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CORPORATE PARTICIPANTS

Florence Lip *Yum China Holdings, Inc. - IR Director*
Jacky Lo *Yum China Holdings, Inc. - CFO, Treasurer*
Joey Wat *Yum China Holdings, Inc. - CEO & Director*

CONFERENCE CALL PARTICIPANTS

Anne Ling *Deutsche Bank AG, Research Division - Regional Sector Head of Asia Consumer and Media Research*
Brian John Bittner *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*
Chen Luo *BofA Merrill Lynch, Research Division - MD*
Leonardo Vasquez *Sanford C. Bernstein & Co., LLC., Research Division - Senior Research Analyst*
Lillian Lou *Morgan Stanley, Research Division - Executive Director*
Matthew Robert McGinley *Evercore ISI Institutional Equities, Research Division - Restaurant Analyst*
Michelle Cheng *Goldman Sachs Group Inc., Research Division - Executive Director*
Xiaopo Wei *Citigroup Inc, Research Division - Director & Head of Asia-Pacific Consumer Research*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Yum China 2018 Fourth Quarter Earnings Conference Call. (Operator Instructions) I must advise you that this conference is being recorded today, Friday, the 1st of February 2019. I would now like to hand the conference over to your first speaker today, Ms. Florence Lip. Thank you. Please go ahead.

Florence Lip ***Yum China Holdings, Inc. - IR Director***

Thank you, operator. Thanks, hello, everyone, and thank you for joining Yum China's fourth quarter 2018 earnings conference call. Joining us on today's call are Ms. Joey Wat, CEO of Yum China; and Mr. Jacky Lo, CFO of the company.

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 and reconciliation thereto.

Today's call includes 3 sections. First, Joey will cover Yum China's fourth quarter 2018 highlights; and Jacky will cover the financial results. We will then open the call to questions. The webcast of this call will be available on our IR website. A PowerPoint presentation, which contains operational and financial information for the quarter, is available for download.

At this time, I would like to turn the call over to Ms. Joey Wat, CEO of Yum China.

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

Thank you. Hello, everyone, and thank you for joining us today. At the close of our second year as an independently listed company, I'm pleased to report that we achieved profitable growth while continuing to build capabilities that will improve our long-term competitiveness and drive sustainable growth. First, I will give an overview of the quarter before providing more detail on our operational initiative for each of our core brands.

We delivered our ninth consecutive quarter of system sales growth since we spun off from Yum! Brands, driven by accelerated new store openings and a strong performance from KFC. I'm also pleased to report that, for 2018, we delivered -- on a reported currency and licensee adjusted basis, we delivered record revenue and operating profit in 2018.

In 2018, we opened 819 stores. This is the second highest number of new stores in our 30 years history in China and an average of more than 2 restaurants per day. This expanded footprint extends our position as market leader and gives us a solid foundation for future growth. Thanks to a resilient business model, strong brand recognition and excellent execution, KFC recorded healthy growth across all city tiers in the fourth quarter, with system sales up 9%. While we are not satisfied by our same-store sales at Pizza Hut, we are pleased to see same-store traffic growth in the quarter as well as positive trends in customer feedback. This shows that the initiatives we are implementing are gradually taking effect. Combined with ongoing margin management, Yum China delivered substantial growth in operating profit for the fourth quarter, which Jacky will elaborate on further.

Now I will provide more color on the performance and strategy of our key brands, starting with KFC. KFC is our primary growth engine and the #1 quick service restaurant brand in China. The key to KFC's success is a relentless focus on innovation, first-class execution and a commitment to consistently exceed customer expectations. In the fourth quarter, KFC continued to deliver strong growth on the back of excellent results in the same quarter last year. In the fourth quarter, system sales grew 9% compared to 11% growth in the previous year, both in constant currency terms. As noted, expansion continue to be a key priority. In 2018, KFC stepped up new store openings to capture the opportunity for growth in underserved and attractive markets across China.

In addition to store expansion, we drove same-store sales by pulling multiple levers including launching smart value campaigns and growing underpenetrated dayparts and product categories. First, let me talk about our ongoing focus on smart value.

