1	
Net periodic benefit cost	\$41	\$46	\$6	\$4

- (a) Excludes pension expense for the Pizza Hut U.K. pension plan of \$1 million and \$3 million for the quarter and year to date ended September 9, 2006, respectively, related to periods prior to our acquisition of the remaining fifty percent interest in this unconsolidated affiliate in September 2006.

As disclosed in our 2006 Form 10-K, based on current funding rules, we are not required to make contributions to the Plan in 2007. While we may make discretionary contributions to the Plan during the year, we do not currently intend to do so. Additionally, as disclosed in our 2006 Form 10-K, the projected benefit obligation of our Pizza Hut U.K. pension plan exceeded plan assets by approximately \$35 million at our 2006 measurement date. We anticipate taking steps to reduce this deficit in the near term, which could include a decision in 2007 to partially or completely fund the deficit. Also, as disclosed in our 2006 Form 10-K, since plan assets approximate the projected benefit obligation at the 2006 measurement date for our KFC U.K. pension plan, we do not anticipate significant near term funding.

## 11. Guarantees, Commitments and Contingencies

### Guarantees and Contingencies

As a result of (a) assigning our interest in obligations under real estate leases as a condition to the refranchising of certain Company restaurants; (b) contributing certain Company restaurants to unconsolidated affiliates; and (c) guaranteeing certain other leases, we are frequently contingently liable on lease agreements. These leases have varying terms, the latest of which expires in 2026. As of September 8, 2007 and December 30, 2006, the potential amount of undiscounted payments we could be required to make in the event of non-payment by the primary lessee was approximately \$400 million. The present value of these potential payments discounted at our pre-tax cost of debt at September 8, 2007 was approximately \$330 million. Our franchisees are the primary lessees under the vast majority of these leases. We generally have cross-default provisions with these franchisees that would put them in default of their franchise agreement in the event of non-payment under the lease. We believe these cross-default provisions significantly reduce the risk that we will be required to make payments under these leases. Accordingly, the liability recorded for our probable exposure under such leases at September 8, 2007 and December 30, 2006 was not material.

### Franchise Loan Pool Guarantees

We have provided approximately \$16 million of partial guarantees of two franchisee loan pools related primarily to the Company's historical refranchising programs and, to a lesser extent, franchisee development of new restaurants, at both September 8, 2007 and December 30, 2006. In support of these guarantees, we posted letters of credit of \$4 million. We also provide a standby letter of credit of \$18 million under which we could potentially be required to fund a portion of one of the franchisee loan pools. The total loans outstanding under these loan pools were approximately \$66 million and \$75 million at September 8, 2007 and December 30, 2006, respectively.

Any funding under the guarantees or letters of credit would be secured by the franchisee loans and any related collateral. We believe that we have appropriately provided for our estimated probable exposures under these contingent liabilities. These provisions were primarily charged to Refranchising (gain) loss. New loans added to the loan pools in the quarter ended September 8, 2007 were not significant.

Insurance Programs

We are self-insured for a substantial portion of our current and prior years' coverage including workers' compensation, employment practices liability, general liability, automobile liability and property losses (collectively, "property and casualty losses"). To mitigate the cost of our exposures for certain property and casualty losses, we make annual decisions to self-insure the risks of loss up to defined maximum per occurrence retentions on a line by line basis or to combine certain lines of coverage into one loss pool with a single self-insured aggregate retention. The Company then purchases insurance coverage, up to a certain limit, for losses that exceed the self-insurance per occurrence or aggregate retention. The insurers' maximum aggregate loss limits are significantly above our actuarially determined probable losses; therefore, we believe the likelihood of losses exceeding the insurers' maximum aggregate loss limits is remote.

In the U.S. and in certain other countries, we are also self-insured for healthcare claims and long-term disability for eligible participating employees subject to certain deductibles and limitations. We have accounted for our retained liabilities for property and casualty losses and healthcare and long-term disability claims, including reported and incurred but not reported claims, based on information provided by independent actuaries.

Due to the inherent volatility of actuarially determined property and casualty loss estimates, it is reasonably possible that we could experience changes in estimated losses which could be material to our growth in quarterly and annual net income. We believe that we have recorded reserves for property and casualty losses at a level which has substantially mitigated the potential negative impact of adverse developments and/or volatility.

Litigation

We are subject to various claims and contingencies related to lawsuits, real estate, environmental and other matters arising in the normal course of business. We provide reserves for such claims and contingencies when payment is probable and estimable in accordance with SFAS No. 5, Accounting for Contingencies.

On November 26, 2001, a lawsuit against Long John Silver's, Inc. ("LJS") styled Kevin Johnson, on behalf of himself and all others similarly situated v. Long John Silver's, Inc. ("Johnson") was filed in the United States District Court for the Middle District of Tennessee, Nashville Division. Johnson's suit alleged that LJS's former Security/Restitution for Losses policy (the "Policy") provided for deductions from Restaurant General Managers ("RGMs") and Assistant Restaurant General Managers ("ARGMs") salaries that violate the salary basis test for exempt personnel under regulations issued pursuant to the U.S. Fair Labor Standards Act ("FLSA"). Johnson alleged that all RGMs and ARGMs who were employed by LJS for the three year period prior to the lawsuit—i.e., since November 26, 1998—should be treated as the equivalent of hourly employees and thus were eligible under the FLSA for overtime for any hours worked over 40 during all weeks in the recovery period. In addition, Johnson claimed that the potential members of the class are entitled to certain liquidated damages and attorneys' fees under the FLSA.

LJS believed that Johnson's claims, as well as the claims of all other similarly situated parties, should be resolved in individual arbitrations pursuant to LJS's Dispute Resolution Program ("DRP"), and that a collective action to resolve these claims in court was clearly inappropriate under the current state of the law. Accordingly, LJS moved to compel arbitration in the Johnson case. LJS and Johnson also agreed to stay the action effective December 17, 2001, pending mediation, and entered into a tolling agreement for that purpose. After mediation did not resolve the case, and after limited discovery and a hearing, the Court determined on June 7, 2004, that Johnson's individual claims should be referred to arbitration. Johnson appealed, and the decision of the District Court was affirmed in all respects by the United States Court of Appeals for the Sixth Circuit on July 5, 2005.



## Edgar Filing: YUM BRANDS INC - Form 10-Q

On December 19, 2003, counsel for plaintiff in the above referenced Johnson lawsuit, filed a separate demand for arbitration with the American Arbitration Association ( AAA ) on behalf of former LJS managers Erin Cole and Nick Kaufman (the Cole Arbitration ). Claimants in the Cole Arbitration demand a class arbitration on behalf of the same putative class - and the same underlying FLSA claims - as were alleged in the Johnson lawsuit. The complaint in the Cole Arbitration subsequently was amended to allege a practice of deductions (distinct from the allegations as to the Policy) in violation of the FLSA salary basis test, and to add Victoria McWhorter, another LJS former manager, as an additional claimant. LJS has denied the claims and the putative class alleged in the Cole Arbitration.

Arbitrations under LJS's DRP, including the Cole Arbitration, are governed by the rules of the AAA. In October 2003, the AAA adopted its Supplementary Rules for Class Arbitrations ( AAA Class Rules ). The AAA appointed an arbitrator for the Cole Arbitration. On June 15, 2004, the arbitrator issued a clause construction award, ruling that the DRP does not preclude class arbitration. LJS moved to vacate the clause construction award in the United States District Court for the District of South Carolina. On September 15, 2005, the federal court in South Carolina ruled that it did not have jurisdiction to hear LJS's motion to vacate. LJS appealed the U.S. District Court's ruling to the United States Court of Appeals for the Fourth Circuit.

On January 5, 2007, LJS moved to dismiss the clause construction award appeal and that motion was granted by the Fourth Circuit on January 10, 2007. LJS had also filed a motion to vacate the clause construction award in South Carolina state court, which was stayed pending a decision by the Fourth Circuit. LJS agreed to dismiss the motion to vacate the clause construction award and agreed not to oppose claimants' cross-motion to confirm that award by the South Carolina court. While judicial review of the clause construction award was pending in the U.S. District Court, the arbitrator permitted claimants to move for a class determination award, which was opposed by LJS. On September 19, 2005, the arbitrator issued a class determination award, certifying a class of LJS's RGMs and ARGMs employed between December 17, 1998, and August 22, 2004, on FLSA claims, to proceed on an opt-out basis under the AAA Class Rules. That class determination award was upheld on appeal by the United States District Court for the District of South Carolina on January 20, 2006, and the arbitrator declined to reconsider the award. LJS appealed the ruling of the United States District Court to the United States Court of Appeals for the Fourth Circuit. LJS also filed a motion to vacate the class determination award in South Carolina state court, which has been stayed by the South Carolina court pending a decision by the Fourth Circuit in the class determination award appeal. Oral argument in the Fourth Circuit was heard on January 31, 2007. Due to the recent death of one of the Fourth Circuit Judges that heard the arguments in appeal, the case has been scheduled for reargument in December 2007. Although we believe that no substantive decision should be made by the arbitrator before the Fourth Circuit rules, we expect discovery in the underlying arbitration to continue and partial motions for summary judgment to be filed before the arbitrator in late 2007 or early 2008.

LJS believes that if the Cole Arbitration must proceed on a class basis, (i) the proceedings should be governed by the opt-in collective action structure of the FLSA, and (ii) a class should not be certified under the applicable provisions of the FLSA. LJS also believes that each individual should not be able to recover for more than two years (and a maximum three years) prior to the date they file a consent to join the arbitration. We have provided for the estimated costs of the Cole Arbitration, based on a projection of eligible claims, the amount of each eligible claim, the estimated legal fees incurred by the claimants and the results of settlement negotiations in this and other wage and hour litigation matters. But in view of the novelties of proceeding under the AAA Class Rules and the inherent uncertainties of litigation, there can be no assurance that the outcome of the arbitration will not result in losses in excess of those currently provided for in our Condensed Consolidated Financial Statements.

