

YUM BRANDS INC  
Form 10-Q  
April 25, 2012

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

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934 for the quarterly period ended March 24, 2012

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-13163

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

North Carolina  
(State or other jurisdiction of  
incorporation or organization)

13-3951308  
(I.R.S. Employer  
Identification No.)

1441 Gardiner Lane, Louisville, Kentucky  
(Address of principal executive offices)

40213  
(Zip Code)

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

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

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

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

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Non-accelerated filer:  Smaller reporting company:

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

The number of shares outstanding of the Registrant's Common Stock as of April 20, 2012 was 460,558,880 shares.

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YUM! BRANDS, INC.

INDEX

	Page No.
Part I. Financial Information	
Item 1 - Financial Statements	
Condensed Consolidated Statements of Income - Quarters ended March 24, 2012 and March 19, 2011	<u>3</u>
Condensed Consolidated Statements of Comprehensive Income - Quarters ended March 24, 2012 and March 19, 2011	<u>4</u>
Condensed Consolidated Statements of Cash Flows – Quarters ended March 24, 2012 and March 19, 2011	<u>5</u>
Condensed Consolidated Balance Sheets – March 24, 2012 and December 31, 2011	<u>6</u>
Notes to Condensed Consolidated Financial Statements	<u>7</u>
Item 2 - Management’s Discussion and Analysis of Financial Condition and Results of Operations	<u>20</u>
Item 3 - Quantitative and Qualitative Disclosures about Market Risk	<u>35</u>
Item 4 – Controls and Procedures	<u>35</u>
Report of Independent Registered Public Accounting Firm	<u>36</u>
Part II. Other Information and Signatures	
Item 1 – Legal Proceedings	<u>37</u>
Item 1A – Risk Factors	<u>37</u>
Item 2 - Unregistered Sales of Equity Securities and Use of Proceeds	<u>37</u>
Item 6 – Exhibits	<u>38</u>
Signatures	<u>39</u>

## 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 ended	
	3/24/2012	3/19/2011
Revenues		
Company sales	\$2,344	\$2,051
Franchise and license fees and income	399	374
Total revenues	2,743	2,425
Costs and Expenses, Net		
Company restaurants		
Food and paper	767	662
Payroll and employee benefits	513	461
Occupancy and other operating expenses	624	568
Company restaurant expenses	1,904	1,691
General and administrative expenses	272	255
Franchise and license expenses	26	30
Closures and impairment (income) expenses	1	69
Refranchising (gain) loss	(26	) (2
Other (income) expense	(79	) (19
Total costs and expenses, net	2,098	2,024
Operating Profit	645	401
Interest expense, net	37	43
Income Before Income Taxes	608	358
Income tax provision	147	91
Net Income – including noncontrolling interests	461	267
Net Income – noncontrolling interests	3	3
Net Income – YUM! Brands, Inc.	\$458	\$264
Basic Earnings Per Common Share	\$0.99	\$0.56
Diluted Earnings Per Common Share	\$0.96	\$0.54
Dividends Declared Per Common Share	\$0.285	\$—

See accompanying Notes to Condensed Consolidated Financial Statements.

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

	Quarter ended	
	3/24/2012	3/19/2011
Net income - including noncontrolling interests	\$ 461	\$ 267
Other comprehensive income, net of tax		
Foreign currency translation adjustment (net of tax impact of \$2 million and \$6 million, respectively)	14	48
Reclassification of pension and post-retirement losses to net income (net of tax impact of \$6 million and \$2 million, respectively)	9	5
Net unrealized loss on derivative instruments (net of tax impact of less than \$1 million)	(1)	—
Other comprehensive income, net of tax	22	53
Comprehensive income - including noncontrolling interests	483	320
Comprehensive income - noncontrolling interests	3	3
Comprehensive Income - Yum! Brands, Inc.	\$ 480	\$ 317

See accompanying Notes to Condensed Consolidated Financial Statements.