As we noted previously, we successfully launched the Crazy Thursday promotion in August. We expanded the promotion into the fourth quarter, introducing a new chicken snack Xiangguji at a very attractive price point and succeeded in driving strong incremental sales. Crazy Thursday is an excellent demonstration of our integrated approach to campaign planning and execution. Through collaboration between our menu innovation, sourcing and marketing teams, we drove profitable growth for KFC while our customers enjoyed delicious food at very good price. Second, we continue to enhance our breakfast coffee and dessert offerings to capture the significant opportunity we see in this segment. Building on the popularity of our breakfast menu that includes congee, panini, rice roll and Chinese pancake Dabing, we launched a Christmas campaign and a seasonal congee, it's called Labazhou, it's a kind of sweet congee, which was well received by customers during the festive period.

Coffee also continued to exceed expectations. In 2018, we recorded double-digit growth, sold over 90 million cups and generated more than CNY 1 billion in revenue. We will continue to drive growth of this high-potential category by introducing innovative, high-quality products at good price again and leveraging our extensive store network and delivering capabilities.

In the dessert category, we continued to expand our network and introduce unique products to entice new customers. At the end of the year, we reached 1,110 dessert kiosks across China, over 250 more than the same time last year, and the sales increased by over 30% in the fourth quarter. We will continue to open more dessert kiosks and diversify the product range to drive growth.

In digital, we continued to focus on seamlessly integrating online platforms with off-line stores to extend our digital ecosystem and maintain engagement throughout the customer journey. One of our key digital initiatives is the KFC privilege subscription program. Almost 2 million privilege members have been sold since it launched in July. The delivery privilege program has been particularly popular and effective in increasing order frequency and customer loyalty. To tap into the hype around Double 11 and Double 12 online sales that are similar to Cyber Monday in the U.S., we launched campaigns with online platforms. We achieved outstanding results, and we were the #1 seller in terms of GMV in the food service category on Tmall and drove incremental sales to our stores throughout the period. This initiative is a great example of the significant upside potential of online to off-line marketing and our ability to monetize our digital assets.

With our massive membership base, extensive digital ecosystem and significant transaction data, we have in-depth understanding of our customers. We are continuing to find new ways to leverage this insight and believe there are significant opportunities to design more targeted marketing campaigns, partnered with high-traffic platforms and, ultimately, improve the dining frequency and ticket average of our customers.

Delivery, similarly, remains a key sales driver that caters to the evolving dining habits of Chinese consumers. We have adopted a hybrid delivery strategy that involves collaborating with aggregators to source traffic and fulfilling our orders with our dedicated KFC riders. This enabled us to simultaneously drive volume and leverage our extensive network to control quality.

In the fourth quarter, delivery represented 16% of sales, up 3 percentage points year-over-year. As a result of our digital initiatives, our own channel delivery sales enjoyed tremendous growth in the fourth quarter, well ahead of growth rates through aggregators. Looking ahead, we remain very excited about KFC's long runway for growth in China. KFC's commitment to smart value, innovation in menu and dayparts and leadership in digital and delivery have created a resilient business model that's geared to growth. And while we have scale, there are plenty of opportunities to expand our footprint. With ongoing improvement in store development cost, we continue to see cash payback of around 2 years and see significant further scope for new store development. In 2019, we will invest in enhancing our core capabilities and continue to pursue an aggressive store-building program.

Now I will provide some color on Pizza Hut's performance. Pizza Hut is the leading Western casual dining restaurant brand in China and represents around 20% of our revenue. As I mentioned earlier, we are pleased to see positive same-store traffic growth in the fourth quarter. We are in the process of repositioning Pizza Hut as a modern, family-oriented, value for money casual dining concept, and we are seeing notable improvement in feedback from our customers. We are confident in our strategy and expect to see higher consumer satisfaction translating to improving performance in due course.

Now I'll provide an update on the progress of our revitalization program, which is focused on 4 pillars: driving digital; optimizing delivery; fixing the fundamentals; and enhancing asset portfolio.

First, let's look at digital. Pizza Hut has made rapid progress over last year by implementing learnings from KFC, which is a digital pioneer in the restaurant industry. Similar to KFC, Pizza Hut leveraged the Double 11 and Double 12 campaigns by partnering with online platforms as well. And we've ranked #1 on Koubei in terms of GMV on November 11 and December 12 and drove meaningful incremental sales and new customers to our stores through these campaigns.