On September 2, 2005, a collective action lawsuit against the Company and KFC Corporation, originally styled Parler v. Yum Brands, Inc., d/b/a KFC, and KFC Corporation, was filed in the United States District Court for the District of Minnesota. Plaintiffs allege that they and other current and former KFC

## Edgar Filing: YUM BRANDS INC - Form 10-Q

Assistant Unit Managers ( AUMs ) were improperly classified as exempt employees under the FLSA. Plaintiffs seek overtime wages and liquidated damages. On January 17, 2006, the District Court dismissed the claims against the Company with prejudice, leaving KFC Corporation as the sole defendant. Notice was mailed to current and former AUMs advising them of the litigation and providing an opportunity to join the case if they choose to do so. Plaintiffs amended the complaint on September 8, 2006, to add related state law claims on behalf of a putative class of KFC AUMs employed in Illinois, Minnesota, Nevada, New Jersey, New York, Ohio, and Pennsylvania. On October 24, 2006, plaintiffs moved to decertify the conditionally certified FLSA action, and KFC Corporation did not oppose the motion. On June 4, 2007, the District Court decertified the collective action and dismissed all opt-in plaintiffs without prejudice. Subsequently, plaintiffs have filed twenty-seven new cases around the country, most of which allege a statewide putative collective/class action. All cases were filed in or have been removed to federal district court. Plaintiffs have also filed 324 individual arbitrations with the American Arbitration Association ( AAA ). KFC has filed a motion with the Judicial Panel on Multidistrict Litigation ( JPML ) to transfer all twenty-eight pending cases to a single district court for coordinated pretrial proceedings pursuant to the Multidistrict Litigation ( MDL ) statute, 28 U.S.C. § 1407. KFC anticipates that this motion will be argued in November. Thus far, ten district courts have stayed proceedings pending a decision by the JPML. KFC has also filed a motion with the Minnesota District Court to enjoin the 324 AAA arbitrations on the ground that Plaintiffs waived the right to arbitrate by their participation in the Minnesota (Parler) litigation. The court heard argument and took KFC's motion under advisement on September 6, 2007. Finally, KFC filed a motion in the new Minnesota action to deny certification of a collective or class action on the ground that Plaintiffs are judicially and equitably estopped from proceeding collectively on behalf of a class in light of positions they took in the Parler case. The Court denied KFC's motion without prejudice so that, assuming that KFC's MDL motion is granted, the MDL court to which the cases are transferred may decide the issue once for all pending cases.

We believe that KFC has properly classified its AUMs as exempt under the FLSA and applicable state law, and accordingly intend to vigorously defend against all claims in these lawsuits. However, in view of the inherent uncertainties of litigation, the outcome of this case cannot be predicted at this time. Likewise, the amount of any potential loss cannot be reasonably estimated.

On August 4, 2006, a putative class action lawsuit against Taco Bell Corp. styled Rajeev Chhibber vs. Taco Bell Corp. was filed in Orange County Superior Court. On August 7, 2006, another putative class action lawsuit styled Marina Puchalski v. Taco Bell Corp. was filed in San Diego County Superior Court. Both lawsuits were filed by a Taco Bell RGM purporting to represent all current and former RGMs who worked at corporate-owned restaurants in California from August 2002 to the present. The lawsuits allege violations of California's wage and hour laws involving unpaid overtime and meal and rest period violations and seek unspecified amounts in damages and penalties. As of September 7, 2006, the Orange County case was voluntarily dismissed by the plaintiff and both cases have been consolidated in San Diego County.

Taco Bell denies liability and intends to vigorously defend against all claims in this lawsuit. However, in view of the inherent uncertainties of litigation, the outcome of this case cannot be predicted at this time. Likewise, the amount of any potential loss cannot be reasonably estimated.

On September 10, 2007, a putative class action against Taco Bell Corp., Yum! Brands, Inc. and other related entities styled Sandrika Medlock v. Taco Bell Corp., was filed in United States District Court, Eastern District, Fresno, California. The case was filed on behalf of all hourly employees who have worked for the defendants within the last four years and alleges numerous violations of California labor laws including unpaid overtime, failure to pay wages on termination, denial of meal and rest breaks, improper wage statements, unpaid business expenses and unfair or unlawful business practices in violation of California Business & Professions Code §17200.



## Edgar Filing: YUM BRANDS INC - Form 10-Q

Taco Bell denies liability and intends to vigorously defend against all claims in this lawsuit. However, in view of the inherent uncertainties of litigation, the outcome of this case cannot be predicted at this time. Likewise, the amount of any potential loss cannot be reasonably estimated.

On December 17, 2002, Taco Bell was named as the defendant in a class action lawsuit filed in the United States District Court for the Northern District of California styled Moeller, et al. v. Taco Bell Corp. On August 4, 2003, plaintiffs filed an amended complaint that alleges, among other things, that Taco Bell has discriminated against the class of people who use wheelchairs or scooters for mobility by failing to make its approximately 220 company-owned restaurants in California (the California Restaurants ) accessible to the class. Plaintiffs contend that queue rails and other architectural and structural elements of the Taco Bell restaurants relating to the path of travel and use of the facilities by persons with mobility-related disabilities (including parking spaces, ramps, counters, restroom facilities and seating) do not comply with the U.S. Americans with Disabilities Act (the ADA ), the Unruh Civil Rights Act (the Unruh Act ), and the California Disabled Persons Act (the CDPA ). Plaintiffs have requested: (a) an injunction from the District Court ordering Taco Bell to comply with the ADA and its implementing regulations; (b) that the District Court declare Taco Bell in violation of the ADA, the Unruh Act, and the CDPA; and (c) monetary relief under the Unruh Act or CDPA. Plaintiffs, on behalf of the class, are seeking the minimum statutory damages per offense of either \$4,000 under the Unruh Act or \$1,000 under the CDPA for each aggrieved member of the class. Plaintiffs contend that there may be in excess of 100,000 individuals in the class. For themselves, the four named plaintiffs have claimed aggregate minimum statutory damages of no less than \$16,000, but are expected to claim greater amounts based on the number of Taco Bell outlets they visited at which they claim to have suffered discrimination.

On February 23, 2004, the District Court granted Plaintiffs' motion for class certification. The District Court certified a Rule 23(b)(2) mandatory injunctive relief class of all individuals with disabilities who use wheelchairs or electric scooters for mobility who, at any time on or after December 17, 2001, were denied, or are currently being denied, on the basis of disability, the full and equal enjoyment of the California Restaurants. The class includes claims for injunctive relief and minimum statutory damages.

Pursuant to the parties' agreement, on or about August 31, 2004, the District Court ordered that the trial of this action be bifurcated so that stage one will resolve Plaintiffs' claims for equitable relief and stage two will resolve Plaintiffs' claims for damages. The parties are currently proceeding with the equitable relief stage of this action. During this stage, Taco Bell filed a motion to partially decertify the class to exclude from the Rule 23(b)(2) class claims for monetary damages. The District Court denied the motion. Plaintiffs filed their own motion for partial summary judgment as to liability relating to a subset of the California Restaurants. The District Court denied that motion as well. Discovery is ongoing as of the date of this report.

On May 17, 2007, a hearing was held on Plaintiffs' Motion for Partial Summary Judgment seeking judicial declaration that Taco Bell was in violation of accessibility laws as to three specific issues: indoor seating, queue rails and door opening force. On August 8, 2007, the court granted Plaintiffs' motion in part with regard to dining room seating. In addition, the court granted Plaintiffs' motion in part with regard to door opening force at some restaurants (but not all) and denied the motion with regard to queue lines.

At a status conference on September 27, 2007, the court set a trial date of November 10, 2008 with respect to not more than 20 restaurants to determine the issue of liability and common issues. Discovery related to the subject of the mini-trial will commence shortly.

Taco Bell has denied liability and intends to vigorously defend against all claims in this lawsuit. Taco Bell has taken certain steps to address potential architectural and structural compliance issues at the restaurants in accordance with applicable state and federal disability access laws. The costs associated with addressing these issues are not expected to significantly impact our results of operations.

## Edgar Filing: YUM BRANDS INC - Form 10-Q

Taco Bell intends to file its own Motion for Summary Judgment seeking judicial declaration that Plaintiffs' claims are moot due to the current condition of the restaurant facilities and to Taco Bell's commitments and policies.

It is not possible at this time to reasonably estimate the probability or amount of liability for monetary damages on a class wide basis to Taco Bell.

On May 11, 2007, plaintiff John Whited filed a putative class action against Long John Silver's, Inc. in Superior Court, Kings County California, styled John Whited, For Himself and On Behalf of All Others Similarly Situated v. Long John Silver's, Inc. and Does 1-10. The complaint alleges, among other things, that LJS has discriminated against the class of people who use wheelchairs or scooters for mobility by failing to make its 23 company-owned restaurants in California (the LJS California Restaurants) accessible to the class. Plaintiff's complaint is based upon the Plaintiff's inspection of one of the LJS California Restaurants and contends that the restroom paper towel dispenser, customer service, sales, order and condiment counters do not comply with the ADA and certain provisions of the CDPA. Plaintiff has requested unspecified injunctive relief and damages. On June 7, 2007, LJS filed to remove the case to the U.S. District Court for the Eastern District of California at Fresno.

LJS sold the LJS California Restaurants to an existing LJS franchisee (the Buyer) on August 22, 2007. The parties have agreed, among other things: (1) that LJS will undertake defense of the action and be responsible for any attorney fees or damages arising out of the action; and (2) that the Buyer will be responsible for performing such construction and other work needed to ensure that the LJS California Restaurants comply with the ADA.

LJS intends to vigorously defend against all claims in this lawsuit. However, in view of the inherent uncertainties of litigation, the outcome of this case cannot be predicted at this time. Likewise, the amount of any potential loss cannot be reasonably estimated.

According to the Centers for Disease Control (CDC), there was an outbreak of illness associated with a particular strain of E. coli 0157:H7 in the northeast United States during November and December 2006. Also according to the CDC, the outbreak from this particular strain was associated with eating at Taco Bell restaurants in Pennsylvania, New Jersey, New York, and Delaware. The CDC concluded that the outbreak ended on or about December 6, 2006. The CDC has stated that it received reports of 71 persons who became ill in association with the outbreak in the above-mentioned area during the above time frame, and that no deaths have been reported.

On December 6, 2006, a lawsuit styled Tyler Vormittag, et. al. v. Taco Bell Corp. Taco Bell of America, Inc. and Yum! Brands, Inc. was filed in the Supreme Court of the State of New York, County of Suffolk. Mr. Vormittag, a minor, alleges he became ill after consuming food purchased from a Taco Bell restaurant in Riverhead, New York, which was allegedly contaminated with E. coli 0157:H7. Subsequently, twenty other cases have been filed naming the Company, Taco Bell Corp., Taco Bell of America, K.F.C. Company (alleged owner/operator of the Taco Bell restaurant claimed to be at issue in one case), and/or Yum! Restaurant Services Group, Inc. and alleging similar facts on behalf of other customers.