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

	Quarter ended	
	3/24/2012	3/19/2011
Cash Flows – Operating Activities		
Net Income – including noncontrolling interests	\$461	\$267
Depreciation and amortization	138	123
Closures and impairment (income) expenses	1	69
Refranchising (gain) loss	(26)	(2)
Contributions to defined benefit pension plans	(8)	(3)
Gain upon acquisition of Little Sheep	(74)	—
Deferred income taxes	(4)	(60)
Equity income from investments in unconsolidated affiliates	(13)	(16)
Excess tax benefits from share-based compensation	(28)	(8)
Share-based compensation expense	11	13
Changes in accounts and notes receivable	29	11
Changes in inventories	27	34
Changes in prepaid expenses and other current assets	(15)	(25)
Changes in accounts payable and other current liabilities	(124)	(14)
Changes in income taxes payable	70	85
Other, net	39	34
Net Cash Provided by Operating Activities	484	508
Cash Flows – Investing Activities		
Capital spending	(184)	(173)
Proceeds from refranchising of restaurants	102	14
Acquisitions	(540)	(1)
Proceeds from sales of property, plant and equipment	4	—
Decrease in restricted cash	300	—
Increase in short-term investments	(79)	—
Other, net	(5)	4
Net Cash Used in Investing Activities	(402)	(156)
Cash Flows – Financing Activities		
Repayments of long-term debt	(3)	(4)
Repurchase shares of Common Stock	(78)	(152)
Excess tax benefits from share-based compensation	28	8
Employee stock option proceeds	16	9
Dividends paid on Common Stock	(131)	(118)
Other, net	(20)	(4)
Net Cash Used in Financing Activities	(188)	(261)
Effect of Exchange Rates on Cash and Cash Equivalents	7	12
Net Increase (Decrease) in Cash and Cash Equivalents	(99)	103
Cash and Cash Equivalents - Beginning of Period	1,198	1,426
Cash and Cash Equivalents - End of Period	\$1,099	\$1,529

See accompanying Notes to Condensed Consolidated Financial Statements.



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

	(Unaudited)	
	3/24/2012	12/31/2011
<b>ASSETS</b>		
Current Assets		
Cash and cash equivalents	\$ 1,099	\$ 1,198
Accounts and notes receivable, net	341	286
Inventories	291	273
Prepaid expenses and other current assets	427	338
Deferred income taxes	128	112
Advertising cooperative assets, restricted	139	114
Total Current Assets	2,425	2,321
Property, plant and equipment, net	4,041	4,042
Goodwill	962	681
Intangible assets, net	811	299
Investments in unconsolidated affiliates	33	167
Restricted cash	—	300
Other assets	531	475
Deferred income taxes	540	549
Total Assets	\$9,343	\$8,834
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current Liabilities		
Accounts payable and other current liabilities	\$ 1,752	\$ 1,874
Income taxes payable	181	142
Short-term borrowings	319	320
Advertising cooperative liabilities	139	114
Total Current Liabilities	2,391	2,450
Long-term debt	3,006	2,997
Other liabilities and deferred credits	1,667	1,471
Total Liabilities	7,064	6,918
Shareholders' Equity		
Common Stock, no par value, 750 shares authorized; 460 shares issued in 2012 and 2011	5	18
Retained earnings	2,362	2,052
Accumulated other comprehensive income (loss)	(225)	(247)
Total Shareholders' Equity – YUM! Brands, Inc.	2,142	1,823
Noncontrolling interests	137	93
Total Shareholders' Equity	2,279	1,916
Total Liabilities and Shareholders' Equity	\$9,343	\$8,834

See accompanying Notes to Condensed Consolidated Financial Statements.





NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

(Tabular amounts in millions, except per share data)

Note 1 - Financial Statement Presentation

We have prepared our accompanying unaudited Condensed Consolidated Financial Statements (“Financial Statements”) in accordance with the rules and regulations of the Securities and Exchange Commission (“SEC”) for interim financial information. Accordingly, they do not include all of the information and footnotes required by Generally Accepted Accounting Principles in the United States (“GAAP”) for complete financial statements. Therefore, we suggest that the accompanying Financial Statements be read in conjunction with the Consolidated Financial Statements included in our annual report on Form 10-K for the fiscal year ended December 31, 2011 (“2011 Form 10-K”). Except as disclosed herein, there has been no material change in the information disclosed in our Consolidated Financial Statements included in the 2011 Form 10-K.

YUM! Brands, Inc. and Subsidiaries (collectively referred to as “YUM” or the “Company”) is comprised primarily by the worldwide operations of KFC, Pizza Hut and Taco Bell (collectively the “Concepts”). References to YUM throughout these Notes to our Financial Statements are made using the first person notations of “we,” “us” or “our.”

YUM’s business consists of four reporting segments: YUM Restaurants China (“China” or “China Division”), YUM Restaurants International (“YRI” or “International Division”), United States (“U.S.” or “U.S. Division”) and YUM Restaurants India (“India” or “India Division”). The China Division includes mainland China and the India Division includes India, Bangladesh, Mauritius, Nepal and Sri Lanka. YRI includes the remainder of our international operations.

Beginning the first quarter of 2012, our India Division is being reported as a standalone reporting segment separate from YRI as a result of changes to our management reporting structure. While our consolidated results are not impacted, our historical segment information has been restated to be consistent with the current period presentation.

Our fiscal year ends on the last Saturday in December and, as a result, a 53rd week is added every five or six years. The first three quarters of each fiscal year consist of 12 weeks and the fourth quarter consists of 16 weeks in fiscal years with 52 weeks and 17 weeks in fiscal years with 53 weeks. Our subsidiaries operate on similar fiscal calendars except that certain international subsidiaries operate on a monthly calendar, with two months in the first quarter, three months in the second and third quarters and four months in the fourth quarter. Our international subsidiaries that operate on a monthly calendar, including China and India, are not impacted by the addition of a 53rd week. All of our international businesses except China close one period or one month earlier to facilitate consolidated reporting.

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

In our opinion, the accompanying Financial Statements include all normal and recurring adjustments considered necessary to present fairly, when read in conjunction with our 2011 Form 10-K, our financial position as of March 24, 2012, and the results of our operations, comprehensive income and cash flows for the quarters ended March 24, 2012 and March 19, 2011. Our results of operations, comprehensive income and cash flows for these interim periods are not necessarily indicative of the results to be expected for the full year.

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

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

	Quarter ended	
	3/24/2012	3/19/2011
Net Income – YUM! Brands, Inc.	\$458	\$264
Weighted-average common shares outstanding (for basic calculation)	465	473
Effect of dilutive share-based employee compensation	13	13
Weighted-average common and dilutive potential common shares outstanding (for diluted calculation)	478	486
Basic EPS	\$0.99	\$0.56
Diluted EPS	\$0.96	\$0.54
Unexercised employee stock options and stock appreciation rights (in millions) excluded from the diluted EPS computation <sup>(a)</sup>	1.9	2.3

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

## Note 3 - Shareholders' Equity

Under the authority of our Board of Directors, we repurchased shares of our Common Stock during the quarters ended March 24, 2012 and March 19, 2011, as indicated below. All amounts exclude applicable transaction fees.

Authorization Date	Authorization Expiration Date	Shares Repurchased (thousands)		Dollar Value of Shares Repurchased		Remaining Dollar Value of Shares that may be Repurchased
		2012	2011	2012	2011	2012
March 2010	March 2011	—	2,873	\$—	\$142	\$—
January 2011	June 2012	1,219	—	78	—	110
November 2011	May 2013	—	—	—	—	750
Total		1,219	2,873	\$78	\$142	\$860

<sup>(a)</sup> Amount excludes the effect of \$19 million in share repurchases (0.4 million shares) with trade dates prior to the 2010 fiscal year end but cash settlement dates subsequent to the 2010 fiscal year end and includes the effect of \$9 million in share repurchases (0.2 million shares) with trade dates prior to March 19, 2011 but with settlement dates subsequent to March 19, 2011.

