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Q4 2021 Yum China Holdings Inc Earnings Call

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## PRESENTATION

**Operator**

Good day, everyone. Thank you for standing by. Welcome to Yum China Fourth Quarter and Fiscal Year 2021 Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions)

I would now like to hand the conference over to your first speaker today, Ms. Michelle Shen, IR Director. Thank you. Please go ahead.

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**Michelle Shen** ***Yum China Holdings, Inc - IR Director***

Thank you, Desmond. Hello, everyone, and thank you for joining Yum China's Fourth Quarter 2021 Earnings Conference Call. Joining us on today's call are our CEO, Ms. Joey Wat; and our CFO, Mr. Andy Yeung.

Before we get started, I'd like to remind you that our earnings call and investor presentation contain forward-looking statements, which are subject to future events and uncertainties. Our actual results may differ materially from these forward-looking statements. All forward-looking statements should be considered in conjunction with the cautionary statement in our earnings release and the risk factors included in our filings with the SEC.

This call also includes certain non-GAAP financial measures. You should carefully consider the comparable GAAP measures. Reconciliation of non-GAAP and GAAP measures is included in our earnings release.

Today's call includes 3 sections. Joey will provide an update regarding our performance over this past year and then review key actions. Andy will then cover the financial performance and outlook in greater detail. Finally, we will open the call to questions. You can find the webcast of this call and a PowerPoint presentation, which contains operational and financial information for the quarter, on our IR website.

Now I would like to turn the call over to Ms. Joey Wat, CEO of Yum China. Joey?

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

Thank you, Michelle. Hello, everyone, and thank you for joining us today. In the fourth quarter, multiple waves of outbreaks across the nation significantly impacted our business. I would like to express my heartfelt gratitude to all of our employees for taking the right actions to ensure customer safety and minimize business disruptions.

For example, during the lockdown in Xi'an, our excellent supply chain team shield us from major disruptions. Our operation teams took immediate actions to quickly resume delivery and takeaway. They provide vital services to the community in this time of need. We also provided free meals to frontline medical and social workers as a token of our appreciation.

We consider people to be a critical pillar of our sustainability strategy. We aim to have a workplace where employees can thrive while protecting them and supporting their careers in times of uncertainty. Therefore, this year, we enhanced the medical insurance coverage for our RGMs, restaurant management teams and supervisors. These greater benefits cover around 100,000 frontline employees.

Despite the challenging environment, for the full year, we grew revenue by 19%. We delivered operating profit of $1.4 billion or $766 million, excluding special items. We opened over 1,800 stores. That is equivalent to 5 new stores per day compared to 3 new stores per day just a year ago.

On a net basis, we added over 1,200 stores. KFC continued to demonstrate remarkable growth and resiliency. System sales grew 8% in 2021. The brand opened more than 1,200 stores. Entering 160 new cities in 2021. More than half of new stores were in lower tier cities, but we're also adding store density in higher-tier cities. The business contributed to the majority of Yum China's product.

Pizza Hut came back stronger, achieving same-store sales growth of 7% for the full year. We are happy to see that growth was driven by transaction volume increase of over 10%. Pizza Hut opened over 300 stores, a record opening since 2016. The brand also strengthened its bottom line with full year segment operating profit up 77%. These results reflect remarkable improvement over the past few years.

Now let me provide some color on the fourth quarter. During the National Day holiday in early October, we saw a sequential recovery from the third quarter. As regional outbreak surged, November same-store sales were down by mid-teens year-over-year or approximately 20% compared to November 2019. Same-store sales improved slightly in December but were still more than 10% below both prior year and 2019 levels.

Authorities implement mass testing, regional lockdowns and stringent travel measures nationwide. These significantly impact the overall restaurant industry and our business. At the height of the outlook, nearly 300 of our stores were temporarily closed or only provided delivery and takeaway services. But more importantly, reduced social activities, less traveling and softened consumption impact foot traffic across our brands.

Let me share with you the key actions we took to stabilize our business. First, we drive traffic and sales with great product and value. The ability to innovate is one of our core competitive advantages. We again launched over 500 new or upgraded product last year. At KFC, new categories, such as Beef Burgers and whole chicken, have received great customer feedback. Beef Burger sales in the fourth quarter exceed RMB 300 million and accounted for 3% menu mix. Juicy Whole Chicken had another successful limited time offer promotion, and therefore, we are putting it on permanent menu this year. We also partnered with popular Chinese brands, Zhou Hei Ya from Hubei and Wen He You from Hunan to design innovative new menu items. Customers love the Chicken & Duck Sandwich and spicy Crayfish Wrap we launched in the quarter.

Beyond national launches, in 2021, KFC launched 12 local dishes in regional markets. We expand our range from breakfast to late-night snack. Beef and lamb kebab from Northwestern China, Xi Bei Kao Rou Chuan and cold noodles with sesame sauce Wu Han Liang Mian are among customer favorites. We have a mechanism to roll out successful regional offerings to more places or even nationwide. Wuhan hot dry noodle, Wuhan Re Gan Mian last year was a big hit.

At Pizza Hut, we launched special winter-themed pizzas for the holiday season, featuring greek cheese, tiger prawns and filet mignon. We also offered more flexibility to our customers, allowing them the option to trade up pizza toppings, which translated into higher average ticket. In response to weakened consumption, we increased value promotions across our brands.

For example, at KFC and Pizza Hut, we built on a well-established promotion mechanism Crazy Thursday and Scream Wednesday to offer effective value promotions while minimizing margin impact. Second, we captured home consumption demand with off-premise services for both KFC and Pizza Hut.

In the fourth quarter, delivery continued to be a key growth driver, mitigating the drop in dining traffic. Delivery grew 60% in 2021 compared to 2019 and contributed to approximately 32% of sales. Combined with takeaway, off-premise services represent more than half of our sales.