In the fourth quarter, we also launched a privilege membership program that is designed to attract families, which is one of Pizza Hut's core customer segments. After testing multiple pilot programs, we launched the family privilege membership program in December. For CNY 98, our members receive a welcome gift, coupons and other discounts that are tailored for families. We observe a meaningful increase in frequency during the pilot period, and we will continue to monitor the impact of privilege membership.

Turning to delivery. In the fourth quarter, we continued to focus on integrating the dine-in and home service brand. This integration was completed in December 2018, and we are seeing the benefit with clearer brand positioning and better marketing and operational efficiencies.

Delivery continued to see double-digit growth, and they account for 25% of Pizza Hut sales, up 3 percentage points year-over-year in Q4. We also recorded over 20% growth in delivery sales from our own channel in the fourth quarter. Our goal at Pizza Hut is to transition to a KFC delivery strategy of the hybrid model of leveraging aggregators to drive traffic while using our own dedicated riders to deliver. We accelerated the rollout of dedicated riders in the fourth quarter. And by year-end, all of our orders in stores were delivered by own order rider network, up from 55% in Q3. There was some impact of sales during the transition period but, in the long term, we are confident that we will have greater control over delivery quality and better availability during peak hours, especially during Chinese New Year. And again, our growth from our own channel is ahead of the delivery growth from the aggregator in Pizza Hut as well.

Following our success of KFC, Pizza Hut also rolled out delivery privilege. Initial results showed that the order frequency has meaningfully increased from our privilege member during the subscription period.

Next, let's look at the fundamentals. As we have previously stated, a key component of our revitalization program is to improve our food. Following our earlier efforts to simplify and revamp the menu, we continue to innovate and improve our food based on consumer feedback, we systematically add the best-performing limited time offer to the permanent menu and continue to develop it to adapt to the changing consumer taste. Following the success of KFC, the Crazy Thursday promotion in mid-December, we launched Scream Wednesdays for members in Pizza Hut as an investment in value to drive traffic and build consumer habit. Select items were offered at RMB 29 and RMB 39 every Wednesday, generating excitement and driving incremental traffic to our stores during the promotion. Building on this initial success, we'll continue the promotion and extend it to all customers in 2019, making it one of our signature campaigns for the near future.

Lastly, we continue to enhance our asset portfolio through accelerated remodels and multiple store formats. To provide a more comfortable and stylish dining environment and also to upgrade the brand image, we refurbished 225 stores in 2018. We plan to ramp up the speed of remodeling further in 2019 and to complete the refresh for our entire portfolio by 2021. We have developed multiple store formats to cater to diversified dining occasions, including delivery at various locations. Our focus is on smaller assets and faster service with better support for delivery needs.

All these initiatives are starting to translate into an improved perception of Pizza Hut. Our latest brand tracking shows that the scores for good taste, value for money and young and energetic have been improving, particularly in Tier 1 cities. We are confident that the improvement in customer satisfaction will support the ongoing revitalization of the brand.

A few words on our other brands. Little Sheep opened 78 new stores in 2018, with total stores exceeding 300 across 10 countries. We will continue to expand this brand in China and overseas. Taco Bell opened a fourth store in Shanghai Lujiazui. We will focus on reaching critical mass and fine-tuning the model before rolling out further. After several years of scaling back that, we've repositioned the East Dawning brand and opened 4 new stores in 2018. We will continue to test and expand selectively with a focus on transportation hubs. And the brand positioning for East Dawning is to focus on food from the south of Yangtze River for the travelers. In Chinese, we call it "Lv tu Zhong de Jiangnan weidao". Our new standalone coffee concept, COFFii & JOY, also add 7 stores during the quarter taking us to 13 stores in 4 cities in Eastern China. We are continuing to test different formats and remain excited about the potential of this category.

With that, I will hand over the call to our CFO, Jacky, who will cover our financial performance in more detail.

Jacky Lo *Yum China Holdings, Inc. - CFO, Treasurer*

Thank you, Joey. Good morning to those calling from Asia and good evening to those calling from the U.S. First, let me quickly go over our fourth quarter and full year 2018 financial results. Total revenues reached $1.91 billion in the quarter, up 7% year-over-year, excluding foreign exchange translation. Total system sales grew 6% year-over-year in the fourth quarter of 2018, excluding FX, primarily due to robust same-store sales growth at KFC and accelerated new store openings. We opened 257 new stores during the quarter, an average of well over 2 stores per day, of which the majority were KFC stores. Our portfolio was nearly 8,500 restaurants as of the end of 2018.