According to the allegations common to all the Complaints, each Taco Bell customer became ill after ingesting contaminated food in late November or early December 2006 from Taco Bell restaurants located in the northeast states implicated in the outbreak. Discovery is in the preliminary stages. However, the Company believes, based on the allegations, that the stores identified in twelve of the Complaints are in fact not owned by the Company or any of its subsidiaries. As such, the Company believes that at a minimum it is not liable for any losses at these stores. Three of these twelve Complaints have been dismissed without prejudice pending settlement discussions with plaintiffs' counsel. A fourth was dismissed with prejudice as against the Company on the ground that neither the Company nor any of its subsidiaries owned or operated the store at issue.



## Edgar Filing: YUM BRANDS INC - Form 10-Q

Additionally, the Company has received a number of claims from customers who have alleged injuries relating to the E.coli outbreak, but have not filed lawsuits.

We have provided for the estimated costs of these claims and litigation, based on a projection of potential claims and their amounts as well as the results of settlement negotiations in similar matters. But in view of the inherent uncertainties of litigation, there can be no assurance that the outcome of the litigation will not result in losses in excess of those currently provided for in our Condensed Consolidated Financial Statements.

On March 14, 2007, a lawsuit styled Boskovich Farms, Inc. v. Taco Bell Corp. and Does 1 through 100 was filed in the Superior Court of the State of California, Orange County. Boskovich Farms, a supplier of produce to Taco Bell, alleges in its Complaint, among other things, that it suffered damage to its reputation and business as a result of publications and/or statements it claims were made by Taco Bell in connection with Taco Bell's reporting of results of certain tests conducted during investigations on green onions used at Taco Bell restaurants. The Company believes that the Complaint should properly be heard in an alternative dispute resolution forum according to the contractual terms governing the relationship of the parties. The Company filed a motion to compel arbitration and stay the litigation on May 1, 2007. The Court entered an order granting this motion on June 14, 2007. Boskovich filed a writ petition to set aside the trial court's ruling compelling arbitration; Taco Bell filed an informal response and the parties are awaiting the Court of Appeals' decision whether to deny the petition or order further briefing. The Company denies liability and intends to vigorously defend against all claims in any arbitration and the lawsuit. However, in view of the inherent uncertainties of litigation, the outcome of this case cannot be predicted at this time. Likewise, the amount of any potential loss cannot be reasonably estimated.

On July 5, 2007, a lawsuit styled Doran Phillips vs. Taco Bell Corp., et al., was delivered to Taco Bell's agent for service of process in Illinois. The lawsuit was filed in the U.S. District Court for the Northern District of Illinois. It is a proposed class action and alleges that Taco Bell failed to protect the private information of its customers under the new federal Fair and Accurate Credit Transaction Act ( FACTA ). Since the complaint alleges a violation of FACTA based on a transaction involving a licensed restaurant, the Company intends to seek dismissal from the action. However, in view of the inherent uncertainties of litigation, the outcome of this case cannot be predicted at this time. Likewise, the amount of any potential loss cannot be reasonably estimated.

On July 11, 2007, a lawsuit styled Melissa Peraria v. KFC Corp., et al., was filed in the U.S. District Court of New Jersey. It is a proposed class action and alleges that KFC failed to protect the private information of its customers under FACTA. Since the complaint alleges a violation of FACTA based on a transaction involving a franchised restaurant, the Company intends to seek dismissal from the action. However, in view of the inherent uncertainties of litigation, the outcome of this case cannot be predicted at this time. Likewise, the amount of any potential loss cannot be reasonably estimated.

### Proposed Internal Revenue Service Adjustments

In early 2007, the Internal Revenue Service (the IRS) informed the Company of its intent to propose certain adjustments based on its position that the Company did not file Gain Recognition Agreements ( GRAs ) in connection with certain transfers of foreign subsidiaries among its affiliated group. On April 30, 2007, the Company met with the IRS and stated its belief that the filing of GRAs was not required, or if required, the Company should be granted relief for a later filing. The Company does not believe at this time that estimation of a meaningful range of potential payments to the IRS is possible. However, the Company currently believes, given our strong defenses to the IRS' position, that any payments we would make to the IRS for the resolution of this matter would not have a significant adverse impact on the Company's financial results or condition.

Obligations to PepsiCo, Inc. After Spin-off

In connection with our October 6, 1997 spin-off from PepsiCo, Inc. ( PepsiCo ) (the Spin-off ), we entered into separation and other related agreements (the Separation Agreements ) governing the Spin-off and our subsequent relationship with PepsiCo. These agreements provide certain indemnities to PepsiCo.

## Edgar Filing: YUM BRANDS INC - Form 10-Q

Under the terms of these agreements, we have indemnified PepsiCo for any costs or losses it incurs with respect to all letters of credit, guarantees and contingent liabilities relating to our businesses under which PepsiCo remains liable. As of September 8, 2007, PepsiCo remains liable for approximately \$19 million on a nominal basis related to these contingencies. This obligation ends at the time PepsiCo is released, terminated or replaced by a qualified letter of credit. We have not been required to make any payments under this indemnity.

Under the Separation Agreements, PepsiCo maintains full control and absolute discretion with regard to any combined or consolidated tax filings for periods through October 6, 1997. PepsiCo also maintains full control and absolute discretion regarding any common tax audit issues. Although PepsiCo has contractually agreed to, in good faith, use its best efforts to settle all joint interests in any common tax audit issue on a basis consistent with prior practice, there can be no assurance that determinations made by PepsiCo would be the same as we would reach, acting on our own behalf. Through September 8, 2007, there have not been any determinations made by PepsiCo that have not been resolved to our satisfaction.

### **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

#### **Introduction and Overview**

The following Management's Discussion and Analysis ( MD&A ), should be read in conjunction with the unaudited Condensed Consolidated Financial Statements ( Financial Statements ), the Cautionary Statements and our annual report on Form 10-K for the fiscal year ended December 30, 2006 ( 2006 Form 10-K ). Throughout the MD&A the Company makes reference to certain performance measures as described below.

The Company provides the percentage changes excluding the impact of foreign currency translation. These amounts are derived by translating current year results at prior year average exchange rates. We believe the elimination of the foreign currency translation impact provides better year-to-year comparability without the distortion of foreign currency fluctuations.

System sales growth includes the results of all restaurants regardless of ownership, including Company-owned, franchise, unconsolidated affiliate and license restaurants. Sales of franchise, unconsolidated affiliate and license restaurants generate franchise and license fees for the Company (typically at a rate of 4% to 6% of sales). Franchise, unconsolidated affiliate and license restaurant sales are not included in Company sales on the Condensed Consolidated Statements of Income; however, the franchise and license fees are included in the Company's revenues. We believe system sales growth is useful to investors as a significant indicator of the overall strength of our business as it incorporates all of our revenue drivers, Company and franchise same store sales as well as net unit development.

Company restaurant margin as a percentage of sales is defined as Company sales less expenses incurred directly by our Company restaurants in generating Company sales divided by Company sales.

Worldwide system same store sales is the estimated growth in sales of all restaurants that have been open one year or more. Blended U.S. same store sales include only KFC, Pizza Hut and Taco Bell Company owned restaurants that have been open one year or more. U.S. same store sales for Long John Silver's and A&W restaurants are not included given the relative insignificance of the Company stores for these brands and the limited impact they currently have, and will have in the future, on our blended U.S. same store sales as well as our overall U.S. performance.

All Note references herein refer to the accompanying Notes to the Financial Statements. Tabular amounts are displayed in millions except per share and unit count amounts, or as otherwise specifically identified. All per share and share amounts herein, and in the accompanying Financial Statements and Notes to the Financial Statements have been adjusted to reflect the June 26, 2007 stock split (see Note 2).



Description of Business

YUM! Brands, Inc. ( "YUM" or the "Company" ) is the world's largest restaurant company in terms of system restaurants with over 34,000 restaurants in more than 100 countries and territories operating under the KFC, Pizza Hut, Taco Bell, Long John Silver's or A&W All-American Food Restaurants brands. Four of the Company's restaurant brands — KFC, Pizza Hut, Taco Bell and Long John Silver's — are the global leaders in the chicken, pizza, Mexican-style food and quick-service seafood categories, respectively. Of the over 34,000 restaurants, 22% are operated by the Company, 72% are operated by franchisees and unconsolidated affiliates and 6% are operated by licensees.

YUM's business consists of three reporting segments: United States, the International Division and the China Division. The China Division includes mainland China, Thailand and KFC Taiwan and the International Division includes the remainder of our international operations. The China and International Divisions have been experiencing dramatic growth and now represent approximately half of the Company's operating profits. The U.S. business operates in a highly competitive marketplace resulting in slower profit growth, but continues to produce strong cash flows.

Strategies

The Company continues to focus on four key strategies:

**Build Dominant China Brands** — The Company has developed the KFC and Pizza Hut brands into the leading quick service and casual dining restaurants, respectively, in mainland China. Additionally, the Company owns and operates the distribution system for its restaurants in mainland China which we believe provides a significant competitive advantage. Given this strong competitive position, a rapidly growing economy and a population of 1.3 billion in mainland China, the Company is rapidly adding KFC and Pizza Hut Casual Dining restaurants and testing the additional restaurant concepts of Pizza Hut Home Service (pizza delivery) and East Dawning (Chinese food). Our ongoing earnings growth model includes annual system-sales growth of 20% in mainland China driven by at least 375 new restaurants each year, which we expect to drive annual operating profit growth of 20% in the China Division.

**Drive Profitable International Division Expansion** — The Company and its franchisees opened over 700 new restaurants in 2006 in the Company's International Division, representing seven straight years of opening over 700 restaurants. The International Division generated over \$400 million in operating profit in 2006 up from \$186 million in 1998. The Company expects to continue to experience strong growth by building out existing markets and growing in new markets including India, France and Russia. Our ongoing earnings growth model includes annual operating profit growth of 10% driven by 750 new restaurant openings annually for the International Division. New unit development is expected to contribute to system sales growth of at least 5% (at least 3% unit growth and 2% to 3% same store sales growth) each year.