Driving profitable growth in off-premise occasion is core to our strategy. Our new retail products are designed to capture home consumption demand by leveraging our online and off-line channels. We added more food choices and tripled sales to over RMB 500 million within 2021.

Lastly, we unleashed the power of digital in customer service and operations. The KFC and Pizza Hut loyalty program exceeds 360 million members as of the end of 2021. It is 60 million or 20% more than the year before. Member sales account for approximately 60%. We continuously enhance our Super App to address the needs of customers and improve their digital experience. For example, KFC's personalized menu display and Pizza Hut order together feature.

With enhanced digital capabilities, Digital sales exceed USD 7 billion or over 85% in 2021. We empower our RGMs with in-store digitalization using AI, automation and IoT. At KFC, our system assesses real-time store level inventory and automatically dispatches coupons to digital ordering users to reduce food waste.

We also introduced a quality control system to automatically evaluate the quality of food products based on the color, shape, et cetera, et cetera. These technologies improve both the customer experience and our operating efficiency.

Now I would like to briefly update you on our emerging brands. Our coffee business is gaining momentum. We expand the Lavazza portfolio from 4 to 58 last year, covering all Tier 1 cities and leading Tier 2 cities such as Hangzhou, Wuhan, Changsha. We continue to enrich our food offerings and tap into lifestyle merchandisers to drive further growth. In 2022, we will open more stores to increase our coverage.

COFFii & JOY total revenue increased both year-over-year and compared to pre-COVID levels as same-store sales grew by over 30% last year. We ended the year with 36 new -- 36 stores with improved store economics, reflecting improved fundamentals.

K Coffee sold 170 million cups in 2021, representing a 22% growth compared to 2020. Taco Bell store count tripled last year from 12 to 37. We took actions to fine-tune the business and make the brand more approachable for Chinese consumers. Pilot tests on smaller formats has shown improved unit economics. This year, we will continue to refine the formula for long-term success just as we have done with KFC and Pizza Hut over the years.

Our Chinese cuisine brands, Little Sheep and Huang Ji Huang, faced a particularly adverse situation during COVID-19. A large number of their stores are located in Northern and Western China, where cases were concentrated. East Dawning was also hit hard due to the transportation location focus. After a careful review, we decided to wind down the operation in 2022 and focus resources on our hot pot brand.

Before I pass the call to Andy, I want to emphasize that we face enormous uncertainties and headwinds from the external environment, but we have the ability to embrace change and to innovate and adapt accordingly. We continue to focus on the key levers I just mentioned to drive sales and protect our profit in the short term. We are also building our core capabilities to strengthen our market leadership for long-term sustainable growth. I'm confident that we can emerge from this challenging period even stronger.

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

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

Thank you, Joey, and hello, everyone. The COVID situation has caused a great deal of volatility to our operations in 2021. We delivered strong performance in the first half of the year when COVID conditions was relatively stable. In the second half of the year, our business was significantly affected by regional outbreaks and tighter public health measures.

Despite the challenges, on a full year basis, revenue reached $9.9 billion. System sales grew 10% in constant currency. We reported operating profit of $1.4 billion and adjusted operating profit of $766 million. In 2021, we received roughly $90 million less in onetime relief from the government and landlord comparing to 2020. If we remove the onetime relief from the equation, our adjusted operating profit will be up 20% year-over-year. This result reflects the volatilities arising from COVID but also reflect the resiliency of our business and tremendous effort our teams put in.

We have accelerated store openings in the past few years. We maintained a healthy store payback period of 2 years for KFC and 3 years for Pizza Hut despite the impact from the pandemic. Even newer stores opened in the first half of 2021 have performed well. A majority of them achieved monthly breakeven within the first 3 months. There are still a lot of white space opportunities in China, especially in lower-tier cities. Small store formats enable us to expand more flexibly. The reduced store size, combined with other cost reduction initiatives, enable us to decrease CapEx per store by around high single digit year-over-year. We will continue to apply a disciplined and systematic approach in our store opening process to ensure we open promising and high-quality stores.

Now let me review our fourth quarter financial results. Even with the repeated outbreaks since mid-October, fourth quarter revenue grew 1% in reported currency to $2.3 billion and remain profitable. System sales were down 3% year-over-year, mainly due to the same-store sales decline, partially offset by new unit growth. Like prior quarters, we are providing pro forma measures here for convenient comparison with 2019.

KFC's same-store sales were approximately 88% of the prior year's level and 85% of the 2019 level with same-store traffic at approximately 80% of 2019 level. Average ticket grew roughly 6% versus 2019, mainly due to the increased in mix, partially offset by increased discounts.

Pizza Hut same-store sales were approximately 92% of the prior year and 88% of the 2019 level. Same-store traffic at approximately 96%, close to 2019 levels. While the average ticket was down by about 8%. This was driven by the increased mix in delivery, which has a lower average ticket than dine in.

KFC was more affected than Pizza Hut in the fourth quarter due to KFC having a higher store mix in transportation and tourist locations. This location experienced a sharp decline in sales, down approximately 40% on a 2-year basis.

The fourth quarter is seasonally the smallest quarter for our sales and margins. So the sales deleveraging impact on margins is more prominent. Restaurant margin was 7.5%, down 760 basis points compared to last year. This was mainly caused by significant sales deleveraging, cost inflation, more value promotions as well as higher delivery costs due to increasing sales in delivery volume.

Let me go through each expense line item. Cost of sales was 32.5%, 150 basis points higher than last year. This was mainly due to increased value promotions to drive customer traffic and upgraded packaging to phase out plastic. Cost of labor was 27.9%, 370 basis points higher than last year. This is due to sales deleveraging, wage inflation of 6%, delivery volume increase resulting in higher delivery rider costs and higher staffing levels as more staff were scheduled to implement increased safety protocols. Occupancy and other was 32.1%, 240 basis points higher than last year. This is mainly attributable to the sales deleveraging impact. In addition, utility prices went up by double digits starting in December.

