YUM CHINA HOLDINGS, INC.
3Q26 FINANCIAL RESULTS

EARNINGS CALL TRANSCRIPT

November 3, 2026

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PRESENTATION

Operator

Good day, everyone, and thank you for standing by. Welcome to Yum China's third-quarter 2026 earnings conference call. (Operator Instructions) Please be advised that today's conference is being recorded.

I'd now like to hand the call over to our first speaker today, Ms. Florence Lip, Senior Director of Investor Relations. Please go ahead, ma'am.

Florence Lip - Yum China - Senior Director, Investor Relations

Thank you, operator. Hello everyone, and welcome to Yum China's third-quarter 2026 earnings conference call. With me on the call are our CEO, Ms. Joey Wat, and our CFO, Mr. Adrian Ding.

Before we begin, please note that our remarks and investor materials contain forward-looking statements. These are subject to future events and uncertainties, and actual results may differ materially. Please refer to the cautionary statement in our earnings release and the risk factors in our SEC filings. We'll also discuss non-GAAP measures; the comparable GAAP measures and reconciliation are in our earnings release on ir.yumchina.com. You can also find the webcast replay and presentation there.

Please note that all year-over-year growth rates exclude the impact of foreign currency unless otherwise mentioned.

With that, I'll turn the call over to Joey Wat, CEO of Yum China. Joey?

Joey Wat - Yum China - Chief Executive Officer

Hello, everyone and thank you for joining us.

In Q3, we continued to grow sales and profit year-over-year. In reporting currency, revenue grew 8%, operating profit grew 13%, and diluted EPS grew 20%, partially supported by favorable foreign exchange impact.

Excluding F/X, system sales grew 3% YoY in Q3 and continued to outperform the catering industry. Core operating profit grew 6% YoY. We also achieved our 10th consecutive quarter of system sales, operating profit, and OP margin growth.

Importantly, we have delivered double-digit diluted EPS growth year-to-date and in each of the past three years, excluding the Meituan investment.

In Q3, same-store sales reached 97% of the prior year's level, primarily reflecting tough lapping from last year's delivery platform subsidies and the impact of extreme weather this August. With our dual focus on innovation and operational efficiency, restaurant and OP margins improved 50 and 40 bps YoY, respectively. This margin expansion demonstrates the resilience of our business and the disciplined execution of our teams in mitigating the sales deleveraging impact. It was also partially supported by license fee savings following the Pizza Hut brand acquisition in Mainland China.

We delivered our 15th consecutive quarter of positive same-store transaction growth, a key element of our growth strategy. Our breakthrough side-by-side modules are helping us capture new occasions and drive incremental sales and profit.

We also continue to build our brand and attract more customers to our stores through compelling in-store offers and experience, as well as greater takeaway convenience. Dine-in and takeaway performance improved sequentially, bucking the previous trend. Active members grew 6% YoY to 278 million, and our goal is to engage them across even more occasions.

We also continue to accelerate new store openings, adding close to 700 net new stores in Q3 – a new quarterly record. Total store count was 19,989, keeping us on track to surpass 20,000 stores this year.

Thanks to our team's strong execution and innovation, we delivered solid operational efficiency, which was particularly important this quarter. We proactively reviewed our store portfolio to reduce rent and lowered delivery rider costs on a per-order basis. We also improved supply chain efficiency through menu innovation. Together with dynamic promotions, this allows us to offer great value for money to consumers.

To ease the burden of our frontline teams, we have been automating and digitizing certain tasks, and shifting some to our operations support center. By combining frontline operational experience with AI-enabled intelligence, the center supports inventory replenishment, staff scheduling, as well as recruiting, training and online customer service for our restaurant teams. All of these efforts have contributed to our margin expansion and will continue to support our growth going forward.

Our innovative side-by-side modules have become meaningful contributors to incremental sales and profit. Their store economics have also improved.