**Improve U.S. Brands Positions and Returns** — The Company continues to focus on improving its U.S. position through differentiated products and marketing and an improved customer experience. The Company also strives to provide industry leading new product innovation which adds sales layers and expands day parts. We are the leader in multibranding, with over 3,500 restaurants providing customers two or more of our brands at a single location. We continue to evaluate our returns and ownership



## Edgar Filing: YUM BRANDS INC - Form 10-Q

positions with an earn the right to own philosophy on Company owned restaurants. Our ongoing earnings growth model calls for annual operating profit growth of 5% in the U.S. with same store sales growth of 2% to 3% and leverage of our General and Administrative infrastructure.

**Drive High Return on Invested Capital & Strong Shareholder Payout** The Company is focused on delivering high returns and returning substantial cash flows to its shareholders via share repurchases and dividends. The Company has one of the highest returns on invested capital in the Quick Service Restaurants ( QSR ) industry. The Company is targeting an annual dividend payout ratio of 35% to 40% of net income.

### Quarter Ended September 8, 2007 Highlights

Diluted earnings per share of \$0.50 or 20% growth.

Worldwide system-same-store sales growth of 4%, including 11% growth in mainland China, 7% growth in the International Division, and 1% growth in the U.S.

Double-digit system-sales growth from: mainland China, 33%; International Division, 16%.

Continued international restaurant unit growth: mainland China, 20%; International Division, 4%, the nineteenth consecutive quarter of at least 3% year-over-year unit growth, our ongoing growth target.

Worldwide operating-profit growth of 16% led by our international divisions: China Division, 28%, and International Division, 21%.

Worldwide operating margin improved by 0.5 percentage points to 15.6%.

Average diluted shares outstanding were reduced by 2%, the thirteenth consecutive quarter with year-over-year share reduction as a result of substantial share buybacks.

All preceding comparisons are versus the same quarter a year ago.

### **Significant Known Events, Trends or Uncertainties Impacting or Expected to Impact Comparisons of Reported or Future Results**

The following factors impacted comparability of operating performance for the quarters and/or years to date ended September 8, 2007 and September 9, 2006 and/or could impact comparability with the remainder of our results in 2007 or beyond. Certain of these factors were previously discussed in our 2006 Form 10-K.

### U.S. Restaurant Profit

## Edgar Filing: YUM BRANDS INC - Form 10-Q

Our U.S. restaurant margin as a percentage of sales decreased by 1.1 percentage points and 1.2 percentage points for the quarter and year to date ended September 8, 2007, respectively. Declines in restaurant margin as a percentage of sales have negatively impacted U.S. operating profit for both the quarter and year to date ended September 8, 2007.

Higher commodity costs (principally cheese and meats) and higher wage rates, due primarily to state minimum wage laws enacted over the last twelve months, are negatively impacting U.S. restaurant profits in dollar terms. Together these factors negatively impacted U.S. restaurant profit by \$26 million and \$47 million in the third quarter and the year to date ended September 8, 2007, respectively. These decreases in restaurant profits were partially offset by lower self-insured property and casualty insurance expenses, exclusive of the estimated reduction due to refranchising Company stores, in the third quarter (\$3 million) and year to date (\$32 million) ended September 8, 2007. These lower insurance expenses were the result

## Edgar Filing: YUM BRANDS INC - Form 10-Q

of improved loss trends, which we believe are primarily driven by safety and claim handling procedures we have implemented over time, as well as workers' compensation reforms at the state level.

Also contributing to the decreases in restaurant profit were Company same store sales declines at Taco Bell. Our Taco Bell business has been negatively impacted by adverse publicity related to a produce-sourcing issue during November and December 2006 and an infestation issue in one franchise store in February 2007. As a result, Taco Bell has experienced significant sales declines at both Company and franchise stores, particularly in the northeast United States where both issues originated. Taco Bell's Company same store sales were down 6% and 8% for the quarter and year to date ended September 8, 2007, respectively. We expect Taco Bell's performance to improve in the fourth quarter of 2007. While we believe that Taco Bell will fully recover from these issues and generate strong fiscal 2008 results, our experience has been that recoveries of this type vary in duration.

### Mainland China Commodity Inflation

China Division restaurant margin as a percentage of sales declined to 23.2% in the quarter ended September 8, 2007 from 23.7% in the quarter ended September 9, 2006. This decline was driven by rising chicken costs, which make up approximately 40% of mainland China's cost of food and paper, and higher restaurant labor costs in mainland China. Rising chicken costs are resulting from both increased demand and lower than expected availability in the market. In mainland China, we expect that commodity inflation (primarily from higher chicken costs) and labor inflation (primarily from higher wage rates) will result in up to a two percentage point decline in China Division's fourth quarter 2007 restaurant margin as a percentage of sales as compared to the fourth quarter of 2006.

### U.S. Beverage Agreement Contract Termination

During the quarter ended March 25, 2006 we entered into an agreement with a beverage supplier to certain of our Concepts to terminate a long-term supply contract. As a result of the cash payment we made to the supplier in connection with this termination, we recorded a pre-tax charge of \$8 million to Other (income) expense in the quarter ended March 25, 2006. The affected Concepts have entered into an agreement with an alternative beverage supplier. The contract termination charge we recorded in the quarter ended March 25, 2006 was partly offset by more favorable beverage pricing for our Concepts in 2006. We expect to continue to benefit from the more favorable pricing in 2007 and beyond.

### Pizza Hut United Kingdom Acquisition

On September 12, 2006, we completed the acquisition of the remaining fifty percent ownership interest of our Pizza Hut United Kingdom ( U.K. ) unconsolidated affiliate from our partner, paying approximately \$178 million in cash, including transaction costs and net of \$9 million of cash assumed. Additionally, we assumed the full liability, as opposed to our fifty percent share, associated with the Pizza Hut U.K.'s capital leases of \$95 million and short-term borrowings of \$23 million. This unconsolidated affiliate operated more than 500 restaurants in the U.K.

Prior to the acquisition, we accounted for our fifty percent ownership interest using the equity method of accounting. Thus, we reported our fifty percent 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 franchise fee income from the stores owned by the unconsolidated affiliate. Since the date of the acquisition, we have reported Company sales and the associated restaurant costs, general and administrative expense, interest expense and income taxes associated with the restaurants previously owned by the unconsolidated affiliate in the appropriate line items of our Condensed Consolidated Statements of Income. We no longer record franchise fee income for the restaurants previously owned by the unconsolidated affiliate nor do we report other income under the equity method of accounting. As a result of this acquisition, Company sales and

Edgar Filing: YUM BRANDS INC - Form 10-Q

restaurant profit increased \$179 million and \$20 million, respectively, franchise fees decreased \$5 million and general and

## Edgar Filing: YUM BRANDS INC - Form 10-Q

administrative expenses increased \$10 million in the quarter ended September 8, 2007 compared to the quarter ended September 9, 2006. Additionally, Company sales and restaurant profit increased \$516 million and \$53 million, respectively, franchise fees decreased \$17 million and general and administrative expenses increased \$29 million in the year to date ended September 8, 2007 compared to the year to date ended September 9, 2006. The impacts on operating profit and net income were not significant.

### Mainland China Tax Legislation

On March 16, 2007, the National People's Congress in mainland China enacted new tax legislation that will go into effect on January 1, 2008. Upon enactment, which occurred in the China Division's second fiscal quarter, the deferred tax balances of all Chinese entities, including our unconsolidated affiliates, were adjusted. The impacts on our income tax provision and operating profit in the quarter and year to date ended September 8, 2007 were not significant. We are in the process of analyzing the impact of the new tax legislation on the Company in future years and anticipate the issuance of additional interpretive guidance from the Chinese government. Based on information currently available, we believe that these income tax rate changes will positively impact our 2008 net income by approximately \$10 million to \$15 million. The impact of this reduced tax rate in 2008 and beyond has previously been factored into our ongoing earnings growth model.

### Store Portfolio Strategy

From time to time we sell Company restaurants to existing and new franchisees where geographic synergies can be obtained or where franchisees' expertise can generally be leveraged to improve our overall operating performance while retaining Company ownership of strategic U.S. and international markets. In the U.S. we are in the process of decreasing our Company ownership of restaurants from its current level of 22% to approximately 17%. This three-year plan calls for selling approximately 1,500 Company restaurants to franchisees from 2006 through 2008. From the beginning of 2006 through the quarter ended September 8, 2007, 670 Company restaurants in the U.S. have been sold to franchisees as part of this plan including 71 U.S. restaurants in the third quarter 2007. In the International Division, we expect to reduce our Company ownership of Pizza Huts in the United Kingdom over the next several years from approximately 80% currently to approximately 40%. Refranchising reduces our reported revenues and restaurant profits and increase the importance of system sales growth as a key performance measure. Additionally, G&A expenses will decline over time as a result of these refranchising activities. The timing of such declines will vary and often lag the actual refranchising activities as the synergies are typically dependent upon the size and geography of the respective deals. G&A expenses included in the tables below reflect only direct G&A that we are no longer incurring as a result of stores that were operated by us for all or some of the comparable period in 2006 and were refranchised as of September 8, 2007.

The following table summarizes our worldwide refranchising activities:

	Quarter		Year to date	
	9/8/07	9/9/06	9/8/07	9/9/06
Number of units refranchised	94	157	285	289
Refranchising proceeds, pre-tax	\$ 18	\$ 48	\$ 83	\$ 96
Refranchising (gain) loss, pre-tax	\$	\$ 4	\$(5)	\$(7)

In addition to our refranchising program, from time to time we close restaurants that are poor performing, we relocate restaurants to a new site within the same trade area or we consolidate two or more of our existing units into a single unit (collectively store closures). Store closure (income) costs includes 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.



Edgar Filing: YUM BRANDS INC - Form 10-Q

The following table summarizes worldwide Company store closure activities:

	Quarter		Year to date	
	9/8/07	9/9/06	9/8/07	9/9/06
Number of units closed	40	47	117	122
Store closure (income) costs	\$(6 )	\$(4 )	\$(12 )	\$(1 )

The impact on operating profit arising from refranchising and Company store closures is the net of (a) the estimated reductions in restaurant profit, which reflects the decrease in Company sales, and general and administrative expenses and (b) the estimated increase in franchise fees from the stores refranchised. The amounts presented below reflect the estimated impact from stores that were operated by us for all or some portion of the comparable period in 2006 and were no longer operated by us as of September 8, 2007. The amounts do not include results from new restaurants that we opened in connection with a relocation of an existing unit or any incremental impact upon consolidation of two or more of our existing units into a single unit.