G&A expenses increased 7% year-over-year in constant currency, mainly due to increased compensation and benefit expenses as well as the impact of consolidating Hangzhou KFC. Compared to last year, we received $10 million less relief from the government and landlords. Proactive cost management and productivity enhancements enabled us to partially mitigate the headwinds and achieve a profitable quarter.

Operating profit was $633 million. Adjusted operating profit was $16 million. The difference is mainly due to the noncash gain of $618 million from the fair value revaluation of Hangzhou KFC. In December, we completed the investment in Hangzhou Catering and now own approximately [60%] of Hangzhou KFC directly and indirectly. Other than these noncash gains, the impact from consolidating Hangzhou KFC was small as the transaction was completed only on December 10.

Effective tax rate was 25.1%. Net income was $475 million, and adjusted net income was $11 million. This includes a mark-to-market investment loss of $9 million in Meituan, in contrast to a gain of $23 million in the fourth quarter of 2020.

Let's now turn to our outlook for 2022. First, we expect stringent health measures to remain in effect in the near future. The development of COVID remains highly uncertain as we have seen last year. In January, apart from the Delta variant outbreak, Omicron cases also spread to important cities, such as Beijing, Shanghai, Tianjin and Shenzhen. Over 500 of our stores were temporarily closed or only provided delivery and takeaway services at the peak in January.

Same-store sales in January improved modestly from the fourth quarter. Comparing to the comparable Chinese New Year holiday period in 2021, same-store sales are still down year-over-year and remain volatile.

Second is on the weakening macro. As the government has recently mentioned, China's economic development is facing triple pressure from demand contraction, supply shocks and the weakening expectations. Therefore, we will continue to focus on providing our customers exceptional value to drive traffic.

On the cost side, inflation is on the rise globally. Commodities such as chicken feed, beef and cheese as well as energy prices have increased double digits. Our team is taking initiative to rebase our cost structure and to improve efficiency, including locking in prices when they are relatively more favorable, innovating menu items to fully utilize all parts of chicken and cattle, expanding our supplier base, especially local suppliers. With this initiative, we expect to partially mitigate rising costs, but we will still face commodity price pressures this year. Additionally, the increase in delivery sales mix will increase rider cost.

We maintained a very strong balance sheet with approximately $4 billion cash and short-term investments. We resumed share repurchases in the third quarter 2021. Approximately $617 million remain available for future share repurchases under the authorization. We will continue to return excessive capital to shareholders.

We anticipate opening approximately 1,000 to 1,200 net new stores as we increase density in higher-tier cities and capture white space in lower-tier cities. We will continue with our disciplined approach of opening high-quality new stores. We expect our capital expenditures in 2022 to be in the range of $800 million to $1 billion. The majority of this is allocated to store openings and remodeling. We are stepping up investments in supply chain, infrastructure and digital as part of our long-term capital allocation, as outlined in the Investor Day last September. This investment is essential to driving the long-term sustainable growth of our business.

With that, I will pass you back to Michelle to start the Q&A. Michelle?

**Michelle Shen** ***Yum China Holdings, Inc - IR Director***

Thanks, Andy. We'll now open the call for questions. (Operator Instructions) Desmond, please start the Q&A.

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) The first question comes from the line of Brian Bittner from Oppenheimer.

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

Your unit openings during a time of heightened uncertainty for the business, and I realize the returns are still very strong as you outlined in your prepared remarks and as you outlined in your presentation. But can you talk to us what specifically is driving this big step-up in unit openings? And it appears it's a trend that is continuing in 2022 based on your outlook. So it wasn't just a onetime situation in 2021. Talk about the dynamics behind this strategy. Do you believe the COVID environment has opened up an elevated amount of development opportunities? Just any type of additional color on this new level of unit growth would be helpful.

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

Thank you, Brian. For our focus on new store opening, the management team has been very transparent about the way that we are thinking. I think we lay out very clearly in our Investor Day that when we look at how to operate this business in a short term and long term, we focus on 3 things: the RGM, the resiliency, the growth and the moat. So even for new store opening, our thinking are still the same. In a way, resilience might be even more important than growth. But once we achieve resiliency, then we really will push to grow. So that's sort of the holistic thinking.

And specifically, why we are still opening that many stores? As you have mentioned earlier, Brian, in your question, the most important criteria is whether we are getting the payback that we are looking for, and the answer is yes. For KFC, we're still getting the payback within 2 years. For Pizza Hut, it actually improved. In the past, in the past 5 years, because Pizza Hut this year, we opened more stores than any other year since 2016. And actually, the net new store opening is more than all the stores we have opened in the last 3 years. So it has improved. The payback has improved now to 3 to 4 years -- well, 2 to 3 years, from 3 to 4 years to 2 to 3 years. Particularly the satellite store, we can get a payback almost as good as KFC.

So that's the key criteria. And when we can get the payback, then we should open stores while our operating team can handle. So that's point 2. One is the -- our thinking, our strategy. Two is our requirement of the payback.

And third, where are the opportunities? Well, the opportunities are still in lower-tier city. As I mentioned earlier, for KFC alone, we enter 160 new cities. So for these new cities, KFC brand is very strong, and there's very limited sales transfer because it's brand new. And then also the other area is the channel opportunities such as highway station, service center, et cetera, and there's a particular opportunity in franchising as well.

And then for Pizza Hut, obviously, the white space is even larger because we're only in few -- Pizza Hut is only in a few hundred cities in China right now. And then even for the existing cities we are in, we see the opportunity to open more stores to increase the store density. When the store density improves, it has the other benefit to our delivery business, because the average distance of the delivery rider has shortened and the convenience has improved, and that both work for the customer because they get better service. And third, it works for the operating cost because the average delivery cost actually improved, too. So that gives you a sense of where are the opportunities.