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

## Little Sheep Acquisition

On February 1, 2012 we acquired an additional 66% interest in Little Sheep Group Limited (“Little Sheep”) for \$540 million, net of cash acquired of \$44 million, increasing our ownership to 93%. The acquisition was driven by our strategy to build leading brands across China in every significant category. Prior to our acquisition of this additional interest, our 27% interest in Little Sheep was accounted for under the equity method of accounting. As a result of the acquisition we obtained voting control of Little Sheep, and thus we began consolidating Little Sheep upon acquisition. As required by GAAP, we remeasured our previously held 27% ownership in Little Sheep, which had a recorded value of \$107 million at the date of acquisition, at fair value based on Little Sheep's traded share price immediately prior to our offer and recognized a non-cash gain of \$74 million. This gain, which resulted in no related income tax expense, was recorded in Other (income) expense on our Condensed Consolidated Statement of Income during the quarter ended March 24, 2012 and was not allocated to any segment for performance reporting purposes.

Other than the \$74 million non-cash gain discussed above, the consolidation of Little Sheep did not impact Operating Profit or Net Income - YUM! Brands, Inc. for the quarter ended March 24, 2012. While we have not yet completed our allocation of the purchase price, our Condensed Consolidated Balance Sheet at March 24, 2012 reflects the consolidation of this entity using preliminary amounts, including approximately \$300 million of goodwill and \$500 million of other intangible assets.

The proforma impact on our results of operations if the acquisition had been completed as of the beginning of 2011 would not have been significant.

## LJS and A&amp;W Divestitures

During the fourth quarter of 2011 we sold the Long John Silver's and A&W All American Food Restaurants brands to key franchise leaders and strategic investors in separate transactions. During the quarter ended March 19, 2011 we recognized \$68 million of pre-tax losses and other costs primarily in Closures and impairment (income) expenses as a result of our decision to sell these businesses. In the full year 2011, these businesses contributed 5% and 1% to Franchise and license fees and income for the U.S. and YRI segments, respectively. While these businesses contributed 1% to both the U.S. and YRI segments' Operating Profit in full year 2011, the impact on our consolidated Operating Profit was not significant.

## Refranchising (Gain) Loss

The Refranchising (gain) loss by reportable segment is presented below. We do not allocate such gains and losses to our segments for performance reporting purposes.

	Quarter ended	
	3/24/2012	3/19/2011
China	\$(2 )	\$(1 )
YRI <sup>(a)</sup>	21	—
U.S. <sup>(b)</sup>	(45 )	(1 )
India	—	—
Worldwide	\$(26 )	\$(2 )

(a) During the quarter ended September 3, 2011, we decided to rebrand or close all of our remaining company operated Pizza Hut dine-in restaurants in the UK market. While the asset group comprising approximately 350

stores we anticipate selling did not meet the criteria for held for sale classification as of September 3, 2011, our decision to sell was considered an impairment indicator. As such we reviewed the asset group for potential impairment and determined that its carrying value was not fully recoverable based upon our estimate of expected refranchising proceeds and holding period cash flows anticipated while we continue to operate the restaurants as company units. Accordingly, we wrote the asset group down to our estimate of its fair value, which was based on the sales price we would expect to receive from a buyer. This fair value determination considered current market conditions, trends in the Pizza Hut UK business, and prices for similar transactions in the restaurant industry and resulted in a non-cash write down of \$74 million which was recorded to Refranchising (gain) loss. The decision to refranchise or close all remaining Pizza Hut dine-in restaurants in the UK was considered to be a goodwill impairment indicator. We determined that the fair value of our Pizza Hut UK reporting unit exceeded its carrying value and as such there was no goodwill impairment.

Based on bids received in 2012, we recorded an additional non-cash pre-tax impairment charge of \$20 million to Refranchising (gain) loss for the quarter ended March 24, 2012. The asset group continues not to meet all of the held for sale criteria as of March 24, 2012.