The following table summarizes the estimated impact on revenue of refranchising and Company store closures:

	Quarter ended 9/8/07			
	International		China	
	U.S.	Division	Division	Worldwide
Decreased Company sales	\$(104 )	\$(40 )	\$(11 )	\$ (155 )
Increased franchise and license fees	4	2		6
Decrease in total revenues	\$(100 )	\$(38 )	\$(11 )	\$ (149 )
	Year to date ended 9/8/07			
	International		China	
	U.S.	Division	Division	Worldwide
Decreased Company sales	\$(325 )	\$(117 )	\$(25 )	\$ (467 )
Increased franchise and license fees	14	6		20
Decrease in total revenues	\$(311 )	\$(111 )	\$(25 )	\$ (447 )

The following table summarizes the estimated impact on operating profit of refranchising and Company store closures:

	Quarter ended 9/8/07			
	International		China	
	U.S.	Division	Division	Worldwide
Decreased restaurant profit	\$(7 )	\$(1 )	\$(2 )	\$ (10 )
Increased franchise and license fees	4	2		6
Decreased general and administrative expenses	2	2		4
Increase (decrease) in operating profit	\$(1 )	\$3	\$(2 )	\$





Edgar Filing: YUM BRANDS INC - Form 10-Q

	Year to date ended 9/8/07			
	U.S.	International	China	Worldwide
Decreased restaurant profit	\$ (30 )	\$ (5 )	\$ (4 )	\$ (39 )
Increased franchise and license fees	14	6		20
Decreased general and administrative expenses	5	3		8
Increase (decrease) in operating profit	\$ (11 )	\$ 4	\$ (4 )	\$ (11 )

**Results of Operations**

	Quarter 9/8/07	9/9/06	% B/(W)	Year to date 9/8/07	9/9/06	% B/(W)
Company sales	\$ 2,243	\$ 1,989	13	\$ 6,258	\$ 5,720	9
Franchise and license fees	321	289	11	896	825	9
Total revenue	\$ 2,564	\$ 2,278	13	\$ 7,154	\$ 6,545	9
Company restaurant profit	\$ 353	\$ 321	10	\$ 951	\$ 906	5
% of Company sales	15.7%	16.1%	(0.4 ) ppts.	15.2%	15.8%	(0.6 ) ppts.
Operating profit	401	344	16	1,027	933	10
Interest expense, net	38	34	(12 )	112	105	(7 )
Income tax provision	93	80	(15 )	237	236	
Net income	\$ 270	\$ 230	17	\$ 678	\$ 592	15
Diluted earnings per share <sup>(a)</sup>	\$ 0.50	\$ 0.42	20	\$ 1.24	\$ 1.05	18

(a) See Note 3 for the number of shares used in this calculation.

**Restaurant Unit Activity**

<u>Worldwide</u>	Company	Unconsolidated Affiliates	Franchisees	Total Excluding Licensees <sup>(a)(b)</sup>
Beginning of year	7,736	1,206	23,516	32,458
New Builds	254	70	648	972

Edgar Filing: YUM BRANDS INC - Form 10-Q

Acquisitions	9		2		(10	)	1	
Refranchising	(285	)	(5	)	290			
Closures	(117	)	(14	)	(444	)	(575	)
Other	(1	)			3		2	
End of quarter	7,596		1,259		24,003		32,858	
% of Total	23%		4%		73%		100%	

Edgar Filing: YUM BRANDS INC - Form 10-Q

<u>United States</u>	Company	Unconsolidated		Total Excluding
		Affiliates	Franchisees	Licenseses <sup>(a)</sup>
Beginning of year	4,212		13,905	18,117
New Builds	31		156	187
Acquisitions	8		(7 )	1
Refranchising	(218 )		218	
Closures	(62 )		(245 )	(307 )
Other	(1 )		2	1
End of quarter	3,970		14,029	17,999
% of Total	22%	%	78%	100%

<u>International Division</u>	Company	Unconsolidated		Total Excluding
		Affiliates	Franchisees	Licenseses <sup>(a)(b)</sup>
Beginning of year	1,762	561	9,387	11,710
New Builds	32	10	473	515
Acquisitions	1	2	(3 )	
Refranchising	(62 )	(5 )	67	
Closures	(34 )	(6 )	(193 )	(233 )
Other			1	1
End of quarter	1,699	562	9,732	11,993
% of Total	14%	5%	81%	100%

<u>China Division</u>	Company	Unconsolidated		Total Excluding
		Affiliates	Franchisees	Licenseses <sup>(a)</sup>
Beginning of year	1,762	645	224	2,631
New Builds	191	60	19	270
Acquisitions				
Refranchising	(5 )		5	
Closures	(21 )	(8 )	(6 )	(35 )
Other				
End of quarter	1,927	697	242	2,866
% of Total	67%	24%	9%	100%

- (a) The Worldwide, U.S. and International Division totals exclude 2,059, 1,873 and 186 licensed units, respectively, at September 8, 2007. There are no licensed units in the China Division. Licensed units are generally units that offer limited menus and operate in non-traditional locations like malls, airports, gasoline service stations, convenience stores, stadiums and amusement parks where a full scale traditional outlet would not be practical or efficient. As licensed units have lower average unit sales volumes than our traditional units and our current strategy does not place a significant emphasis on expanding our licensed units, we do not believe that providing further detail of licensed unit activity provides significant or meaningful information.

## Edgar Filing: YUM BRANDS INC - Form 10-Q

- (b) The Worldwide and International Division totals exclude approximately 35 units from the acquisition of the Rostik's brand (see 2006 Form 10-K) that have not yet been co-branded into Rostik's/KFC restaurants. The Rostik's units will be presented as franchisee new builds as the co-branding into Rostik's/KFC restaurants occurs.

Multibrand restaurants are included in the totals above. Multibrand conversions increase the sales and points of distribution for the second brand added to a restaurant but do not result in an additional unit count. Similarly, a new multibrand restaurant, while increasing sales and points of distribution for two brands, results in just one additional unit count. Franchise unit counts below include both franchisee and unconsolidated affiliate multibrand units. Following are multibrand restaurant totals at September 8, 2007 and December 30, 2006:

<u>9/8/07</u>	Company	Franchise	Total	
United States	1,747	1,818	3,565	
International Division	6	271	277	(a)
Worldwide	1,753	2,089	3,842	

<u>12/30/06</u>	Company	Franchise	Total
United States	1,802	1,631	3,433
International Division	11	192	203
Worldwide	1,813	1,823	3,636

(a) Includes 53 Pizza Hut Wing Street units that were not reflected as multibrand units at December 30, 2006.

For the year to date ended September 8, 2007, Company and franchise multibrand unit gross additions were 41 and 144, respectively. There are no multibrand units in the China Division.

### System Sales Growth

Quarter	Increase/(Decrease)		Increase excluding currency translation	
	9/8/07	9/9/06	9/8/07	9/9/06
United States	2%	(1)%	N/A	N/A
International Division	16%	10%	11%	9%
China Division	31%	28%	23%	25%
Worldwide	9%	5%	7%	4%

The explanations that follow for system sales fluctuations consider year over year changes excluding the impact of foreign currency translation.

The increase in U.S., China Division, and Worldwide system sales were all driven by new unit development and same store sales growth, partially offset by store closures.

The increase in International Division system sales was driven by same store sales growth and new unit development, partially offset by store closures.



Edgar Filing: YUM BRANDS INC - Form 10-Q

Year to date	Increase/(Decrease)		Increase excluding currency translation	
	9/8/07	9/9/06	9/8/07	9/9/06
United States	%	2%	N/A	N/A
International Division	15%	6%	10%	7%
China Division	27%	26%	21%	23%
Worldwide	7%	5%	5%	5%

The explanations that follow for system sales fluctuations consider year over year changes excluding the impact of foreign currency translation.

U.S. system sales were flat as store closures and same store sales declines were offset by new unit development.

The increase in International Division system sales was driven by same store sales growth and new unit development, partially offset by store closures.

The increases in China Division and Worldwide system sales were driven by new unit development and same store sales growth, partially offset by store closures.

**Revenues**

Quarter	Amount		% Increase/(Decrease)	% Increase/(Decrease)
				excluding currency translation
	9/8/07	9/9/06		
Company sales				
United States	\$ 1,059	\$ 1,145	(8 )	N/A
International Division	603	399	51	44
China Division	581	445	30	24
Worldwide	2,243	1,989	13	10
Franchise and license fees				
United States	165	155	6	N/A
International Division	137	119	15	9
China Division	19	15	35	27
Worldwide	321	289	11	8
Total revenues				
United States	1,224	1,300	(6 )	N/A
International Division	740	518	43	36
China Division	600	460	31	24
Worldwide	\$ 2,564	\$ 2,278	13	10

The explanations that follow for revenue fluctuations consider year over year changes excluding the impact of foreign currency translation.



## Edgar Filing: YUM BRANDS INC - Form 10-Q

Excluding the favorable impact of the Pizza Hut U.K. acquisition, Worldwide Company sales increased 1%. The increase was driven by new unit development and same store sales growth, partially offset by refranchising and store closures.

Excluding the unfavorable impact of the Pizza Hut U.K. acquisition, Worldwide franchise and license fees increased 10%. The increase was driven by new unit development, same store sales growth and refranchising, partially offset by store closures.

The decrease in U.S. Company sales was driven by refranchising and store closures, partially offset by new unit development.

Blended U.S. Company same store sales decreased 1% due to a decrease in transactions, partially offset by an increase in average guest check.

The increase in U.S. franchise and license fees was driven by refranchising and new unit development, partially offset by store closures.

Excluding the favorable impact of the Pizza Hut U.K. acquisition, International Division Company sales were flat as the impact of refranchising and store closures was offset by same store sales growth and new unit development.

Excluding the unfavorable impact of the Pizza Hut U.K. acquisition, International Division franchise and license fees increased 13%. The increase was driven by new unit development, same store sales growth and refranchising, partially offset by store closures.

The increases in China Division Company sales and franchise and license fees were driven by new unit development and same store sales growth.

Year to date	Amount		% Increase/(Decrease)	% Increase/(Decrease)
	9/8/07	9/9/06		excluding currency translation
<b>Company sales</b>				
United States	\$3,170	3,515	(10 )	N/A
International Division	1,737	1,139	53	46
China Division	1,351	1,066	27	21
Worldwide	6,258	5,720	9	7
<b>Franchise and license fees</b>				
United States	472	454	4	N/A
International Division	380	337	13	9
China Division	44	34	31	25
Worldwide	896	825	9	7
<b>Total revenues</b>				
United States	3,642	3,969	(8 )	N/A
International Division	2,117	1,476	43	38



Edgar Filing: YUM BRANDS INC - Form 10-Q

China Division	1,395	1,100	27	21
Worldwide	\$7,154	\$6,545	9	7

## Edgar Filing: YUM BRANDS INC - Form 10-Q

The explanations that follow for revenue fluctuations consider year over year changes excluding the impact of foreign currency translation.