KCOFFEE café exceeded 4,000 locations. The Apple Sparkling Americano sold more than 1 million cups per week during the peak summer season. Non-coffee drinks more than tripled YoY in Q3 with the addition of the popular Mango pomelo sago (杨枝甘露) and Sparkling Tea.

KPRO surpassed 700 locations. We expanded the menu to broaden its appeal, developing sandwiches as another sales growth pillar alongside energy bowls. We also introduced high-protein smoothies, which have been particularly popular with certain consumer segments and have generated strong repeat purchases. KPRO is now in around 250 cities, demonstrating solid potential for further growth.

Pizza Hut Burger Bar reached more than 300 locations in 50 cities, contributing double-digit incremental sales and meaningful profit to parent stores. Overall, Pizza Hut's burger category captured new customers – especially young people and solo diners – with sales growing in the high double-digit percentage YoY in Q3.

As side-by-side modules help us capture new occasions, our hero products anchor our strong fundamentals, inspiring innovations to drive sales and social buzz.

In August, KFC launched the Intriguing Oreo Original Recipe Chicken Burger (奥利奥味原味鸡汉堡), a new twist on last year's Original Recipe Chicken Burger, with a cocoa bun and creamy Oreo-blended sauce. *Trust me, it does taste pretty good.* On its first day, we sold more than 1.5 million burgers, roughly three times the launch-day sales of the Original Recipe Chicken Burger last year.

At Pizza Hut, pizza is our hero category, accounting for over 40% of sales. We sold 17% more pizzas YoY in the first nine months. In August, we launched the exciting Handheld pizza (手握披萨), targeting solo diners and on-the-go occasions. Made with our latest low-sugar, multi-grain crust and available with a variety of toppings, it offers a high-protein option under 500 calories. The Handheld pizza drove strong repeat purchases and attracted younger customers, helping us tap into the emerging light-meal market.

Let me now turn the call over to Adrian. Adrian?

Adrian Ding - Yum China - Chief Financial Officer

Thank you, Joey. Let me update the key financial highlights by brand, starting with KFC.

In Q3, KFC opened over 500 net new stores and exceeded 14,000 total stores. System sales grew 3% YoY, and Operating profit grew 4% YoY.

Same-store sales index was 97% of the prior year's level. Same-store transactions grew 3% YoY. Ticket average was down 5% to RMB 36. The rapid growth of incremental smaller orders from new consumer segments and occasions, such as KCOFFEE and KPRO, was partially offset by increased delivery mix, which carries a higher ticket average. This offset was less than in the first half, due to slower year-over-year delivery mix growth.

KFC's restaurant margin improved by 10 bps YoY, as efficiency gains more than offset sales deleveraging. This once again demonstrates our resilience and strong execution.

Moving on to Pizza Hut. In Q3, Pizza Hut added nearly 200 net new stores, with total stores surpassing 4,700 across 1,300 cities. System sales grew 1% YoY. Operating profit grew 21% YoY, partially supported by Pizza Hut license fee savings previously payable to Yum! Brands.

Same-store sales index was 97% of the prior year's level, with transactions up 5% YoY, the 15th consecutive quarter of growth. Ticket average was down 8% YoY to 65 RMB, in line with our mass-market strategy, primarily driven by value-for-money offerings and incremental smaller orders such as those from solo diners.

Pizza Hut's restaurant margin improved by 190 bps, or up 30 bps YoY excluding the license fee savings. Streamlined operations and automation more than offset higher cost of sales.

Let me now go through our Q3 P&L.

System sales grew 3% YoY, mainly driven by store growth.

Same-store sales index was 97% of the prior year's level, against a tough comparison from last year's delivery platform subsidies. Having accounted for the later start of the summer holiday, July was broadly in line with expectations. August was more challenging than expected. More frequent adverse weather impacted consumption, particularly in East China, one of our strongest markets. Delivery subsidies also scaled back faster than expected. We stepped up our efforts, and the sales index sequentially improved in September.

Our restaurant margin was 17.8%, up 50 bps YoY. Occupancy and other improvements more than offset higher cost of sales and labor.