During the quarter, KFC's year-over-year system sales grew by 9%, while Pizza Hut system sales declined by 2% both excluding FX. Yum China's same-store sales increased by 2% in the fourth quarter of 2018. KFC same-store sales grew by 3% despite lapping 6% same-store sales growth in the prior year. Pizza Hut same-store sales declined by 4% year-over-year, a slight improvement from the third quarter. The decline was largely attributable to soft trading conditions and underperformance in the dine-in segment.

During the quarter, KFC traffic increased by 3% year-over-year, a bounce back compared to the third quarter. Ticket average was flat year-over-year due to increased promotions. Pizza Hut traffic increased by 1% year-over-year. This is a significant improvement from the previous 3 quarters. Ticket average decreased by 5% year-over-year due to value campaign.

KFC restaurant margin improved year-over-year in the fourth quarter to 14.3% versus 13.9% in 2017, primarily due to positive sales leverage and store cost savings, partially offset by inflation, product upgrades and promotions. Pizza Hut restaurant margins was 4.9% in the fourth quarter compared to 6.4% in the same period last year. The brand stepped up promotional activities given the soft trading conditions which was partly offset by improved labor efficiencies and effective management of other store cost. Overall, Yum China restaurant margin was 11.5%, almost flat compared to the same period last year. For the fourth quarter of 2018, wage inflation was up 6% while commodity inflation was up 3% as compared to the same period last year.

For the third consecutive quarter, we recorded a year-over-year decrease of G&A expenses, ex FX. The decrease came from a mix of one-off benefits and ongoing cost control with a portion of savings we invest in technology and other key initiatives. On a full year basis, G&A expenses reduced by 9% year-over-year in constant currency. Our long-term goal remains to maintain G&A growth rate lower than the revenue growth rate.

Operating profit for the fourth quarter of 2018 increased by 84% year-over-year, ex FX. Factors such as same-store sales leverage, net new unit growth and G&A expense improvement made a positive impact on operating profit, partially offsetting the negative impact of inflation, increased promotional activities and the $12 million impairment on the intangible assets acquired from Daojia. Excluding the Daojia impairment, adjusted operating profit for the fourth quarter of 2018 was $96 million, an increase from $47 million in the prior year period.

For the fourth quarter of 2018, KFC operating profit improved by 19% year-over-year, ex FX. While Pizza Hut recorded an operating loss, the loss narrowed compared with the period a year ago due to one-off integration impairment charge last year. We recorded a tax benefit of $36 million in the fourth quarter as a result of adjusting the provisional amount of transition tax related to U.S. tax reform previously recorded in fourth quarter 2017. On a full year basis, the effective tax rate, excluding the special items, was 26.5%. In 2019, due to the progress made on the application of reduced withholding tax rate on cash repatriated outside of China, our best estimate of the effective tax rate is below 28%.

Finally, diluted EPS was $0.19 in the fourth quarter of 2018 compared to a loss of $0.28 in the same period last year. Adjusted diluted EPS was $0.12 compared to $0.14 in the same period last year. The decline in adjusted diluted EPS was due to a $27 million mark-to-market loss on our equity investment in Meituan which impact EPS by $0.07. Our Meituan shareholding is an investment made as part of our overall delivery strategy.

Next, let me cover our capital allocation strategy. In 2018, we generated net cash from operations of $1.33 billion, and free cash flow of $863 million, after subtracting $470 million in capital expenditures. Our balance sheet remained strong with over $1.39 billion in cash and short-term investments. With our healthy cash positions, we returned $191 million to our shareholders in the fourth quarter, including our cash dividend of $46 million and share repurchases of $145 million. There's approximately $960 million remaining under the new share repurchase authorization as of the end of 2018. Our recently increased dividend and share buyback authorization reflect our confidence in our business model and ability in generating cash.

Now I'll share our outlook for 2019. On the plus side, robust demand in delivery will help to drive our business. We expect continued sales momentum at KFC will contribute to our growth in 2019. However, we do see some challenges ahead as trading conditions remained soft and Pizza Hut's revitalization is still in progress. In addition, as we have had 3 very successful Chinese New Years since 2016, it will be a tough lap in the first quarter of 2019.