These impairment charges decreased depreciation expense versus what would have otherwise been recorded by \$3 million for the quarter ended March 24, 2012. Neither the impairment charges nor the depreciation reduction were allocated to the YRI segment, resulting in depreciation expense in the YRI segment results continuing to be recorded at the rate at which it was prior to these impairment charges being recorded for these restaurants.

(b) In the quarter ended March 24, 2012, U.S. Refranchising (gain) loss primarily relates to gains on the sales of Taco Bell restaurants.

#### Store Closure and Impairment Activity

Store closure (income) costs and Store impairment charges by reportable segment are presented below. This table excludes \$66 million of net losses recorded in the quarter ended March 19, 2011 related to the decision to divest the LJS and A&W businesses. This amount was not allocated to segments for performance reporting purposes.

	Quarter ended March 24, 2012				
	China	YRI	U.S.	India	Worldwide
Store closure (income) costs <sup>(a)</sup>	\$—	\$—	\$(1	) \$—	\$(1
Store impairment charges	1	1	—	—	2
Closure and impairment (income) expenses	\$1	\$1	\$(1	) \$—	\$1

  

	Quarter ended March 19, 2011				
	China	YRI	U.S.	India	Worldwide
Store closure (income) costs <sup>(a)</sup>	\$(1	) \$1	\$1	\$—	\$1
Store impairment charges	1	1	—	—	2
Closure and impairment (income) expenses	\$—	\$2	\$1	\$—	\$3

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.

#### Note 5 - Recently Adopted Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards (Topic 820) - Fair Value Measurement (ASU 2011-04), to provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards. ASU 2011-04 changes certain fair value measurement principles and enhances the disclosure requirements particularly for level 3 fair value measurements. ASU 2011-04 was effective for the Company in the first quarter of fiscal 2012. The measurement provisions of this ASU did not impact our financial statements and all necessary disclosures have been complied with in this Form 10-Q.

In June 2011, the FASB issued Accounting Standards Update No. 2011-05, Comprehensive Income (Topic 220)-Presentation of Comprehensive Income (ASU 2011-05), to require an entity to present the total of

comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of equity. ASU 2011-05 was effective for the Company in its first quarter of fiscal 2012 and applied retrospectively. All necessary disclosures have been complied with in this Form 10-Q.



## Note 6 - Other (Income) Expense

	Quarter ended	
	3/24/2012	3/19/2011
Equity income from investments in unconsolidated affiliates	\$(13 )	\$(16 )
Gain upon acquisition of Little Sheep	(74 )	—
Foreign exchange net (gain) loss and other <sup>(a)</sup>	8	(3 )
Other (income) expense	\$(79 )	\$(19 )

<sup>(a)</sup> Includes \$6 million of deal costs related to the acquisition of Little Sheep that were allocated to the China Division for performance reporting purposes.

## Note 7 - Supplemental Balance Sheet Information

## Receivables

The Company's receivables are primarily generated as a result of ongoing business relationships with our franchisees and licensees as a result of royalty and lease agreements. Trade receivables consisting of royalties from franchisees and licensees are generally due within 30 days of the period in which the corresponding sales occur and are classified as Accounts and notes receivable on our Condensed Consolidated Balance Sheets.

	3/24/2012	12/31/2011
Accounts and notes receivable	\$364	\$308
Allowance for doubtful accounts	(23 )	(22 )
Accounts and notes receivable, net	\$341	\$286

## Property, Plant and Equipment

	3/24/2012	12/31/2011
Property, plant and equipment, gross	\$7,274	\$7,267
Accumulated depreciation and amortization	(3,233 )	(3,225 )
Property, plant and equipment, net	\$4,041	\$4,042

Assets held for sale at March 24, 2012 and December 31, 2011 total \$20 million and \$24 million, respectively, and are included in Prepaid expenses and other current assets in our Condensed Consolidated Balance Sheets.