Cost of sales was 31.5%, up 20 bps YoY, mainly from better value-for-money offerings and investment in our new modules, including KCOFFEE cafe, KPRO and Burger Bar.

Cost of labor was 26.5%, up 30 bps YoY. Rider cost remained a headwind, although the impact moderated from 1H to 30 bps this quarter. We kept non-rider costs relatively stable, with efficiency gains offsetting wage inflation and sales deleveraging.

Occupancy and other was 24.2%, down 100 bps YoY, helped by lease renegotiations, more favorable rent in lower-tier cities and other efficiency initiatives. Pizza Hut license fee savings also contributed 30 bps of YoY improvement.

OP margin was 13.0%, up 40 bps YoY. Operating profit was 451 million USD, growing 6% YoY.

Net income was 311 million USD, up 3% YoY, or flat excluding the Meituan investment. Our Meituan investment had a positive impact of 1 million USD in Q3, compared to a negative impact of 8 million USD in Q3 last year. As a reminder, we recognized 16 million USD less in interest income in Q3 this year due to a lower cash balance, resulting from the cash we returned to shareholders, lower interest rates, and more interest expense to fund the Pizza Hut deal. Diluted EPS was 91 cents, up 12% YoY, or 8% excluding the Meituan investment.

Following completion of the Pizza Hut brand acquisition, Pizza Hut was no longer subject to license fees, resulting in around 30 bp benefit to both restaurant and OP margins in Q3. Net of interest and financing expenses and taxes, the acquisition was accretive to diluted EPS by around 2 cents in Q3.

Let's turn to store openings. In the first nine months, we opened a record 1,888 net new stores. We are entering new cities and adding store density in existing cities to better serve customers. With our dual focus on system sales growth and same-store sales growth, over half of our new stores were opened in new cities, strategic locations, or trade zones with no dine-in or delivery coverage.

With nearly 20,000 stores spanning Tier 1 to 7 cities, a tiered-market playbook is essential. We developed store formats for lower-tier cities, including KFC Small Town, Pizza Hut WOW, and the KFC and Pizza Hut Gemini formats. These formats accounted for more than half of the new stores opened in lower-tier cities this year.

We also introduced a tailored menu at KFC for select lower-tier cities to better match consumer needs in these markets. It is a simplified menu featuring our signature products alongside specially designed items to deliver excellent value for money. Food is mostly made-to-order to fit the lifestyle in smaller cities.

Our new stores remain healthy, with a payback period of around two to three years. With a lower store opening hurdle and more flexible store formats with better-suited menus, we see significant opportunities across city tiers. Accordingly, we are raising this year's net new store target from 1,900 to over 2,400. With more than 20,500 stores expected by year-end, we are moving closer to our goal of 30,000 stores by 2030.

Now, moving on to our 2026 outlook. Let me start with sales. We are working hard to deliver a sequential improvement in same-store sales index in Q4 despite its higher base. While we continue to face tough comparisons from last year’s delivery subsidies, we exited Q3 with better momentum in September, and October was broadly in line with our expectations. In November, the autumn school break is slightly more broad-based than last year, which could provide some tailwind. Overall, we are confident in delivering our 16th consecutive quarter of positive same-store transaction growth.

Moving on to margins. Before considering the impact of the Pizza Hut deal, we expect OP margin to be relatively stable YoY for Yum China in Q4. We expect rider cost pressure to moderate, and our efficiency and cost initiatives to support margins, including rent, labor productivity and capex. As a reminder, Q4 is seasonally lower in sales and profit, so sales volatility could have a more potent profitability impact.

The Pizza Hut deal will have a full-quarter benefit in Q4. It's expected to contribute around 50-60 bps of incremental restaurant and OP margin to Yum China. The Pizza Hut deal is expected to be accretive to Q4 diluted EPS.