On the development front, we'll continue to roll out more new stores. We expect to build 600 to 650 new units. We expect wage inflation to maintain at high single digit and commodity inflation to be at low single digit for the full year, but higher in the first half of 2019 largely due to increases in poultry prices. Value campaigns such as Crazy Thursday and Scream Wednesday will continue as they are instrumental in driving sales and profit in the fourth quarter of 2018. With the accelerated store openings particularly in 2018, there will also be short-term pressure on the restaurant margin as these stores move up the maturity curve. We'll look to mitigate with ongoing operational efficiency improvements through digital and diligent cost management. I'm confident that these investments will pay off as the business continues to grow. Also note that Pizza Hut margin will remain under pressure as we continue to reinvigorate the brand.

We'll implement a new lease standard ASC 842 effective January 1, 2019. This will affect approximately 60% of our leases, which are on a fixed payment basis and with a term greater than 12 months. We estimate adoption of the standard will result in recognition of Right of Use asset and lease liabilities of approximately $2 billion and $2.2 billion, respectively as of January 1, 2019. In the absence of any impairment, there will be no material change on the rent recognized in the income statement. However, given the materially higher Right of Use asset on our balance sheet, any lease impairments may also be higher, negatively impacting operating profit in the year of the impairment. Please note that prior results have not been restated for the impact of this accounting change, and therefore comparative periods remain as reported historically. Upon adoption of the new lease standard, an additional impairment test for all qualified stores will be conducted in the first quarter. Changes to the lease impairment charges described above is expected to negatively impact our Operating Profit growth in 2019.

We maintain our long-term financial targets of high single-digit system sales growth, ex FX, around 17% restaurant margin and double-digit operating profit growth, excluding foreign exchange impact, although there'll be fluctuations quarter-on-quarter and year-on-year. Let me turn it back to Joey briefly before we open up the call to questions.

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

Thank you, Jacky. To sum up, 2018 marked another year of profitable growth for Yum China, thanks to the collective efforts and hard work of our 450,000 employees. Looking ahead, we are well positioned and prepared for uncertainties in the market, and we'll continue to focus relentlessly on driving profitable growth through innovation, first-class execution and consistently exceeding customer expectations. KFC continues to perform well. We are excited about the special offers we have prepared for Chinese New Year and the opportunities to add new units across the country. While we are not satisfied with our same-store sales at Pizza Hut, we are encouraged by the growth in same-store traffic in the fourth quarter as well as positive trends in customer feedback. We remain committed to the revitalization plan for Pizza Hut. We will continue to invest in profitable growth for our core brands to strengthen our leadership in China's restaurant industry. We look forward to welcoming our investors to our Investor Day on March 12, 2019, where we will have the opportunity to provide a detailed update of our performance and strategy. Those of you not able to join us in Shanghai can access via webcast.

With that, I'll pass you back to Florence to start the Q&A. Florence?

QUESTIONS AND ANSWERS

Florence Lip ***Yum China Holdings, Inc. - IR Director***

Thanks, Joey. We will now turn the call for questions. (Operator Instructions) Operator, please start the Q&A.

Operator

(Operator Instructions) Your first question comes from the line of Xiaopo Wei from Citigroup.

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

My question is regarding the new openings. Absolutely, KFC new openings is well ahead of expectations. But in terms of competition, what do you see the competitors' penetration into the low-tier cities and of their opening pace? Do you see any competition pressure of the new openings from your competitor?

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

Thank you, Xiaopo. For the KFC, we certainly exceed our own expectation as well. We opened 566 stores for KFC while we have also remodeled over 700 stores at the same time. But even for the additional stores we opened, it's important to note that we maintain our disciplined approach to ensure good payback. So for KFC, we still are able to achieve 2 years payback in -- across all city tiers in China. So right now, we are in 1,200 cities. Of course, we still have another 1,000 cities that we don't have any KFC that we can tap into. And for all these new stores opening or accelerated growth, we have our strategic partners to thank for as well and these are the very good strategic partners who we have been working with for over a decade. In terms of competition, my overall view is, well, I mentioned it before it's not something new to us, and we always stay agile facing the competition. And we are also mindful of the increased competition for best locations, especially in lower-tier cities. However, we do have rather a significant competitive advantage in the area such as a very strong development team across China, we have strong local knowledge, we have our own supply chain pretty much to support store in any part of China, and we have a very strong brand, especially in the lower-tier cities, thanks to early-mover advantage in the last 3 decades. So as a result, we are competitive. While we accelerate our growth of 2018 without sacrificing the quality of the returns, we will remain rather aggressive in 2019 with our new store openings. Thank you, Xiaopo.