And then in terms of how COVID gives us more opportunity in store opening, in a way, yes, because I think during good time when the market is growing, it's much harder to see the resiliency of Yum China business. And during bad time, particularly in the last 2 years, landlords can see that very clearly. So we have become even more popular tenant for landlords across all tier cities. Not only we can deliver good profit and secure the opportunity to our shareholders and to our employees, but we also can deliver reliable rental income to landlords. So you can imagine why we are a popular tenant. And therefore, a significant percentage of the lease, we are talking about 70%, 80% of our lease have certain -- the rent is calculated based on percentage of sales, which give us the flexibility and resiliency in terms of our cost structure.

So I hope that gives you some more color in terms of the new store opening. We never chase after the specific numbers, and we emphasize it again and again and again. But when we can get the payback 2 to 3 years, which is fantastic , then we'll open the store when we see the opportunity. Thank you, Brian.

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**Operator**

Next question comes from the line of Christine Peng from UBS.

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**Yan Peng** ***UBS Investment Bank, Research Division - Executive Director and China Consumer Staples Sector Analyst***

So I have a question regarding the delivery competition landscape. In 2021, we noticed that McDonald initiated a much more upgraded version of the app in China, enabling its digital strategy expansion in the country. So can you share with us more color you have observed in terms of the delivery competition landscape in the whole Chinese restaurant industry, particularly considering McDonald's new strategy?

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

Christine, we have been putting delivery at very high priority in our business since a long, long time ago. And as you can see, compared to 2019, our delivery business has grown even stronger. As you can see from our numbers, 60% full year delivery growth versus 2019. And then for KFC alone, it's 70% plus, and then Pizza Hut is 37%. So that gives you a sense.

We are very focusing on the app to improve the convenience both in terms of the app experience, but also it might not be so clear to our investors that we also have a team, we call it digital operation team that work with our store operating team to ensure the seamless experience, online and offline, for our delivery business. So that helps a lot because one is about the digital experience, two is we have people working together with the store team to deliver the services. And that will include the membership engagement, too, right? So that's the second thing.

The third bit, which is rather unique to Yum China, it's not only unique, probably the only one, we have our own hybrid delivery model, which we have been building since -- well, actually from the very beginning, but we insist on building our own rider capability, and that can be understood right now. I think if we use the framework that we shared again in our Investor Day, the resilience, the growth and the moat, and this is the moat, the strategic moat is our own long-term competitive advantage with our delivery rider, the hybrid model. While we work with the platforms to source traffic, we rely exclusively on our own rider to deliver the product, and that has multiple advantages. One is the quality. The quality, the percentage of service complain is much lower, which we have experienced when we convert the Pizza Hut delivery from the past version to current one. When we took the delivery rider service in-house, we see the drop of the customer complaint, and thus, the sales increase. So that gives us a very unique advantage in our delivery business.

So net-net, it has been a very important part of business. It has become even more important in the last 2 years given the COVID situation, and we have very unique resiliency to grow the business in the long term with our unique capabilities that give us strategic moat to continue to deliver good services to our customers. Thank you, Christine.

**Operator**

Next question comes from the line of Chen Luo of Bank of America.

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

So I've got a follow-up question on our new store opening. So as we are accelerating our new store opening pace, are we seeing any challenges in terms of training the right store managers and hiring additional staff? Meanwhile, we understand that although the store payback period for new stores could be still pretty impressive, the new stores may actually create cannibalization to the existing stores, and it may also create additional resources requirement in terms of management attention. So with this factor in mind, if our same-store sales growth remain under pressure for the coming 12 months because of the COVID impact, is there any chance for us to consider to slow down our store expansion temporarily?

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

Luo Chen, thank you. Our staff or resources, we manage to handle it quite all right. And as you can see, actually since 2014 and 2015, despite the growth of new stores, from 7,000-plus stores, right now, it's 11,000, we managed to maintain the total number of staff in our system at 420,000 plus. So we increased the store but without increasing the total number of staff, and the delta here is automation in AI and digital. So particularly right now with our store base, we can train our staff to meet the new store opening demand. And if we cannot do it, if we somehow see the challenge in terms of quality of the staff in the new store, then we will adjust our pace of new store opening, of course. So with that, I pass the question to Andy, and Andy can comment about the other number impact from the new stores. Andy?

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

Thanks, Joey. So Luo Chen, Happy New Year. So first of all, I want to say a little bit about -- obviously, echo what Joey has mentioned in terms of new store openings. China is a growth market and there's lots of white space, especially in lower tier cities and recently urbanized areas. And so I think sometimes we encourage investors and analysts to look more into the system sales rather than SSSG. Especially over the past 2 years, on a quarter-on-quarter basis, we see a lot of volatility because of COVID development. As we have mentioned over the past 2 years, we expect a recovery from COVID to take time, nonlinear and uneven. So it still remains the case right now.

In terms of our store opening, we're very disciplined. As we have disclosed in our prepared remarks, we have quite disciplined evaluation process and to determine our investment. That's why we continue to have consistent payback for KFC, 2 years. And for Pizza Hut, it's 3 years. And for Pizza Hut satellite store, it's close to 2 years. These are very, very good return on investment. So we're very comfortable with our strategies and also in terms of the quality of the store. As I mentioned, even the new stores that we have opened in the first half 2021, they're also performing well despite the overall impact from pandemic. A majority of them are reaching breakeven in the first few months of opening.

Now in terms of cannibalization, I think certainly, new store openings, sometimes we transfer some sales, especially in delivery, to a new store. But we have been growing our store network over the past 30-some years. And if you look back before the pandemic, we're growing...and right now, we've been very consistent and very disciplined in the way how we deal with it. So we have experience dealing with normalized SSSG impact from new store opening.