Looking ahead to 2027, we are confident in delivering both sales and profit in line with the three-year growth algorithm outlined at our investor day last year. As we continue to accelerate store openings, we are targeting 0-2% same-store sales growth on a full-year basis, in line with our investor day target. We will provide more details on 2027 when we report our Q4 results in February.

In terms of capital returns to shareholders, we plan to return 1.5 billion USD to shareholders in 2026, around 10% of our market cap. In the first nine months, we returned 1,080 million USD, including 778 million USD of buybacks and 302 million USD of dividends. In Q4, share repurchases will be around 315 million USD, or about 20% above the average quarterly run rate in the first nine months.

From 2027, we remain committed to returning around 100% of annual FCF after subsidiaries' dividends to non-controlling interests. This is expected to be about 900 million USD to 1 billion plus USD on average in 2027–2028, and exceed 1 billion USD from 2028 onward.

Our capital return program reflects confidence in the long-term earnings power of our business.

With that, let me hand it back to Joey for future growth drivers and closing remarks.

Joey Wat - Yum China - Chief Executive Officer

Thank you, Adrian. As we expect sales growth to pick up over time, let me walk you through our key growth drivers.

In Q4, we'll continue our side-by-side module rollout and hero product innovation, which have proven effective. We are also focusing on bringing customers back into stores.

First, our side-by-side modules tap into large, fast-growing categories, such as light meals and burgers, where our trusted brand, national store network and supply chain give us a natural advantage.

KCOFFEE café is well on track to exceed 5,000 locations by the end of 2027.

KPRO is set to surpass 850 locations by year-end, with plans to reach 1,500 locations by 2027. We aspire to be a market leader in China's promising and underserved light meal market.

Burger Bar is set to exceed 500 locations at year-end, doubling to 1,000 by 2027. This helps us build awareness of Pizza Hut's burger category while driving incremental traffic and sales, targeting over 1 billion RMB in total burger sales at all Pizza Hut stores and the Burger Bar this year. This is around 5-6% of Pizza Hut sales.

Second, our hero product platforms. Chicken wings, Zinger, Original Recipe Chicken, whole chicken, egg tarts and their extensions represent close to 30 billion RMB or 40% of KFC's annual sales. They provide a strong foundation for efficient product innovation. Every quarter, we launch something new and exciting, driving repeat purchases and attracting new customers.

Third is to drive dine-in and takeaway. Our nearly 20,000 stores across China give us a strong platform. We are enhancing in-store offers, the dining experience and convenience to attract

customers to our stores. Building on our strong brand equity, we are also strengthening brand loyalty. Here are some examples:

At KFC, car-side pickup has expanded to over 9,000 stores, targeting over 10,000 by year-end. In addition to drive-thru, options like door-side pickup and curb-side pickup significantly improve customer convenience and investment efficiency. So far, over 12 million members have used these services in 2026, with strong repeat purchases. We target this business to reach 1 billion RMB in sales this year.

At Pizza Hut, the late-September autumn menu upgraded over 20 items. In addition to beef and chicken Fajitas, we added pork, shrimp and dual-protein options. The new menu also includes global flavors such as Tteokbokki, a Korean-style rice cake dish, with melted cheese and grilled pork. These items suit dine-in and bring new customers into stores.

Taken together, we are building brands designed to deliver sustainable growth, not just for Q4.

Now, a few words about the strategic benefits of owning the Pizza Hut brand in Mainland China.

In addition to increasing net new openings to 800 stores annually in 2027 and 2028, brand ownership also allows us to move more quickly on growth opportunities such as Burger Bar. Additionally, we're tapping into incremental opportunities such as the retail business with greater flexibility. We see potential to broaden both categories and distribution channels. Beyond our existing pasta and steak offerings, we are also exploring new product categories. Distribution will extend beyond e-commerce and our own restaurants to offline channels, including modern trade.

Overall, owning the brand gives us greater flexibility and agility in unlocking Pizza Hut's long-term growth potential in Mainland China.