Operator

Your next question comes from the line of Sara Senatore from Bernstein.

Leonardo Vasquez ***Sanford C. Bernstein & Co., LLC., Research Division - Senior Research Analyst***

This is Leo for Sara. So I have a question on the G&A expenses. Could you give some color on the one-off that you called out for this quarter? And how should we think about it in 2019?

Jacky Lo ***Yum China Holdings, Inc. - CFO, Treasurer***

Leo, thank you for the questions. So as I mentioned, for the third consecutive quarter, we record year-over-year decrease of G&A expenses. So our 21% year-over-year reduction in G&A expenses in Q4 came from a mix of one-off benefits, such as government incentives, also performance-based compensation and also from our ongoing cost control. So we have been actively controlling our G&A cost by simplifying the organizational structure, optimizing our procurement of different services and tightening expense policies so -- which all started to pay off in the last few quarters. So for the full year 2018, if we exclude all these one-off benefits, the underlying G&A expenses will have increased by about 1%, excluding FX. But our long-term goal remains just to keep G&A expense growth rate lower than revenue growth rate. But for 2019, due to the lapping of all these one-off benefits in 2018, the G&A growth rate may be higher. But as mentioned before, we intend to just continue to optimize our cost structure to manage G&A expenses.

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

Maybe I'll just add 1 comment on the G&A. We have full support from our own team, particularly headquarter staff, to support the G&A initiative because in the long term, we want to commit to our shareholder that we'll grow G&A below the revenue growth. I think that's a very good discipline. And in the short term, we also have the commitment from our staff that we'll save the G&A and we'll use part of the savings invest to employee benefits or the food to customers. So for example, we utilize part of the savings for 2018 to buy health insurance of the parents -- for the parents of our store managers. So that has very, very good impact, as you can imagine, for my staff. And within headquarter, we are very proud that our G&A savings, the money is being used very well at the end as well. So it's not only about savings, it's about using the money in an even better way. Thank you, Leo.

Operator

Your next question comes from the line of Chen Luo from Merrill Lynch.

Chen Luo ***BofA Merrill Lynch, Research Division - MD***

I've got 1 question on the chicken cost. We noticed that the chicken cost has increased quite a lot in China. And we also heard that recently, one of our key supplier has raised the supply price to us. Can you actually give us an update on how much -- what percentage of our food and paper cost actually goes to the chicken cost? And what is our estimate chicken cost increase on the full year basis for 2019? And what kind of measures are we going to take to mitigate the cost pressure?

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

Chen Luo, let me give some color about the chicken cost. In terms of chicken cost, you're right, in Q4, in particular the cost has gone up quite a bit. And we expect the trend will continue to early part of Q1 this year. But you can see the total cost of sales in -- for KFC for Q4 is slightly higher, slightly higher but not completely out of proportion. So I think the key question is how do we handle it? I think that's a really good question, not only for Q3, Q4 but in general, particularly for 2019 when value is such an important factor in our business. And the way that we have been doing it since Q3, Q4 in particular, is we leverage our scale and we also become innovative. For example, the single-bone spicy chicken, in Chinese, we call it Xiangguji is the part of the chicken that was never used in our business before. We just became more innovative and tried to find -- it's still chicken but slightly different part of chicken. And we cook it in a way that we're very, very good at and we sold it at very, very good price despite the increased chicken cost overall. So there are ways to do it. But it would require innovation in the food team, creative, marketing team and very flexible supply chain team and a very strong operational team. And I think for -- particular for Q4 this year, we have proved that we can do it and we certainly -- we'll take the learning for 2019 and going forward as well. Thank you, Chen Lou.

Operator

Your next question comes from the line of Brian Bittner from Oppenheimer.

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

You guys mentioned a couple of times that you're well-positioned to face potential market softness. Are you starting to see the macro change in 2019 thus far? Are you starting to see a softer backdrop just trying to triangulate why you mentioned that a couple of times.