## Noncontrolling Interests

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

Noncontrolling interests as of December 31, 2011	\$93
Net Income – noncontrolling interests	3
Foreign currency translation adjustment	—
Dividends declared	(20 )
Noncontrolling interest - Little Sheep acquisition	61
Noncontrolling interests as of March 24, 2012	\$137



## Note 8 - Short-term Borrowings and Long-term Debt

On March 22, 2012, the Company executed a five-year syndicated senior unsecured revolving credit facility (the "Credit Facility") totaling \$1.3 billion which replaced a syndicated senior unsecured revolving domestic credit facility in the amount of \$1.15 billion and a syndicated revolving international credit facility of \$350 million that were both set to expire in November 2012. The Credit Facility includes 24 participating banks with commitments ranging from \$23 million to \$115 million. Under the terms of the Credit Facility, the Company may borrow up to the maximum borrowing limit, less outstanding letters of credit or banker's acceptances, where applicable. At March 24, 2012, our unused Credit Facility totaled \$1.2 billion net of outstanding letters of credit of \$88 million. There were no borrowings outstanding under the Credit Facility at March 24, 2012. The interest rate for most borrowings under the Credit Facility ranges from 1.00% to 1.75% over the "London Interbank Offered Rate" ("LIBOR"). The exact spread over LIBOR under the Credit Facility depends upon our performance under specified financial criteria. Interest on any outstanding borrowings under the Credit Facility is payable at least quarterly.

The Credit Facility is unconditionally guaranteed by our principal domestic subsidiaries. This agreement contains financial covenants relating to maintenance of leverage and fixed charge coverage ratios and also contains affirmative and negative covenants including, among other things, limitations on certain additional indebtedness and liens, and certain other transactions specified in the agreement. Given the Company's strong balance sheet and cash flows we were able to comply with all debt covenant requirements at March 24, 2012 with a considerable amount of cushion.

The Credit Facility contains cross-default provisions whereby our failure to make any payment on our indebtedness in a principal amount in excess of \$125 million, or the acceleration of the maturity of any such indebtedness, will constitute a default under such agreement.

## Note 9 - Income Taxes

	Quarter ended	
	3/24/2012	3/19/2011
Income taxes	\$147	\$91
Effective tax rate	24.1	% 25.2 %

Our effective tax rates were lower than the expected U.S. federal statutory rate of 35% primarily due to the majority of our income being earned outside of the U.S. where tax rates are generally lower than the U.S. rate.

Our first quarter effective tax rate was lower than the prior year driven by the positive impact of the \$74 million gain recognized upon our acquisition of additional interest in Little Sheep, which resulted in no related tax expense. This was partially offset by lapping prior year favorability resulting from the 37% tax benefit related to the \$66 million non-cash write down of LJS and A&W in the quarter ended March 19, 2011.

On June 23, 2010, the Company received a Revenue Agent Report ("RAR") from the Internal Revenue Service (the "IRS") relating to its examination of our U.S. federal income tax returns for fiscal years 2004 through 2006. The IRS has proposed an adjustment to increase the taxable value of rights to intangibles used outside the U.S. that YUM transferred to certain of its foreign subsidiaries. The proposed adjustment would result in approximately \$700 million of additional taxes plus net interest to date of approximately \$175 million. Furthermore, if the IRS prevails it is likely to make similar claims for years subsequent to fiscal 2006. The potential additional taxes for these later years, through 2011, computed on a similar basis to the 2004-2006 additional taxes, would be approximately \$350 million plus net interest of approximately \$25 million.

We believe that the Company has properly reported taxable income and paid taxes in accordance with applicable laws and that the proposed adjustment is inconsistent with applicable income tax laws, Treasury Regulations and relevant case law. We intend to defend our position vigorously and have filed a protest with the IRS. As the final resolution of the proposed adjustment remains uncertain, the Company will continue to provide for its position in accordance with GAAP. There can be no assurance that payments due upon final resolution of this issue will not exceed our currently recorded reserve and such payments could have a material adverse effect on our financial position. Additionally, if increases to our reserves are deemed necessary due to future developments related to this issue, such increases could have a material, adverse effect on our results of operations as they are recorded. The Company does not expect resolution of this matter within twelve months and cannot predict with certainty the timing of such resolution.