To wrap up, while the market remains dynamic in the near term, our fundamentals are strong, and we are confident in our long-term growth. We estimate Return on Equity of around 19% this year. This is clear evidence that our growth is capital efficient.

On a three-year basis, we remain committed to the growth algorithm outlined at our Investor Day. We are laser-focused on execution. Put simply, execution is growth.

Now, let me pass it back to Florence.

QUESTION AND ANSWER SESSION

Florence Lip - Yum China - Senior Director, Investor Relations

Thanks, Joey. Now we'll open the call for questions. To give more people a chance to ask questions, please limit it to one question at a time. Operator, please start the Q&A.

Operator

Thank you. [*Operator instructions*] Our first question comes from the line of Michelle Cheng from Goldman Sachs. Please ask your first question, Michelle. Your line is open.

Michelle Cheng - Goldman Sachs - Managing Director

Hey, Joey, Adrian, congrats again for the consistent profit growth, market expansion, and market share gain. As we know, the environment is very challenging. And also, thank you, Adrian, talk about the same-store sales thoughts. Still want to explore the exact, the relationship among these same-store sales, store expansion, and margin a bit more. So given these volatile consumption sentiment and also the very fluid weather condition, how do we see, or how confident do we see the same-store sales growth? And especially, we continue to accelerate the store expansion. Do we really see some dilution on the same-store sales?

On the flip side, we actually continue to see the margin expansion. So at the end, should we just not look at same-store sales volatility in the near term, but we still have decent room for these cost optimizations to drive profit growth? So, as a result, the priority is actually profit growth, and no matter same-store sales is pulling in the short term, we are still confident to see the profit growth. So just want to understand the relationship between these three factors. Thank you.

Joey Wat - Yum China - Chief Executive Officer, Director

Thank you, Michelle. I think there are three points here. The same-store sales growth, store expansion, and then the consumer sentiment, and I will leave the profit question to Adrian.

Same-store sales first. As we mentioned in the prepared remark, Michelle, we faced tough lapping from delivery platform subsidies last year and more frequent adverse weather in August this year. With that said, even with the same-store sales pressure, we did deliver solid sales and profit growth. So system sales, operating profit, OP margin all grew year-over-year for 10th consecutive quarter.

And of course, for shareholder, our year-to-date diluted EPS growth is double-digit, following double-digit EPS growth each year in the past three years. It has been a long-term commitment.

And on top of that, the same-store transaction growth, which is the absolute key in our business, grew for 15th consecutive quarter. It's a very, very important element, if not the most important element of our growth strategy.

We continue to build our brand and attract more customers back to our store through compelling in-store only offers and experience, and of course, the bigger takeaway convenience. So therefore, dine-in and takeaway performance improved sequentially, bucking the previous trend. We will continue to drive that change over time.

One last bit about the SSG is, as someone clever say, sales is vanity, profit is sanity. And we, of course, want a bit of both. But if we must do the trade-off, we tend to focus on the profit, slightly more. With that said, we are still working very hard to deliver a sequential improvement in the same-store sales index in quarter four, despite its high base, and remain confident in delivering the three-year growth algorithm in 2027, as mentioned by Adrian in the prepared remark.

Now, come to the store opening. We are both entering new cities and adding store density in existing cities to better serve customers. We have dual focus on system sales and same store sales growth.

Over half of our new store openings were opened in new cities, new strategic locations, or trade zones with no dining or delivery coverage to mitigate the cannibalization. However, naturally, there's some sales transfer that may impact the same store sales growth, but it's important to recognize that we are driving incremental sales and profitable growth while protecting the margin.

Point three about the consumer sentiment. We continue to see improving trends and believe that some volatility along the way is normal. The sequential improvement in September retail sales compared with August is encouraging.

As I mentioned in my prepared remark, certain consumer occasions have been growing very nicely and rapidly, light meals and burgers. Consumers are willing to spend when offered innovative product and experience with strong value for money.