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

Sure, Brian. Let me share my view of 2019 and then share some learning of both business from 2018 and then our view going forward. We see 2019 is a year of uncertainty, but we also understand customers actually look for value with great products. And for both brands, I mean at the same time, to be honest, 2018 was not easy either. So how did we do it? What have we learned in 2018? I mean for 2018, let's say, KFC. We, accelerate the store retention, focus on key regions such as East China, enabling us to achieve dominant market share in those regions. And for northeast part of China, actually, we achieved turnaround because northeast part of China has always been under challenge over few years due to even more challenging situation. And their hard work paid off. And we achieved positive same-store sales growth for northeast part of China for 2018 as well. And then, of course, we leverage digital initiative. We launched trendsetting new products like what I mentioned earlier, the spicy single-bone chicken and then we have the Crazy Thursday. And we have a good result. And then for 2018, for Pizza Hut. Pizza Hut was a transition year but we are happy to see despite a challenging 2018, the early indications that the plan is gaining traction with part of the traffic growth. And we scale back on new store opening, with complete remodeling of 225 new stores. And we also complete the transformation of the delivery business. And we launched the screaming Wednesdays to rebuild the permanent menu, et cetera, et cetera. So for both business, while KFC has proven to be a resilient business, Pizza Hut, we manage to go through this transformation. So for 2019, we would take these learnings and apply them in 2019 as well. In the long term, China is still a very attractive market with over 6% GDP growth, and we are committed to China. And we do have confidence that we are well-positioned to stay competitive and maintain the leadership position in China. I mean I just want to mention one more thing. Pizza Hut, obviously, with the value perception, because of higher ticket average, will be more challenged. However, for 2018, we also achieved good value perception from customers now. So even for Pizza Hut, we believe that we are finding that value perception improvement measures that we can continue into 2019 as well. So I hope that addressed your question, Brian. Thank you.

Operator

Your next question comes from the line of Michelle Cheng from Goldman Sachs.

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

My question is about rental negotiation. We see KFC has successfully accelerated store expansion. And we also hear a lot of leading brands, they have very aggressive store expansion as well. With this kind of economy slowdown, can you show us any changes or dynamics on the bargaining power over the landlords and possible to see any like cost saving on the rental side in the future?

Jacky Lo ***Yum China Holdings, Inc. - CFO, Treasurer***

Michelle, yes. I mean, we work very closely with a lot of strategic alliances like real estate developers. And right now, about 80% of our lease contain some sort of variable element that's tied to our sales. So that gives us a lot of flexibility in terms of managing our rental cost. And so I guess -- yes, just because we have been in China for over 30 years, we have established a great network with all these developers and we have the size and scale. So that actually gives us a lot of room in terms of managing our rental cost and also just opening -- selecting good sites, opening store locations, yes.

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

Maybe I'll just add a few comments to the rent. First of all, Michelle, it's an ongoing effort. It's always difficult to negotiate rent with landlords, but we've been doing this for 30 years, and we'll continue to do that, and we've been pretty good with that. Secondly, in terms of negotiation power, it's related to brand positioning, brand power and also sales. Because at such high percentage of rent tied to sales on -- there are a few benefits. One is it goes with the sales. And to the landlord with our robust sales right now, they get more rent as well. So that helps our ability to secure good sites and negotiation power. On top of that, in lower-tier cities, we have, as I mentioned earlier, very strong competitive advantage compared to our competitors in terms of brand, in terms of rental negotiation. So we remain reasonably confident to manage our rental cost going forward for both businesses. Thank you, Michelle.

Operator

Your next question comes from the line of Matt McGinley of Evercore ISI.

Matthew Robert McGinley ***Evercore ISI Institutional Equities, Research Division - Restaurant Analyst***

My question is on the new unit growth. Your gross openings from a unit standpoint of 800 far exceeded the high end of your plan to do 650. My question is compared to the existing store base, were these smaller units or any different than the existing store base that you're able to put up more of them later in the year? And the second question is on the closure rates. Overall, they remain high even at KFC. Was there any increase in the number of units that relocated during the year? Or this is just normal management of underperforming locations that's a normal course of business?

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

I'll take it. Okay. So Matt, this is Joey, for the new stores. Overall, on average they are smaller for both business. And for KFC, as you are aware, we've been doing it for a few years now so it's nothing new. For Pizza Hut, for the new store that we opened, we also tend to open smaller stores. But on top of that actually, we also have 2 things that we are pushing for: smaller store, faster service and more delivery friendly. So these are all important elements for the new stores. Or even remodeling, when we do remodeling for both business, we make sure we have an area called dedicated delivery room or delivery area to support the delivery. For the closure, I'll let Jacky respond to your question. Jacky?