The other one is that when we look at opening a new store, we also capture incremental sales and profit. And then, also as Joey mentioned, positive network effects on delivery and takeaway business. Given the pandemic, given so many changes, we also started redesigning our store network. As Joey mentioned, we look at East Dawning, for example, we are winding down the operations because of its concentration on transportation and logistics hubs. So -- and then allow us to open more locations that better serve off-premise dining, for example.

And so all in all, I think if you take a step back in terms of a long-term view as we do, we obviously are investing to build up, continue to enhance our resiliency, but we're positioning ourselves for growth and capturing the market opportunity. And if you look at what we are able to achieve this year, despite some of these very challenging environment, we are able to generate on a full year basis revenue of $9.9 billion. And we grow our system sales by 10% in constant currency. And then we also achieved and increased our profit on a reported basis $1.4 billion. On adjusted basis, our operating profit was $766 million, and that's the resiliency. Despite the significant impact of the pandemic, it's very good. So I think internal cannibalization and new store openings, obviously, we'll continue to review that, but I think we're pretty confident in the strategy that we have right now.

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

Thank you, Andy. And Luo Chen, I think I'll just make one more comment because there's such a strong interest in our new store opening. For our new store, particularly in lower tier city, it has lower CapEx, we have differentiating pricing strategy, means the price will be lower compared to Tier 1 city. We even have differentiated menu. We will have some very special, incredibly good value for money product in that menu only. And we also leverage franchisee to help us as well. So that helps.

But just in terms of the numbers and in terms of modeling, I just want to draw your attention to one number historically, CapEx number. Our new store opening has increased a lot, and that might be the reason that gives some of you concern. But if you look at our CapEx number historically, 2016, we spent $436 million on CapEx. That's the year we got independently listed. With that amount of money, we opened 575 stores. By 2020, we opened twice as many stores. Our CapEx is $419 million, which is less than 2016. So what it means, our efficiency of new stores has improved significantly, right? And on top of that, by 2021, we increased new store to 1,800. Our CapEx increased a bit more, I mean, 50% more, $689 billion -- but $689 million, but the bulk of it is also going to digital and infrastructure as well.

So going forward, for the coming year, Andy just mentioned $800 million to $1 billion, half of it or slightly more than half of it will be on new store openings. So that's the way that we look at it. Number of new stores is one thing, but the key thing is the efficiency and the total amount allocated to CapEx, and that's resiliency and our ability to continue to get more efficiency out of CapEx and open new stores in the long term. It becomes strategic moat of our business. Thank you.

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**Operator**

Next question comes from the line of Lillian Lou.

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

Since we talk a lot about the new store opening, maybe switch gear a little bit on the -- another driver for the revenue growth despite that Andy said that we need to focus on sales growth, less on same-store sales growth. But I think a little bit color can you provide why in fourth quarter the same-store sales growth trend quite similarly in August? Because I remember in August, our same-store sales growth also down like mid-teens. And by that time, I think the number of cities, that is medium or high risk cities, the number actually is way higher than fourth quarter. So trying to understand the dynamics, the impact to our same-store sales growth from this COVID development. And also, I know that this situation remains challenging to predict, but standing at the current situation, what do you think is the most possible scenario for our same-store sales growth trend if the COVID continues like the current level?

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

Andy?

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

I think Q4 is actually, I believe, in terms of COVID conditions, the worst since the first quarter 2020 (corrected by company after the call). I think it's pretty obvious to most folks here in China. We have a Delta variant outbreak. And then later on in the year, we also begin to see Omicron cases popping up here in China. Now cases is -- case load may be one and is quite deceptive here because, obviously, in China here, generally, we have very stringent health measures and try to sort of achieve a dynamic zero cases for COVID, and so that rely on a lot of these health restriction measures. But now if you look at the outbreak in the cases and also the wide spread, it's the worst since the first quarter in 2020.

So as we have mentioned in our press release, in the same trend, we've seen some recovery from the summer outbreak in October, but then we see significant impact from the outbreak in November and then a little bit recovery in December, but still down double digits. Now obviously, as we have mentioned, when we look at COVID, it's going to introduce volatilities in our operation, and we have told investors and analysts, and internally as well, that we need to have scenario analysis and preparation, how to deal with it. When time is good, how we can execute well and capture more market opportunities. When situation becomes more challenging, how we can rely on our resiliency and operations and ensure that even in bad time, we're able to make profit.

And so I think for the fourth quarter, that's what we do. But I think it's worthwhile to step back because from a quarter-over-quarter basis, it's very hard, or even month-to-month basis to predict what's going to happen with COVID. But if we step back for the full year, as I mentioned, you will see a little bit better picture, right? Despite the volatilities and a challenging environment that we operate in 2021, we're able to grow our revenue, able to grow our system sales, even grow our core operating profit. And so I think, in a sense, I think sometimes we need to take a little bit care, but we also have to accept the fact that with COVID, there will be some uncertainty.

Now in terms of SSSG and then also profit, you can see that like when the situation is stabilized, we're able to excel very well in the first half and even the second half in 2021. Now obviously, when the things are challenging, we continue to rely on our team, our operations, our brand, our product and customer, both digital and delivery. So it's kind of hard for me to provide guidance on the COVID development and related SSSG impact. But as we have mentioned, the biggest impact on SSSG right now, the volatility is because of COVID. I am confident because over the last couple of years, we do both in terms of abilities and in terms of our RGM, our operational team, we learned something over the past 2 years, how to respond when there's a COVID outbreak and try to mitigate some of those impacts.

So I think the way I look at the situation right now is that, sure, in the short term, we have COVID, we have some of the macro headwinds. So it's in short term, a little bit more cautious. But we are very confident in our operations, our brand, our products and the consumer loyalties, I think, have been demonstrated amply. We have the largest customer membership base, 360 million, which has been growing 20% from last year. Now membership accounts for more than 60% of our sales. And so we're confident on our operation, our brand and customer base and the products that we have and the new opportunity that Joey has mentioned.