We also continue to see significant opportunities from the ongoing chainification. The chain restaurant penetration in China is still relatively low, but has grown from 20% to 30%, but it's still low compared to 60% in other mature markets. Last but not the least, we continue to see some stabilization in pricing trends, with more players becoming more rational on discounts and even taking price, reflecting a more supportive consumer environment.

Adrian?

Adrian Ding - Yum China - Chief Financial Officer

Thank you, Joey. Michelle, I guess, to the final part of the question on margin, you're kind of right that our margin performance has been very resilient, despite there are some challenges on comp sales. And indeed, a lot of credit to the team on the strong execution. As Joey mentioned in the prepared remark, execution is growth. Specifically on margin, I'll briefly comment on quarter three and then addressing your question regarding the near-term outlook.

On quarter three, obviously, as you noted from our earnings release, O&O's improvement more than offset some slight increase in COS and COL. And among the O&O line items, obviously thanks to Project Sacred Cow that we mentioned previously in our earnings, rental has a good improvement. And this quarter, our rental gets to approximately 8%. We don't normally externally disclose our exact rental for store, but this is a key milestone that reaches slightly below 8%, approximately 8% for the first time, ever since our listing back in 2016.

AMP, there's slight improvement as well as percentage of sales, given our efficiency improvement there. And also, there is some contribution by the Pizza Hut transaction. And as I mentioned in prepared remarks, that contribution is roughly 30 basis points of sales. So that's on Q3.

If you look at near term, or speaking of 2027, as Joey pointed out, we're still quite confident to achieve 0% to 2% of comp sales in 2027, in line with our Investor Day guidance. Specific on margin, if you think about COS, COL and O&O, for all the three lines, I'll provide a bit more color in February earning, but I'll just give very high-level preview, kind of preview on these line items.

For COS in 2027, we think it will be broadly stable for the group. Obviously, for Pizza Hut, it may slightly improve over the roughly 34% level for this year, as we previously guided. And for COL, if you think about the delivery sales mix, it will be broadly stable, similar to this quarter of 54%, or only slightly up. So the overall pressure on rider will be moderate next year, compared to this year when we lock in last year.

And lastly, when you think about O&O, the Project Sacred Cow impact on rental will be a structural impact that will still benefit next year as well, and we'll still enjoy some benefits on depreciation and probably a little bit on AMP. So overall, let me get back to our Investor Day guidance.

We think our restaurant margin for KFC will be broadly stable. That was consistent to what we guided back last year in our Investor Day. For Pizza Hut, before considering the Pizza Hut transaction, the restaurant margin will slightly improve, hopefully next year. And then we're still quite committed to deliver double-digit EPS growth. That was actually achieved in each of the previous three years, as well as year-to-date. So we continue to commit to that next year as well. Michelle, thank you.

Michelle Cheng - Goldman Sachs - Managing Director

Thank you, Joey, Adrian, very, very clear.

Operator

Thank you. The next question comes from Chen Luo from Bank of America. Please ask your question, Chen. Your line is open.

Chen Luo - BofA Merrill Lynch Asset Holdings Inc - Analyst

Hey, Joey and Adrian. Congrats again on the stellar earnings, of course. I hate to ask this question because we always regard YumC as a steady compounder, driven by very good expansion as well as margin management. But it seems that the market currently cares all about just SSSG.

So Q3 is already behind us, so now all the eyes are on Q4. Just now in the opening remarks, Adrian mentioned that October SSSG was broadly in line with management expectation. I also highlight that in November this year, we are going to see more regions adopting the autumn school breaks. Can we share a bit more color on the Q4 SSSG trend as well as our outlook? For example, October was pretty much in line with expectation. So with regard to expectation, does it refer to the 0% to 2% SSSG that we guided historically?

And also, we all know that based on channel checks, November comps were very difficult, but that was partly due to the first-time introduction of autumn school break last year, whereas this year, there were more regions adopting this break. So I am very confused. Is November really having a tough comps or because of more holidays in more regions this year, actually November should be okay? Any color would be helpful. Thank you.