Jacky Lo ***Yum China Holdings, Inc. - CFO, Treasurer***

Yes. In terms of the closure, I mean if you look at the number this year, we closed 318 stores. That's about 4% of our total portfolio. But I think we always said in our business, it's normal, it's healthy to close about 2% to 3% of our stores. So if you look at the breakdown, 144 is actually KFC. So that's 2% of our portfolio. That's very normal. For Pizza Hut, it was 112 stores. That's 5%. But the reason of the increase is due to more closure from the integration of dine-in and home service, which we complete by the end of this year. And also we were closing some nonperforming stores. The remaining was Little Sheep stores. Because that's just strategic reason. We are trying to strategically upgrade the location and also we are upgrading the franchise operators to improve the quality of the overall brand. So that gives you an idea in terms of like the breakdown of the closure.

Operator

Your next question comes from the line of Lillian Lou from Morgan Stanley.

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

Joey, could you give us a little bit more color about the recent Chinese New Year efforts? Because it's probably the most -- one of the most important seasons for the full year and that sets the tone for 2019.

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

Thank you, Lillian. Chinese New Year is always important, challenging and very exciting because everything happens within very short time. For us, the focus is on both food and labor on top of the marketing campaign. And for both business, let me talk about food and then labor. Food, we, right now, tend to focus on signature products with marked appeal. It's still very good value. And the whole preparation process need to be less complex, the whole focus for operation is to increase the speed of services. For labor, the most important bit here is robust plan. We have very, very good data with good level of detail to do forecast, even better than before. Why is this forecast important? Because they help the scheduling. As you are aware, for the Chinese New Year, the salary for the 3 Chinese New Year days is triple. So the accuracy of forecasting is absolutely important to get the right scheduling and then to make sure we have enough staff for the Chinese New Year, which we have started the preparation very, very early. On top of that, we need to make sure we have enough dedicated riders for the peak trading hours and peak trading days. And thanks to a lot of good effort and this transformation for Pizza Hut's side, we have dedicated riders for both business for Chinese New Year. So fingers crossed, we have prepared well for this Chinese New Year. So we always pray that the weather is good as well, which always helps. Thank you, Lillian.

Operator

Your next question comes from the line of Anne Ling from Deutsche Bank.

Anne Ling ***Deutsche Bank AG, Research Division - Regional Sector Head of Asia Consumer and Media Research***

I have a question on the accounting side for Jacky. So Jacky, you mentioned about the U.S. GAAP, the change in terms of your operating lease. I just want to check, did you mention that for year 2019, there will be no key change -- no -- like no material changes on the P&L? And you mentioned -- also mentioned about the higher impairment cost, potentially. So if I look at, like for example, in year 2018, if you use the new accounting treatment, what would be the impact? Just to give us some idea. And in that sense, does it mean that in the future, we should look at your EBITDA, which based on the new change -- accounting changes, there wouldn't be that much of the impact?

Jacky Lo ***Yum China Holdings, Inc. - CFO, Treasurer***

Yes, Anne, so in terms of income statement in the absence of any impairment, so there will be no change in terms of the rents being recognized. But in the impairment on the store, part of the corresponding right of use asset will be impaired as well. And I'll just mention the right of use asset we estimate to be about USD 2 billion. And we have to conduct an additional impairment test in Q1 this year. So in total, we'll be conducting 3 asset impairment tests, in Q1, Q2 and in Q4. So as far as how much of the right of use asset will be impaired in 2019, it is very difficult to estimate because there may be a large variance depending on the impaired stores. But if you look at the fixed asset balance at year-end and also the size of the right of use asset, they are about the same amount. So we anticipate impairment charges across the 3 impairment test in 2019 will increase roughly proportionately to the increase in the asset on the balance sheet from the Right of Use asset. In terms of EBITDA, I don't think there will be any impact. When there's no impairment, yes.

Operator

There are no further questions at this time. I would now like to hand the conference back to today's presenter. Please continue.

Florence Lip ***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. That concludes today's call. Have a great day.

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

Zhu dajia Xin nian kuai le!

Florence Lip ***Yum China Holdings, Inc. - IR Director***

Happy new year. Happy Chinese New Year.

Operator

Ladies and gentlemen, this concludes our conference for today. Thank you for your participation. You may all disconnect.