Excluding the favorable impact of the Pizza Hut U.K. acquisition, Worldwide Company sales decreased 2%. The decrease was driven by refranchising and store closures, partially offset by new unit development and same stores sales growth.

Excluding the unfavorable impact of the Pizza Hut U.K. acquisition, Worldwide franchise and license fees increased 9%. The increase was driven by new unit development, refranchising and same store sales growth, partially offset by store closures.

The decrease in U.S. Company sales was driven by refranchising, same store sales declines and store closures, partially offset by new unit development.

Blended U.S. Company same store sales decreased 3% due to a decrease in transactions, partially offset by an increase in average guest check.

The increase in U.S. franchise and license fees was driven by refranchising and new unit development, partially offset by store closures and same store sales declines.

Excluding the favorable impact of the Pizza Hut U.K. acquisition, International Division Company sales increased 1%. The increase was driven by same store sales growth and new unit development, partially offset by refranchising and store closures.

Excluding the unfavorable impact of the Pizza Hut U.K. acquisition, International Division franchise and license fees increased 14%. The increase was driven by new unit development, same store sales growth and refranchising, partially offset by store closures.

The increase in China Division Company sales and franchise and license fees were driven by new unit development and same store sales growth.

### Company Restaurant Margins

<u>Quarter ended 9/8/07</u>	United States		International Division		China Division		Worldwide	
	100.0	%	100.0	%	100.0	%	100.0	%
Company sales	29.4		29.9		36.0		31.2	
Food and paper	30.4		25.7		11.7		24.3	
Payroll and employee benefits	27.2		31.2		29.1		28.8	
Occupancy and other operating expenses	13.0	%	13.2	%	23.2	%	15.7	%
Company restaurant margin								

<u>Quarter ended 9/9/06</u>	United States		International Division		China Division		Worldwide	
-----------------------------	---------------	--	---------------------------	--	-------------------	--	-----------	--

Edgar Filing: YUM BRANDS INC - Form 10-Q

Company sales	100.0	%	100.0	%	100.0	%	100.0	%
Food and paper	27.8		33.0		35.0		30.5	
Payroll and employee benefits	30.2		23.8		11.4		24.7	
Occupancy and other operating expenses	27.9		29.8		29.9		28.7	
Company restaurant margin	14.1	%	13.4	%	23.7	%	16.1	%

The decrease in U.S. restaurant margin as a percentage of sales was driven by higher commodity costs (primarily cheese and meat) and higher labor costs (primarily wage rates and benefits). The decrease was

## Edgar Filing: YUM BRANDS INC - Form 10-Q

partially offset by the favorable impact on restaurant margin of refranchising and closing certain restaurants as well as the impact of same store sales on restaurant margin (due to higher average guest check).

The decrease in International Division restaurant margin as a percentage of sales was driven by higher labor costs (primarily wage rates) and the impact of lower margins associated with Pizza Hut units in the U.K. which we now operate. The decrease was partially offset by the impact of same store sales growth on restaurant margin and the favorable impact on restaurant margin of refranchising certain restaurants. As a percentage of sales, Pizza Hut U.K. units negatively impacted payroll and employee benefits and occupancy and other operating expenses and positively impacted food and paper.

The decrease in China Division restaurant margin as a percentage of sales was driven by higher commodity costs (primarily chicken), higher labor costs and the impact of lower margins associated with new units during the initial periods of operations. The decrease was partially offset by the impact of same store sales growth on restaurant margin.

<u>Year to date ended 9/8/07</u>	United States		International		China		Worldwide	
		%		%		%		%
Company sales	100.0	%	100.0	%	100.0	%	100.0	%
Food and paper	29.0		29.8		35.9		30.8	
Payroll and employee benefits	30.3		26.0		12.7		25.3	
Occupancy and other operating expenses	26.8		31.5		29.9		28.7	
Company restaurant margin	13.9	%	12.7	%	21.5	%	15.2	%

<u>Year to date ended 9/9/06</u>	United States		International		China		Worldwide	
		%		%		%		%
Company sales	100.0	%	100.0	%	100.0	%	100.0	%
Food and paper	28.2		33.2		35.4		30.5	
Payroll and employee benefits	30.0		24.0		12.5		25.6	
Occupancy and other operating expenses	26.7		30.0		30.5		28.1	
Company restaurant margin	15.1	%	12.8	%	21.6	%	15.8	%

The decrease in U.S. restaurant margin as a percentage of sales was driven by higher commodity costs (primarily cheese and meat), the impact of same store sales declines on restaurant margin and higher labor costs (primarily wage rates and benefits). The decrease was partially offset by the favorable impact of lower property and casualty insurance expense driven by improved loss trends and the favorable impact on restaurant margin of refranchising and closing certain restaurants.

The decrease in International Division restaurant margin as a percentage of sales was driven by higher labor costs (primarily wage rates) and the impact of lower margins associated with Pizza Hut units in the U.K. which we now operate. The decrease was almost fully offset by the impact of same store sales growth on restaurant margin and the favorable impact on restaurant margin of refranchising certain restaurants. As a percentage of sales, Pizza Hut U.K. units negatively impacted payroll and employee benefits and occupancy and other operating expenses and positively impacted food and paper.

The decrease in China Division restaurant margin as a percentage of sales was driven by higher commodity costs (primarily chicken), the impact of lower margins associated with new units during the initial periods of operation and higher labor costs. The decrease was almost fully offset by the impact of same store sales growth on restaurant margin.



**Worldwide General and Administrative Expenses**

General and administrative ( G&A ) expenses increased \$10 million or 4% in the quarter, including a 2% unfavorable impact of foreign currency translation. Excluding the additional G&A expenses associated with acquiring the Pizza Hut U.K. business (which were previously netted within equity income prior to our acquisition of the remaining fifty percent of the business) and the unfavorable impact of foreign currency translation, G&A expenses decreased 2% for the quarter. The decrease was driven by lower costs in the U.S. principally due to lapping higher prior year conference and project spending as well as reductions resulting from our U.S. refranchising plan. These decreases were partially offset by higher compensation costs, including amounts associated with strategic initiatives in China and other international growth markets.

General and administrative expenses increased \$41 million or 5% year to date, including a 1% unfavorable impact of foreign currency translation. Excluding the additional G&A expenses associated with acquiring the Pizza Hut U.K. business (which were previously netted within equity income prior to our acquisition of the remaining fifty percent of the business) and the unfavorable impact of foreign currency translation, G&A expenses were flat. Higher compensation costs, including amounts associated with strategic initiatives in China and other international growth markets, were offset by reductions of G&A expenses resulting from our U.S. refranchising plan and the impact of lapping higher prior year litigation related costs.

**Worldwide Other (Income) Expense**

	Quarter 9/8/07	9/9/06	Year to date 9/8/07	9/9/06
Equity income from investments in unconsolidated affiliates	\$ (19 )	\$ (16 )	\$ (40 )	\$ (37 )
Gain upon sale of investment in unconsolidated affiliate <sup>(a)</sup>	(1 )	(2 )	(6 )	(2 )
Contract termination charge <sup>(b)</sup>				8
Foreign exchange net (gain) loss and other	1	1	(1 )	(2 )
Other (income) expense	\$ (19 )	\$ (17 )	\$ (47 )	\$ (33 )

(a) Reflects recognition of income associated with receipt of payments for a note receivable arising from the 2005 sale of our fifty percent interest in the entity that operated almost all KFCs and Pizza Huts in Poland and the Czech Republic to our then partner in the entity.

(b) Reflects an \$8 million charge associated with the termination of a beverage agreement in the United States segment.

**Worldwide Closure and Impairment (Income) Expense and Refranchising (Gain) Loss**

See the Store Portfolio Strategy section for more detail of our refranchising and closure activities and Note 7 for a summary of the components of facility actions by reportable operating segment.



**Operating Profit**

	Quarter			Year to date		
	9/8/07	9/9/06	% B/(W)	9/8/07	9/9/06	% B/(W)
United States	\$187	\$183	1	\$543	\$565	(4 )
International Division	127	105	21	347	288	21
China Division	135	105	28	276	220	25
Unallocated and corporate expenses	(48 )	(47 )	(5 )	(148 )	(151 )	2
Unallocated other income (expense)		2	NM	4	4	NM
Unallocated refranchising gain (loss)		(4 )	NM	5	7	NM
Operating profit	\$401	\$344	16	\$1,027	\$933	10
United States operating margin	15.2%	14.2%	1.0 ppts.	14.9%	14.2%	0.7 ppts.
International Division operating margin	17.2%	20.2%	(3.0 ) ppts.	16.4%	19.5%	(3.1 ) ppts.
Worldwide operating margin	15.6%	15.1%	0.5 ppts.	14.4%	14.3%	0.1 ppts.

Unallocated and corporate expenses comprise general and administrative expenses, which are not allocated to the U.S., International Division, or China Division segments for performance reporting purposes. Year to date unallocated and corporate expense decreased due to the impact of lapping higher prior year litigation related costs.

U.S. operating profit increased 1% in the third quarter. The increase in U.S. operating profit for the quarter was driven by lower G&A expenses and the impact of same store sales (due to higher guest check) on restaurant profit and franchise and license fees. These increases were partially offset by higher restaurant operating costs, principally commodities and labor.

U.S. operating profit decreased 4% year to date. The decrease in U.S. operating profit for the year to date was driven by the impact of same store sales declines on restaurant profit and higher restaurant operating costs, principally commodities and labor. These declines were partially offset by lower G&A expenses, lower closure and impairment expense and the lapping of a prior year charge associated with the termination of a beverage agreement in 2006.

Excluding the favorable impact from foreign currency translation, International Division operating profit increased 14% in the quarter and 16% year to date. The increases were driven by the impact of same store sales growth and new unit development on franchise and license fees and restaurant profit. The increases were partially offset by higher G&A expenses (including expenses which were previously netted within equity income prior to our acquisition of the remaining fifty percent of the Pizza Hut U.K. business) and higher restaurant operating costs.