Adrian Ding - Yum China - Chief Financial Officer

Thank you, Luo Chen. Well, indeed, I understand that the market actually cares a lot about the comp sales. And again, before I answer the question specifically on color on comp sales, I would like to reiterate that for us, as Joey mentioned in the previous Q&A, sales is vanity, profit is sanity, right?

And so obviously, in normal times, we will get both. But in special situations, for instance, quarter three, when we face the extreme weather in August, in those kind of situations, if we have to choose one, we kind of choose profit, and hopefully that is also what our shareholders want. And the fact that we deliver a double-digit EPS growth in each of the previous three years as well as year-to-date also demonstrates the track record there.

And to answer your question on comp sales for quarter four, in October, as I mentioned in the prepared remark, it is broadly in line with our internal expectation. If we were have to provide some a little bit more color, I would say, the Golden Week had a little sequential improvement over the Mid-Autumn Festival, which is a few days before the Golden Week, if people still remember, right? So there is a sequential improvement there. And October as a whole is in line, so there is no surprises, no negative surprise, no positive surprise, it is broadly in line.

November, we are only on the second day of November, and I guess the good thing is, the autumn school break is a bit more broad-based this year in November compared to last year, which may provide some tailwind. But the headwind is obviously quarter four of last year has an index of 103, which is meaningfully higher than the rest of the three quarters in the base last year. So it is a tough lapping, but we are working hard to try to achieve a sequential improvement in our comp sales in quarter four over quarter three.

But I think if you were to look at further down the road in 2027, I think we are quite confident to achieve 0% to 2% comp sales for full year 2027, which is actually only two months from now. I know I didn't give overly concrete information on quarter four comp sales, because it is still two full months to go, but hopefully that color may be potentially helpful. Thank you, Luo Chen.

Chen Luo - Bofa Merrill Lynch Asset Holdings Inc - Analyst

That is already very helpful indeed. I know how difficult or fluid the situation is, and I really appreciate any efforts to share as much information as possible, and also hope that our operation can go from strength to strength.

Adrian Ding - Yum China - Chief Financial Officer

Thank you.

Operator

Thank you. And our next question comes from the line of Lillian Lou from Morgan Stanley. Please ask your question. Lillian, your line is open.

Lillian Lou - Morgan Stanley - Managing Director, Equity Research Analyst

Thanks a lot, Joey and Adrian. I have a question on Pizza Hut, because on the Investor Day, for the next three years or longer term, there should be better growth coming from Pizza Hut. I know there should be some short-term volatilities, but based on this year so far, in particular third quarter, I think Pizza Hut system sales have been slower than KFC. And would like to understand whether it is just a one-off, in particular because of weather, because of some short-term volatilities, or how do we see Pizza Hut again as a driver for the whole Group? That's my main question.

And just to double-check, given the comment on fourth quarter same store sales, we don't have so-called guidance for 2026 same store, right? Just a small follow-up check. Thank you.

Adrian Ding - Yum China - Chief Financial Officer

Lillian, let me address your question here. Your final part of the question on guidance for comp sales for full year, yes, given the fluid situation, particularly around the lapping of delivery subsidy, and as I mentioned in prepared remark, the subsidy did scale back faster than expected in quarter three. And obviously, the August extreme weather didn't help. It's a peak month of the year as well.

We didn't explicitly guide in this earnings on a full year comp sales for 2026, but we did guide on 2027 outlook. And also we reiterated our guidance for the three-year growth algo. On a three-year basis, we're still quite confident to achieve our guidance that we shared on Investor Day.

On Pizza Hut growth, as you correctly pointed out, in near term, there is some dynamic situation. Also, we are indeed working on the various strategic levers on improving the Pizza Hut growth. But if you looked a bit more further down the road, we are confident that Pizza Hut will deliver very solid growth. I think we gave some figures back at our Investor Day. Specifically, we guided a restaurant margin of 14.5% before the Pizza Hut transaction by 2028. And if you were to include the impact of Pizza Hut transaction, hopefully the margin will exceed 17% by 2028.