## Note 10 - Reportable Operating Segments

We identify our operating segments based on management responsibility. The China Division includes mainland China and the India Division includes India, Bangladesh, Mauritius, Nepal and Sri Lanka. YRI includes the remainder of our international operations. We consider our KFC-U.S., Pizza Hut-U.S. and Taco Bell-U.S. operating segments to be similar and therefore have aggregated them into a single reportable operating segment.

The following tables summarize Revenues and Operating Profit for each of our reportable operating segments:

Revenues	Quarter ended	
	3/24/2012	3/19/2011
China	\$1,218	\$906
YRI	708	653
U.S.	800	853
India	17	13
	\$2,743	\$2,425

  

Operating Profit	Quarter ended	
	3/24/2012	3/19/2011
China <sup>(a)</sup>	\$256	\$215
YRI	168	158
United States	158	123
India	1	—
Unallocated Occupancy and other	4	3
Unallocated and corporate expenses	(42	) (38
Unallocated Other income (expense) <sup>(b)</sup>	74	4
Unallocated impairment expense <sup>(c)</sup>	—	(66
Unallocated Refranchising gain (loss) <sup>(d)</sup>	26	2
Operating Profit	\$645	\$401
Interest expense, net	(37	) (43
Income Before Income Taxes	\$608	\$358

(a) Includes equity income from investments in unconsolidated affiliates of \$13 million and \$16 million for the quarters ended March 24, 2012 and March 19, 2011, respectively.

(b) Includes gain on acquisition of additional interest in Little Sheep for the quarter ended March 24, 2012. See Note 4.

(c) Amount represents impairment charges resulting from our decision to divest the LJS and A&W businesses in 2011. See Note 4.

(d) Includes U.S. refranchising gains of \$45 million partially offset by an impairment charge of \$20 million related to our Pizza Hut UK dine-in business for the quarter ended March 24, 2012. See Note 4.

## Note 11 - 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. plan 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 UK. Our plans in the UK have previously been amended such that new employees are not eligible to participate in those plans and, during 2011, one of our UK plans was frozen such that existing participants can no longer earn future service credits.

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 ended		Quarter ended	
	3/24/2012	3/19/2011	3/24/2012	3/19/2011
Service cost	\$6	\$5	\$—	\$1
Interest cost	15	15	2	2
Expected return on plan assets	(16	) (16	) (2	) (2
Amortization of net loss	15	7	—	—
Net periodic benefit cost	\$20	\$11	\$—	\$1

We made no contributions to the Plan during the quarter ended March 24, 2012. Subsequent to March 24, 2012, we made a contribution of \$33 million to the Plan. While we are not required to make further contributions to the Plan in 2012, we may choose to make additional discretionary contributions as part of our overall capital structure strategy. We contributed \$7 million to one of our UK plans during the quarter ended March 24, 2012. We do not anticipate making any additional significant contributions to any plan outside of the U.S. in 2012.

#### Note 12 - Derivative Instruments

The Company is exposed to certain market risks relating to its ongoing business operations. The primary market risks managed by using derivative instruments are interest rate risk and cash flow volatility arising from foreign currency fluctuations.

We enter into interest rate swaps with the objective of reducing our exposure to interest rate risk and lowering interest expense for a portion of our fixed-rate debt. At March 24, 2012, our interest rate derivative instruments outstanding had notional amounts of \$550 million and have been designated as fair value hedges of a portion of our debt. These fair value hedges meet the shortcut method requirements and no ineffectiveness has been recorded.