Excluding the favorable impact from foreign currency translation, China Division operating profit increased 20% in the quarter and 19% year to date. The increases were driven by the impact of same store sales growth and new unit development on restaurant profit. The increase was partially offset by higher restaurant operating costs and higher G&A expenses.





**Interest Expense, Net**

	Quarter			Year to date		
	9/8/07	9/9/06	% B/(W)	9/8/07	9/9/06	% B/(W)
Interest expense	\$44	\$ 40	(11 )	\$ 130	\$ 116	(13 )
Interest income	(6 )	(6 )	NM	(18 )	(11 )	NM
Interest expense, net	\$38	\$ 34		\$112	\$105	

Interest expense increased \$4 million or 11% for the quarter and \$14 million or 13% year to date. These increases were driven by an increase in borrowings compared to prior year, including the capital leases associated with the Pizza Hut U.K. acquisition, and higher interest rates on the variable portion of our debt compared to prior year.

**Income Taxes**

	Quarter		Year to date	
	9/8/07	9/9/06	9/8/07	9/9/06
Income taxes	\$93	\$80	\$237	\$236
Effective tax rate	25.5%	25.8%	25.9%	28.5%

Our effective tax rate for the quarter was lower as a result of the mix of our earnings, primarily due to a higher percentage of our income being earned outside of the U.S. This resulted in the reversal of beginning of the year valuation allowances associated with certain foreign tax credits that we deemed more likely than not will be realized as a result of higher foreign earnings as well as a lower current year provision. We also reversed beginning of the year valuation allowances associated with foreign tax credits that we will now realize as a result of the determinations that certain foreign earnings will not be permanently invested. The reversal of valuation allowances as a result of these determinations was offset by tax we provided on those earnings. The decrease in the quarter was in part offset by the lapping of higher prior year adjustments to reserves and prior years.

Our effective rate for the year was favorably impacted by tax reserve reversals and out of year adjustments to reserves and accruals as well as the earnings mix shift as described above. Reserve reversals were due to the expiration of the statute of limitations in certain foreign jurisdictions and settlements of U.S. state audits.

**Consolidated Cash Flows**

Net cash provided by operating activities was \$1,169 million compared to \$1,007 million in 2006. The increase was driven by higher net income and lower pension contributions in 2007.

Net cash used in investing activities was \$256 million versus \$300 million in 2006. The decrease was driven by the year over year change in short term investments, a decrease in acquisition of restaurants from franchisees and the lapping of the acquisition of the Rostik's brand in Russia in 2006, partially offset by an increase in capital spending.

## Edgar Filing: YUM BRANDS INC - Form 10-Q

Net cash used in financing activities was \$734 million versus \$597 million in 2006. The increase was driven by a decrease in net borrowings and higher dividend payments, partially offset by lower share repurchases.

### **Consolidated Financial Condition**

The increase in short-term borrowings was primarily due to the classification of \$250 million in Senior Unsecured Notes as short-term borrowings due to their May 2008 maturity date, partially offset by the

repayment of two term-loans in the International Division during the year to date ended September 8, 2007.

## **Liquidity and Capital Resources**

Operating in the QSR industry allows us to generate substantial cash flows from the operations of our Company stores and from our franchise operations, which require a limited YUM investment. In each of the last five fiscal years, net cash provided by operating activities has exceeded \$1 billion. We expect these levels of net cash provided by operating activities to continue in the foreseeable future. Our discretionary spending includes capital spending for new restaurants, acquisitions of restaurants from franchisees, repurchases of shares of our Common Stock and dividends paid to our shareholders. Unforeseen downturns in our business could adversely impact our cash flows from operations from the levels historically realized. However, we believe our ability to reduce discretionary spending and our borrowing capacity will allow us to meet our cash requirements in 2007 and beyond.

### Discretionary Spending

In the year to date ended September 8, 2007, capital spending has totaled \$391 million, including \$150 million in the U.S., \$106 million for the International Division and \$135 million for the China Division.

During the year to date ended September 8, 2007, we repurchased shares for \$774 million. At September 8, 2007, we had remaining capacity to repurchase up to approximately \$165 million of our outstanding Common Stock (excluding applicable transaction fees) under a March 2007 authorization by our Board of Directors.

On October 8, 2007, our Board of Directors authorized additional share repurchases of up to \$1.25 billion (excluding applicable transaction fees) of our outstanding Common Stock through October 2008. The October 8, 2007 authorization is part of the Company's overall plan to substantially increase the amount of share buybacks over the next two years; buying back a total of up to \$4 billion of the Company's outstanding common stock, reducing our diluted share count by as much as 20%. We expect this two-year share repurchase program will be funded by a combination of the Company's ongoing free cash flow, additional debt and refranchising proceeds. The completion of this plan will depend on the Company's cash flows, credit rating, proceeds from our refranchising efforts and availability of other investment opportunities, among other factors.

During the year to date ended September 8, 2007, we paid cash dividends of \$196 million. Additionally, subsequent to the third quarter, our Board of Directors declared a cash dividend on September 20, 2007, of \$0.15 per share of Common Stock, which will be distributed on November 2, 2007 to shareholders of record at the close of business on October 12, 2007. The Company is targeting an annual dividend payout ratio of 35% to 40% of net income.

### Borrowing Capacity

Our primary bank credit agreement comprises a \$1.0 billion senior unsecured Revolving Credit Facility (the "Credit Facility") which matures in September 2009. At September 8, 2007, our unused Credit Facility totaled \$443 million, net of outstanding letters of credit of \$211 million. There were borrowings of \$346 million outstanding under the Credit Facility at September 8, 2007. We were in compliance with all debt covenants under this facility at September 8, 2007.

## Edgar Filing: YUM BRANDS INC - Form 10-Q

We also have a \$350 million, five-year revolving credit facility (the International Credit Facility or ICF ) which matures in November 2010. There were borrowings of \$146 million outstanding and available credit of \$204 million under the ICF at September 8, 2007. We were in compliance with all debt covenants under the ICF at September 8, 2007.

## Edgar Filing: YUM BRANDS INC - Form 10-Q

In 2006, we executed two term-loans on behalf of the International Division in the amount of \$183 million, both of which were repaid in the quarter ended March 24, 2007.

The majority of our remaining debt primarily comprises Senior Unsecured Notes with varying maturity dates from 2008 through 2016 and interest rates ranging from 6.25% to 8.88%. The Senior Unsecured Notes represent senior, unsecured obligations and rank equally in right of payment with all of our existing and future unsecured unsubordinated indebtedness. Amounts outstanding under Senior Unsecured Notes were \$1.6 billion at September 8, 2007.

### Recently Adopted Accounting Pronouncements

Effective December 31, 2006, we adopted Financial Accounting Standards Board ( FASB ) Interpretation No. 48, Accounting for Uncertainty in Income Taxes ( FIN 48 ), an interpretation of Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes. FIN 48 requires that a position taken or expected to be taken in a tax return be recognized in the financial statements when it is more likely than not (i.e., a likelihood of more than fifty percent) that the position would be sustained upon examination by tax authorities. A recognized tax position is then measured at the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. Upon adoption, we recognized an additional \$13 million for unrecognized tax benefits, which was accounted for as a reduction to our opening balance of retained earnings on December 31, 2006. Subsequent to this adjustment, we had \$283 million of unrecognized tax benefits at December 31, 2006, \$185 million of which, if recognized, would affect the effective income tax rate.

FIN 48 also requires that changes in judgment that result in subsequent recognition, derecognition or change in a measurement of a tax position taken in a prior annual period (including any related interest and penalties) be recognized as a discrete item in the period in which the change occurs. Prior to the adoption of FIN 48, we recorded such changes in judgment, including audit settlements, as a component of our annual effective rate. This change will not impact the manner in which we record income taxes on an annual basis.

The Company recognizes interest and penalties accrued related to unrecognized tax benefits and penalties as components of its Income tax provision. The Company had approximately \$74 million for the payment of interest and penalties accrued at December 31, 2006.

The major jurisdictions in which the Company files income tax returns include the U.S. federal jurisdiction, China, the United Kingdom, Mexico and Australia. Upon adoption of FIN 48, the earliest years that the Company was subject to examination in these jurisdictions were 1999 in the U.S., 2003 in China, 2000 in the United Kingdom, 2001 in Mexico and 2001 in Australia. In addition, the Company is subject to various U.S. state income tax examinations, for which, in the aggregate, we had significant unrecognized tax benefits at December 31, 2006. We anticipate that our recorded uncertain tax benefits for certain tax positions we have taken may increase or decrease during the remainder of 2007 as a result of the continuation of these and other examinations. However, given the status of these examinations we cannot reliably estimate a range of a potential change at this time. Upon completion of audit examinations and the expiration of certain statutes of limitation during the quarter ended June 16, 2007, the Company's aggregate, unrecognized tax benefits recorded at December 31, 2006 were reduced by \$8 million and the amount accrued for payment of interest and penalties for unrecognized tax benefits was reduced by \$21 million. As a result of these reductions, our recorded Income tax provision was \$18 million lower for the year to date ended September 8, 2007.

In June 2006, the FASB ratified the Emerging Issues Task Force ( EITF ) issue 06-3, How Taxes Collected From Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is Gross Versus Net Presentation) ( EITF 06-3 ). EITF 06-3 addresses income statement presentation and disclosure requirements for taxes assessed by a governmental authority that are directly imposed on and concurrent with a revenue-producing transaction between a seller and a



## Edgar Filing: YUM BRANDS INC - Form 10-Q

customer, including sales, use, value-added and some excise taxes. EITF 06-3 permits such taxes to be presented on either a gross basis (included in revenues and costs) or on a net basis (excluded from revenues). The Company has historically presented and will continue to present such taxes on a net basis.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

There were no material changes during the quarter ended September 8, 2007 to the disclosures made in Item 7A of the Company's 2006 Form 10-K, except as follows.

In anticipation of issuing fixed-rate debt in the fourth quarter of 2007, we entered into forward starting interest rate swaps ( "interest rate swaps" ) during the quarter ended September 8, 2007. These interest rate swaps had an aggregate notional amount of \$400 million and were designated as hedges of the risk of changes in future interest payments attributable to changes in the London Interbank Offered Rate prior to the issuance of the debt. As of September 8, 2007, the fair values of these interest rate swaps were in a liability position of \$33 million. As the ineffective portion of these interest rate swaps recognized in our Condensed Consolidated Statement of Income for the quarter ended September 8, 2007 was not significant, the offset to this liability was almost entirely recognized in Accumulated Other Comprehensive Loss at September 8, 2007. Upon the issuance of the debt and settlement of the interest rate swaps, any gain or loss on the interest rate swaps at that time not previously recognized in our Condensed Consolidated Statement of Income will be amortized over the life of the anticipated debt issuance as a decrease or increase, respectively, in interest expense. As of October 12, 2007, the fair values of these interest rate swaps had decreased to a liability position of \$21 million.