And then in the longer term, I think we still are very optimistic about the opportunity here in China, and that's why we're investing not only in the store network expansion, but building our capabilities in digital infrastructure and supply chain. And so hopefully, that will give you some perspective on how we look at the market and the situation here in China.

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

Thank you, Andy. Thank you, Andy. And thank you, Lillian. I think I'll just like to summarize. Again, the management thinking is very clear in this. We don't have the crystal ball towards the COVID situation, but we are very clear about our focus.

What do we need to do? Again, 3 focus: resilience, growth and strategic moat. Very simple. Resilience, as Andy talked about, is the resilience of operating team. We are fast; we are responsive;and our team after 2 years training even down to each market level, like Shanghai market, Beijing market, Guangzhou market, there's the national strategy, there's the local strategy, our team knows what to do.

In terms of growth, 2 sources of growth, very clear, as Andy mentioned. The product in terms of new category like beef burger, whole chicken. Why whole chicken is important? Because it's also home consumption, right, which is a trend.

The local innovation, the partnership with Zhou Hei Ya, Wen He You, Wuhan Reganmian et cetera, something exciting, interesting, fun to drive the traffic. And we focus on the value. We have done incredibly good job in terms saving what we can save and pass on the savings to customers through value. Right now, the signature value campaign like Crazy Thursday and Scream Wednesday is something working very well.

And then the other source of growth is the off-premise demand, the delivery, the takeaway, the home consumption retail. The home consumption retail for SoulFun, which is our own retail brand, and KFC and Pizza Hut tripled to over 500 million in 2021 alone.

And then last is the strategic moat, which is the digital of $7 billion of digital sales of 360 million membership and our supply chain. Our ability in terms of getting the scale, getting the efficiency and also our ability to rebase our cost base and remain competitive in the long term in terms of building our own infrastructure, that all helps our business.

So the focus is very, very clear. If I could just mention another thing about how do we utilize our core capability to grow the business. For example, we use our hybrid delivery model, our own rider, to deliver the new retail. It makes sense. We have the riders in the stores already, and we utilize the rider to deliver the new retail to our customer directly. Service is good, reliable and cost is low. So that hopefully gives you a sense of management's very clear focus on resiliency, growth and moat strategy, given the uncertainties and the evolving situation of COVID. Thank you, Lillian.

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**Operator**

Our next question comes from Xiaopo Wei from Citi.

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**Xiaopo Wei** ***Citigroup Inc., Research Division - Director & Head of Asia-Pacific Consumer Research***

My question is focusing on your operation of the store in terms of business model. You guys have long preferred self-operating stores to franchising out stores. Given all the fluid situation in COVID, you have a better infrastructure, supply chain, et cetera, will you consider franchising out more stores looking forward versus self-operating most of stores looking forward? And also clarifying the target -- your new opening target for the year. So your target new store opening 1,000 to 1,200 this year, including only self-operated stores or including both franchise stores and self-operated stores?

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

So the new store target includes the franchising stores as well. And go back to your question, the first part of your question, the majority of the new store will still be equity store because the payback is so good. However, as you can see, over the years, right now, the mix of our franchise store has increased, especially after the acquisition of Huang Ji Huang. It's in the mid-teens already. But going forward, we'll be quite open mind about the franchising option, and we've always been open minded about it. We do it when it's right.

So in terms of the franchising strategy, there are 3 focus. One is we do the franchising in some remote locations, such as Tibet or Qinghai . You can imagine why because it's lot more efficient to manage it that way instead of managing all the way from the headquarters.

Secondly, it's channel. So the strategic channels such as the highway service center, et cetera, so these are very sensible franchising opportunity.

And then the third thing I would like to mention is the ability to use technology to help managing the franchising system. We have been very cautious about the franchising strategy. As you can imagine, there are a lot of advantage of the franchising strategy in China, but there are also a lot of challenges in terms of the quality of the service that we care most about. But right now, with the end-to-end digitization process going on, with the IoT, with the automation, our ability to ensure good store operation among the franchising store has improved significantly in the last few years. So that certainly gives us better comfort. And hopefully, greater comfort that when we're open minded about franchising strategy, it does not mean that we compromise the quality of the service, we don't, in particular in terms of product as well. So I think we have a few more questions. Let's move on to the next one.

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

Before we move on the next one, I just want to jump in there to clarify. The number that we talk about is the net new store that we opened, not the gross number of stores. And the net new store open, we expect, is about 1,000 to 1,200, which include both franchise and equity stores. And as Joey mentioned, most of them is going to be our own operated stores.

**Operator**

Next question comes from the line of Anne Ling of Jefferies.

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

The first question is for Andy. Regarding the cost trend moving forward, if I have missed it, would you share with us the cost trend or your cost increase expectation for commodity cost, staff and also the occupancy cost for the whole year of year 2022 as well as first quarter '22?

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

Sure. So okay. Okay. So I think if you look at -- obviously, right now, we look at globally, we see commodity price inflation. If you look at chicken feed, beef and cheese, energy costs are all up double digits. Now obviously, without doing anything, we're probably at low to mid-single digit for commodity price of all our COS.

And then also, if you look at cost of labor, there's 2 components driving it. One is, obviously, as we have mentioned in last year, we have increased the wages at the market level and at the store level, and so we're likely going to continue to see mid- to high single-digit rate increase, which is a normalized rate for China. And also, we'll probably see a little bit increase in rider cost as we continue to see delivery as a growth driver and continue to grow very robustly. So the mix shift to delivery would increase delivery cost there as well.

Now on the occupancy and others side, one thing is energy cost. In China, the utility price have increased by double digits since December. That's obviously in response to some of the power shortage that we have experienced in the summer and encourage more production and more reductions in more savings energy to balance that market dynamic. And so all in all, I think we're looking at some commodity inflation, labor headwind.