We enter into foreign currency forward contracts with the objective of reducing our exposure to cash flow volatility arising from foreign currency fluctuations associated with certain foreign currency denominated intercompany short-term receivables and payables. The notional amount, maturity date, and currency of these contracts match those of the underlying receivables or payables. For those foreign currency exchange forward contracts that we have designated as cash flow hedges, we measure ineffectiveness by comparing the cumulative change in the fair value of the forward contract with the cumulative change in the fair value of the hedged item. At March 24, 2012, foreign currency forward contracts outstanding had a total notional amount of \$547 million.

The fair values of derivatives designated as hedging instruments as of March 24, 2012 and December 31, 2011 were:

	3/24/2012	12/31/2011	Condensed Consolidated Balance Sheet Location
Interest Rate Swaps - Asset	\$5	\$10	Prepaid expenses and other current assets
Interest Rate Swaps - Asset	22	22	Other assets
Foreign Currency Forwards - Asset	—	3	Prepaid expenses and other current assets
Foreign Currency Forwards - Liability	(3	) (1	) Accounts payable and other current liabilities
Total	\$24	\$34	

The unrealized gains associated with our interest rate swaps that hedge the interest rate risk for a portion of our debt have been reported as an addition of \$3 million and \$20 million to Short-term borrowings and Long-term debt, respectively, at March 24, 2012 and as an addition of \$5 million and \$21 million to Short-term borrowings and Long-term debt, respectively at December 31, 2011. During the quarters ended March 24, 2012 and March 19, 2011, Interest expense, net was reduced by \$4 million and \$8 million , respectively, for recognized gains on these interest rate swaps.



Changes in fair value of derivative instruments:

	Quarter ended	
	3/24/2012	3/19/2011
Beginning Balance	\$34	\$45
Changes in fair value recognized into Other Comprehensive Income ("OCI")	(5 )	(10 )
Changes in fair value recognized into income	2	4
Cash settlements	(7 )	(7 )
Ending Balance	\$24	\$32

For our foreign currency forward contracts the following effective portions of gains and losses were recognized into OCI and reclassified into income from OCI:

	Quarter ended	
	3/24/2012	3/19/2011
Gains (losses) recognized into OCI, net of tax	\$(4 )	\$(6 )
Gains (losses) reclassified from Accumulated OCI into income, net of tax	\$(3 )	\$(6 )

The gains/losses reclassified from Accumulated OCI into income were recognized as Other income (expense) in our Condensed Consolidated Statement of Income, largely offsetting foreign currency transaction losses/gains recorded when the related intercompany receivables and payables were adjusted for foreign currency fluctuations. Changes in fair values of the foreign currency forwards recognized directly in our results of operations either from ineffectiveness or exclusion from effectiveness testing were insignificant in the quarters ended March 24, 2012 and March 19, 2011.

Additionally, we had a net deferred loss of \$13 million, net of tax, as of March 24, 2012 within Accumulated OCI due primarily to treasury locks and forward starting interest rate swaps that were cash settled in prior years. The majority of this loss arose from the 2007 settlement of forward starting interest rate swaps entered into prior to the issuance of our Senior Unsecured Notes due in 2037, and is being recognized in interest expense through 2037 consistent with interest payments made on the related Senior Unsecured Notes. In the quarters ended March 24, 2012 and March 19, 2011, an insignificant amount was reclassified from Accumulated OCI to Interest expense, net as a result of these previously settled cash flow hedges.

As a result of the use of derivative instruments, the Company is exposed to risk that the counterparties will fail to meet their contractual obligations. To mitigate the counterparty credit risk, we only enter into contracts with carefully selected major financial institutions based upon their credit ratings and other factors, and continually assess the creditworthiness of counterparties. At March 24, 2012, all of the counterparties to our interest rate swaps and foreign currency forwards had investment grade ratings. To date, all counterparties have performed in accordance with their contractual obligations.

#### Note 13 - Fair Value Disclosures

The following table presents the fair values for those assets and liabilities measured at fair value on a recurring basis and the level within the fair value hierarchy in which the measurements fall. No transfers among the levels within the fair value hierarchy occurred during the quarter ended March 24, 2012.