### Item 4. Controls and Procedures

#### Evaluation of Disclosure Controls and Procedures

The Company has evaluated the effectiveness of the design and operation of its disclosure controls and procedures pursuant to Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 as of the end of the period covered by this report. Based on the evaluation, performed under the supervision and with the participation of the Company's management, including the Chairman, Chief Executive Officer and President (the "CEO") and the Chief Financial Officer (the "CFO"), the Company's management, including the CEO and CFO, concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by the report.

#### Changes in Internal Control

There were no changes with respect to the Company's internal control over financial reporting or in other factors that materially affected, or are reasonably likely to materially affect, internal control over financial reporting during the quarter ended September 8, 2007.

### Cautionary Note Regarding Forward-Looking Statements



## Edgar Filing: YUM BRANDS INC - Form 10-Q

This report may contain forward-looking statements within the meaning of the U.S. federal securities laws. These forward-looking statements are intended to be covered by the safe harbor provisions for forward-looking statements in the federal securities laws. The statements include those identified by such words as may, will, expect, project, anticipate, believe, plan and other similar terminology. These forward-looking statements reflect our current expectations regarding future events and operating and financial performance and are based upon data available at the time of the statements. Actual results involve risks and uncertainties, including both those specific to us and those specific to the industry, and could differ materially from expectations. These risks and uncertainties include, but are not limited to those described in Part II, Item 1A

Risk Factors in this report, those described under Risk Factors in Part I, Item 1A of our Form 10-K for the year ended December 30, 2006, and those described from time to time in our reports filed with the Securities and Exchange Commission. We do not

## Edgar Filing: YUM BRANDS INC - Form 10-Q

undertake any obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise. You are cautioned not to place undue reliance on forward-looking statements.

**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Shareholders

YUM! Brands, Inc.:

We have reviewed the accompanying Condensed Consolidated Balance Sheet of YUM! Brands, Inc. and Subsidiaries ( YUM ) as of September 8, 2007, the related Condensed Consolidated Statements of Income for the twelve and thirty-six weeks ended September 8, 2007 and September 9, 2006, and the related Condensed Consolidated Statements of Cash Flows for the thirty-six weeks ended September 8, 2007 and September 9, 2006. These Condensed Consolidated Financial Statements are the responsibility of YUM's management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the Condensed Consolidated Financial Statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Consolidated Balance Sheet of YUM as of December 30, 2006, and the related Consolidated Statements of Income, Cash Flows and Shareholders' Equity and Comprehensive Income for the year then ended not presented herein; and in our report dated February 28, 2007, we expressed an unqualified opinion on those Consolidated Financial Statements. In our opinion, the information set forth in the accompanying Condensed Consolidated Balance Sheet as of December 30, 2006, is fairly stated, in all material respects, in relation to the Consolidated Balance Sheet from which it has been derived.

/s/ KPMG LLP  
Louisville, Kentucky  
October 16, 2007

**PART II Other Information and Signatures**

Item 1. Legal Proceedings

Information regarding legal proceedings is incorporated by reference from Note 11 to the Company's Condensed Consolidated Financial Statements set forth in Part I of this report.

Item 1A. Risk Factors

We face a variety of risks that are inherent in our business and our industry, including operational, legal, regulatory and product risks. The following are some of the more significant factors that could affect our business and our results of operations:

Food-borne illness (such as E. coli, hepatitis A., trichinosis or salmonella) concerns, and health concerns arising from outbreaks of Avian Flu, may have an adverse effect on our business;

Our foreign operations, which are significant, subject us to risks that could negatively affect our business such as fluctuations in foreign currency exchange rates and changes in economic conditions, tax systems, consumer preferences, social conditions and political conditions inherent in foreign operations;

Changes in commodity and other operating costs or supply chain and business disruptions could adversely affect our operating results;

Our operating results are closely tied to the success of our franchisees, and any significant inability of our franchisees to operate successfully could adversely affect our operating results;

We could be party to litigation that could adversely affect us by increasing our expenses or subjecting us to material money damages and other remedies;

Changes in governmental regulations may adversely affect our business operations;

We may not attain our target development goals which are dependent upon our ability and the ability of our franchisees to upgrade existing restaurants and open new restaurants and to operate these restaurants on a profitable basis; and

The restaurant industry in which we operate is highly competitive.

These and other risks are described in more detail under "Risk Factors" in Item 1A of our 2006 Form 10-K. We encourage you to read these risk factors in their entirety. Other factors may also exist that we cannot anticipate or that we do not consider to be significant based on information that is currently available.



## Edgar Filing: YUM BRANDS INC - Form 10-Q

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table provides information as of September 8, 2007 with respect to shares of Common Stock repurchased by the Company during the quarter then ended adjusted for the June 26, 2007 two-for-one stock split:

Fiscal Periods	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Approximate dollar value of shares that may yet be purchased under the plans or programs
Period 7 6/17/07 - 7/14/07	2,590,000	\$33.39	2,590,000	\$422,985,181
Period 8 7/15/07 - 8/11/07	2,280,000	\$32.65	2,280,000	\$348,541,639
Period 9 8/12/07 - 9/8/07	5,690,000	\$32.24	5,690,000	\$165,073,811
Total	10,560,000	\$32.61	10,560,000	\$165,073,811

In March 2007, our Board of Directors authorized additional share repurchases, through March 2008, up to an additional \$500 million (excluding applicable transaction fees) of our outstanding Common Stock. For the quarter ended September 8, 2007, approximately 10.6 million shares were repurchased under this authorization.

In October 2007, our Board of Directors authorized additional share repurchases, through October 2008, up to an additional \$1.25 billion (excluding applicable transaction fees) of our outstanding Common Stock. Shares to be purchased under this program are not included in the table above.

### Item 6. Exhibits

- (a) Exhibit Index

#### EXHIBITS

Exhibit 15	Letter from KPMG LLP regarding Unaudited Interim Financial Information (Acknowledgement of Independent Registered Public Accounting Firm).
Exhibit 31.1	Certification of the Chairman, Chief Executive Officer and President pursuant to Rule 13a-14(a) of Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
Exhibit 31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) of Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

Edgar Filing: YUM BRANDS INC - Form 10-Q

Exhibit 32.1

Certification of the Chairman, Chief Executive Officer and President pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

43

Exhibit 32.2

Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.



SIGNATURES

Pursuant to the requirement of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, duly authorized officer of the registrant.

YUM! BRANDS, INC.  
(Registrant)

Date: October 16, 2007

/s/ Ted F. Knopf  
Senior Vice President of Finance

and Corporate Controller  
(Principal Accounting Officer)



**Exhibit 15**

**Acknowledgement of Independent Registered Public Accounting Firm**

The Board of Directors

YUM! Brands, Inc.:

We hereby acknowledge our awareness of the use of our report dated October 16, 2007, included within the Quarterly Report on Form 10-Q of YUM! Brands, Inc. for the twelve and thirty-six weeks ended September 8, 2007, and incorporated by reference in the following Registration Statements:

<u>Description</u>	<u>Registration Statement Number</u>
<b><u>Forms S-3 and S-3/A</u></b>	
Debt Securities	333-133097
YUM! Direct Stock Purchase Program	333-46242
\$2,000,000,000 Debt Securities	333-42969
<b><u>Form S-8s</u></b>	
YUM! Restaurants Puerto Rico, Inc. Save-Up Plan	333-85069
Restaurant Deferred Compensation Plan	333-36877, 333-32050
Executive Income Deferral Program	333-36955
YUM! Long-Term Incentive Plan	333-36895, 333-85073, 333-32046
SharePower Stock Option Plan	333-36961
YUM! Brands 401(k) Plan	333-36893, 333-32048, 333-109300
YUM! Brands, Inc. Restaurant General Manager Stock Option Plan	333-64547
YUM! Brands, Inc. Long-term Incentive Plan	333-32052, 333-109299

Pursuant to Rule 436(c) under the Securities Act of 1933 (the "Act"), such report is not considered part of a registration statement prepared or certified by an independent registered public accounting firm, or a report prepared or certified by an independent registered public accounting firm within the meaning of Sections 7 and 11 of the Act.

/s/ KPMG LLP  
 Louisville, Kentucky  
 October 16, 2007

**Exhibit 31.1**

**CERTIFICATION**

I, David C. Novak, certify that:

1. I have reviewed this report on Form 10-Q of YUM! Brands, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant, as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: October 16, 2007

/s/ David C. Novak

Chairman, Chief Executive Officer and President



**Exhibit 31.2**

**CERTIFICATION**

I, Richard T. Carucci, certify that:

1. I have reviewed this report on Form 10-Q of YUM! Brands, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant, as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: October 16, 2007

/s/ Richard T. Carucci  
Chief Financial Officer

**Exhibit 32.1**

CERTIFICATION OF CHAIRMAN AND CHIEF EXECUTIVE OFFICER

PURSUANT TO

18 U.S.C. SECTION 1350,

AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of YUM! Brands, Inc. (the Company) on Form 10-Q for the quarter ended September 8, 2007, as filed with the Securities and Exchange Commission on the date hereof (the Periodic Report), I, David C. Novak, Chairman, Chief Executive Officer and President of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. the Periodic Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. the information contained in the Periodic Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: October 16, 2007

/s/ David C. Novak\_\_\_\_\_

Chairman, Chief Executive Officer and President

A signed original of this written statement required by Section 906 has been provided to YUM! Brands, Inc. and will be retained by YUM! Brands, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.





**Exhibit 32.2**

CERTIFICATION OF CHIEF FINANCIAL OFFICER

PURSUANT TO

18 U.S.C. SECTION 1350,

AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of YUM! Brands, Inc. (the Company) on Form 10-Q for the quarter ended September 8, 2007, as filed with the Securities and Exchange Commission on the date hereof (the Periodic Report), I, Richard T. Carucci, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. the Periodic Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. the information contained in the Periodic Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: October 16, 2007  
Chief Financial Officer

/s/ Richard T. Carucci

A signed original of this written statement required by Section 906 has been provided to YUM! Brands, Inc. and will be retained by YUM! Brands, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.