Now again, also on the margin side, the biggest impact on margin is actually sales leverage and deleveraging. Obviously, same-store growth would have an impact on that. But we're not sitting still obviously. We have a very good team, and there's a lot of initiatives to try to fight this headwind, obviously. One is to protect margins, and we want to offer products with a wider pricing range, allow people to upgrade but also provide lower entry prices for new customers. Then we also want to leverage our scale and supply chain efficiency to lessen the inflationary pressure. As we have mentioned on the prepared remarks, so that's including potentially locking in more favorable price when the market opportunity arise. We will also have -- try to -- look into how to increase our efficiency in utilization of the ingredient that we have, right. Like chicken, how do we use the full chicken, use part of the chicken. And same for the beef, the cow, how we can utilize that great product and that our customers like and also gives us good margins.

We also have obviously a team of supply chain and other people in the brand. They're looking to rebasing overall cost and then also increase the efficiency of our labor. And that technology, as we have always mentioned, is an important part of labor productivity improvement. That's why we're investing, as we have mentioned, earmarked $1 billion in IT investment and digital capability investments and then $1 billion in supply chain infrastructure over the next few years.

So I think, all in all, we try to drive that labor productivities, process/operational efficiency to reduce waste and whatnot. And then we also continue to try to improve and utilize our membership program, which is one of the largest in the world, 360 million members. And to drive marketing efficiency and then also drive member frequency, spend and overall sales, and so this is how we look at the commodity pressure and then the inflation, how we respond to it.

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

Got it. And just to clarify, for this commodity cost increase, I estimate that you provide like low to mid-single digit or the labor cost of mid- to high single-digit increase, that's before the -- your efficiency exercise. Is that correct?

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

Well, like the commodity prices itself in the marketplace have increased by double digits, and so obviously, we are reducing that. Wages, we are expecting a normalized rate of mid- to high single digits. So -- and then for -- we are also COS side we also estimate last year, we're beginning to phase out plastics all through the country. And then we have rolled that out last year, and then we continue to roll out to more markets this year.

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

Okay. Got it. Got it. And my second question is on the store opening, the 1,000 to 1,200 net store opening. I understand that a majority of the store opening will be under KFC brand. But could you share with us like what is your estimate of your budget for like Lavazza, your other coffee brands, as well as Pizza Hut, which I believe last year, you received the store opening plan for Pizza Hut as well. So maybe you can share with us the store opening plan moving forward for the other brands?

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

Sure. So I think like if you break it down, obviously, KFC is still the very important and largest brand for us. They have the majority of store opening. But if you look at Pizza Hut because improved economics, unit economics at Pizza Hut store also have accelerated new store openings last year. In fact, if you look at Pizza Hut, it opened 335 new store, higher since 2016. And if you look at the net store increase of 235 last year, it's, I think, if I remember correctly, it's a combined of the previous 3-year total. And so I think Pizza Hut obviously will play an important role, especially with the success of the satellite store model.

Lavazza is -- also will have -- I would say it's like at the beginning of last year, we have about -- at the beginning of the year, we have 4 stores. We have opened up 50-some store. And now we -- and obviously, it's still a pretty new brand in China, but we have expanded the joint venture with Lavazza last year. We have great plans for the brand. As we have mentioned, we deem it as our third growth engine. So now we're not only in the top tier cities, the Tier 1 cities, but also in several Tier 2 cities. We will continue to look into experimenting with different store formats and then expand to more markets. And in the brand, I think we have all seen pretty good membership growth. And so as such, we will expect Lavazza to open more store in this year.

And Taco Bell is like a brand that we did not talk as much, but we also opened some -- 20-some store last year at Taco Bell. Again, it's one of the highest store opening in many years combined. So I think we -- in terms of all opportunities, I think going back there, is how we utilize the store format to target the market, how we're able to take some cost initiatives. We designed the format of the store and the menu at the store that allow us to open some more flexibly. And I think the smaller format right now is very key to overall development across all these brands. So that's how we look at it. The key is going to still be KFC and then Pizza Hut and then coffee and another segments of the business. Thank you.

**Operator**

We have questions from the line of Michelle Cheng of Goldman Sachs.

**Michelle Cheng** ***Goldman Sachs Group, Inc., Research Division - Executive Director***

I still want to follow up a little bit on the cost front. So if we look at the occupancy and other costs, it seems that the deleverage impact is more significantly. You mentioned the energy cost has contributed this increase, but I remember in the past few years, these items actually drive a lot of efficiency gains. So can you still give us more color, take aside the energy cost, like rental, other cost items, whether there's anything we see more pressure in the near term? And on top of that, wage cost. So since the digital orders are already contributing like close to 90% of the sales, so is there any further room to say the like labor staff number per store or any like a delivery efficiency gain we can expect going forward?

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

Michelle, yes, thank you for your questions. In terms of O&O, I think, obviously, one thing to point out is utility price increase because it's obviously a government policy, that we see double-digit increase in prices. The other one is obviously rent, as we have mentioned to folks. Even though we have high percentage of our store have a components, almost 80% of our stores have a component of variable rent, but there's also a fixed component of that. And so when there's a sales deleveraging, generally, we see impact on O&O as a percentage of revenues, and so that's what -- that is the key driver for that.

The other one is in terms of our labor productivity improvement. I think obviously, some of this improvement, you can see on the store, for example, using digital app or kiosks to make orders and make digital payments. And so I think that has rollout quite good already. But there's other things that you do not see that digital actually help a lot in labor productivity. We have mentioned before, we have the pocket manager that help our store manager to manage the store more efficiently, get more real-time information and also help them to do staff scheduling. We continue to invest in IoT to automate our kitchens and also our inventory count and all that. I think right now, I think digitalization is not only investment in the front end with the customer, but more moving into the kitchen and more into our supply chain and in our back office, right? So supply chain, we'll continue to invest over there in terms of routing, in terms of integration with suppliers. That allow us to do better forecast demand and product management.

And then also in our back office, as I have mentioned before, we have a 3-year digitalization program, for example, even for our finance department, right, to fully automate manual process and then link up the data across the company. And then also in the delivery side, right, as Joey has mentioned, not only we use delivery to better optimize the queuing of our food production, but also better routing for our rider, also more optimized trade zone design as well as potentially having other product initiatives, such as tea time and also new retail to basically better utilize the rider that we have. So there's a lot of ways to look at labor productivity improvement. And if you look at over time, we have done quite well despite delivery increase and all that. We have seen labor cost as a percentage of overall revenues before the pandemic are relatively stable. And given enough time, I think we're able to continue to improve labor productivities to offset some of these near-term shocks from COVID.

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

I think in the long term -- I would like to comment 2 things, Michelle. One is, in a way, if you think about it, our expansion of delivery business helped reduce the rent. Think about it, right? Because when our delivery business continues to grow, it means the location, the new store location, we don't need to be in the prime prime prime area. We can compromise a little bit, and that helped. So the saving of the rental expenses helped the delivery cost side, point one.

Point one. In terms of riders, the way that we look at the rider cost also show our mentality, our philosophy in resilience and strategic moat. Because the fact is right now, the cost of average order, the cost of delivery rider per order is higher than the platform, and we understand that. We have the option, but we keep it this way because our riders right now, they deliver a better quality of service. So when it comes to cost: quality first, then we work on the cost side. And instead of pushing down to pay the rider less, because if you pay them less, they go, right, they leave, we make sure that they're paid well. But then we leverage our rider to deliver higher average ticket items such as new retail. So that's the way that we think about the cost structure of the delivery rider side as well. Thank you, Michelle.

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**Operator**

The last question will come from Walter Woo from CMB International.

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**Wing Hong Woo** ***CMB International Securities Limited, Research Division - Research Analyst***

Can you hear me?

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

We can hear you well.

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**Wing Hong Woo** ***CMB International Securities Limited, Research Division - Research Analyst***

Okay. So my question is about your ticket size. If we take out the positive impact from the increased delivery sales mix, was KFC average ticket still increasing in the last quarter? And given the industry dynamics and the outlook in the FY '22, do you think it is still suitable for KFC and Pizza Hut to increase the average ticket or perhaps the reduction of the level of promotions? That's the first question.

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

So let me address a little bit about the TA situation. And TA situation, obviously, for KFC and Pizza Hut is slightly different. For KFC, the delivery actually increased the ticket average. So the mix shift to delivery actually will help them over there normally.

When just kind of opposite, at Pizza Hut, because generally, we have been a place for gathering, social activities. And so the dine-in actually have a ticket average, that is, higher than the delivery side. So when there is mix shift there, then we'll have lower ticket average.

Now I think the questions regarding, I think, the ticket average and high and lower, I think, is really depending on other things, too. One is also the promotional activities that we have. Obviously, right now, we have more campaign probably.

The other one is that overall pricing strategy. I think it's important for us to look at the pricing, especially in face of COVID uncertainty and rising inflation and some of the consumer sentiment. So we want to make sure that what we offer is good value to our customers. And so as we mentioned, how do we protect our margins and as Joey has mentioned, I just want to say it again. All the great products for the customer, products that cover a wide range, both high price, low price because value is different from pricing.

The other one is, again, leverage our supply chain and supply chain efficiency, our scale to sort of like to have that cost competitive advantage to make it more prominent. The other one is enhance, obviously, the usage of our resources, including the meats that we have to reduce wastage. Like chicken bone, for example, we turned it into a product popular with consumers. We also want to continue to invest in technology to improve efficiency and productivity, right? So -- and the membership program is a very important thing. So membership continue to help us to drive spending. So if we -- if you look at our KFC, for example, member, if you have a privileged member subscription, generally that customer, that member, spend twice as much as nonmember. So a lot of things that we would like to do. So the ticket average is one of the moving parts.

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**Wing Hong Woo** ***CMB International Securities Limited, Research Division - Research Analyst***

Got it. Very clear. And my next question is about your performance during the Chinese New Year. How was it compared to last quarter? And it seems the number of travelers returning home has increased versus last year as well. So was that a positive to your business at the transportation hubs? Or how does it impact your overall business? And then how do you see this domestic travelling trends going into the next 2 quarters?

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

Right. So I think this year, Chinese New Year is a little bit earlier than last year. Obviously, last year, it was mostly in middle of February for Chinese New Year. And this year, it's the beginning of February for Chinese New Year. So in January, we did see a modest improvement sequentially compared to the fourth quarter. But as I mentioned on the prepared remarks, for the comparable Chinese New Year period, this is basically for the Chinese New Year, 15 days before the Chinese New Year and 15 days after the Chinese New Year for that comparable period. At least so far, we're still in the middle of it. And so far, we see that's still down year-over-year.

And the travel, I think the travel pattern is probably a bit different compared to last year. But I think overall, if you look at the overall travel and whatnot, I think it will take some time for the transportation hub business to recover to any reasonable level, compared to the pre-COVID level. So the way we look at it is that it's slightly down year-over-year compared to last year. And -- but still, there's a good deal of uncertainty. And we have launched different campaigns. Obviously, when we go into the Chinese New Year, there's quite a bit of uncertainty in terms of travel because we do see authorities that encourage folks to stay put, stay in the cities to locally celebrate Chinese New Year. But the pandemic is now extending to the third year. So I think there's also the uncertainty about how people respond to that. So we have different contingency plans, and we'll continue to respond to changes in the market and to what we see.

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**Operator**

Thank you for the questions. I would now like to turn the call back to the management for closing remarks.

**Michelle Shen** ***Yum China Holdings, Inc - IR Director***

Thank you for joining the call today. We look forward to speaking with you on the next earnings call. Have a great day.

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

Thank you, everyone.

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

Thank you. Thank you.

**Operator**

This concludes today's conference call. Thank you for participating. You may now disconnect.