Obviously, we will invest a bit of the margin, saving from the 2.8% into new stores, because new store in the first year, the margin is lower than the normal stores because it takes around three years for the stores to mature. We'll invest a bit of the margin on new modules such as Pizza Burger Bar, although it's profit accretive, but it's slightly margin dilutive, as we pointed out previously. But overall, we are still confident to achieve a restaurant margin of approximately 17% or slightly higher by 2028. That will actually imply Pizza Hut will get to KFC's restaurant margin level in a bit more than a year's time.

And also, in terms of the new store growth, we dialed up the annual open guidance from 600 to 800 stores each of 2027, 2028. Hopefully, if you have an own assumption on comp sales for each of the next two years, that will give you a high-level top-line growth figure. And then with the margin expansion, you can get to a high-level bottom-line growth figure. Despite the short-term dynamic situation, we are confident about the mid- to long-term growth potential of Pizza Hut.

Joey Wat - Yum China - Chief Executive Officer, Director

Lilian, just a few more comment on the Pizza Hut growth. First of all, we are truly excited to buy back the brand because it does give us both short-term and long-term strategic implication in a very positive way. And I would just like to highlight the few key growth driver.

First of all, pizza. We don't talk enough about it. I mean, pizza is 40% of our business, and year to date, we sold 180 million pizzas already, and the number is 17% up year-over-year. And that's the number of pizza. I mean, the sales number is slightly less because these are the incremental. A lot of it is incremental, like the smaller order, the smaller pizza, solo diner. But that's fantastic because this is 40% of our business. And particularly the one-person pizza, the smaller one, it increased by 40%. I mean, in this market, like anything double-digit, not to mention 40%, is something that we are excited about.

Secondly, the Burger Bar that we talked quite a bit, we expanded to 50 cities in just nine months. 300 locations, and we are targeting 500 by end of this year, and 1,000 locations by 2027. And the investment is rather sensible and modest, really, but yet it delivered double-digit sales uplift and incremental profit to the parent stores. That's something to be excited about for the Pizza Hut business.

The third, the Pizza Hut WOW, is still going very nicely, and the store count doubled year-over-year to 490 year-to-date. And we're going to do more by end of the year. And this is very effective to help us entering new cities. For many years, Pizza Hut business stuck at 900 cities, but now with the new modules and more store formats, we enter 350 new cities in a year, which is fantastic breakthrough and milestone for Pizza Hut. So all these are something that we are quite excited about.

And then not to mention, buying back the brand allow us to do something strategically much faster. For example, retail. I don't know whether some of you guys have tried already. It's just this week, we start to sell frozen durian, which is just retail, like sold through retail.

I try myself. It smells fantastic. It smells and tastes like durian ice cream, but it's real durian frozen. I mean, now we own the brand, we can make this kind of decision and try new things much, much faster. Quite excited about Pizza Hut growth prospect in the short term and the long term too. Thank you, Lilian.

Lillian Lou - Morgan Stanley - Managing Director, Equity Research Analyst

Thanks a lot, Joey and Adrian.

Operator

Thank you. Our next question comes from the line of Anne Ling from Jefferies. Please ask your questions, Anne. Your line is open.

Anne Ling - Jefferies - Analyst

Thank you very much, management team. Just a quick one. Just want to check regarding last year, 4Q, how much of the 3% same store is coming out from the delivery subsidy, and how much is coming out from the autumn break? So just wanted to check the base impact.

Regarding the 4Q outlook, it is like we are expecting a sequential improvement versus third quarter, right? Do you expect that you will also be, at this point, able to gain some share from the peers?

Some of the same store sales is actually coming out from the peers rather than the industry growth. Thanks.

Adrian Ding - Yum China - Chief Financial Officer

Thank you, Anne. Well, I think this question is, it is very hard to break down the impact of the delivery subsidy back in quarter four last year versus the school break in quarter four. But what I would say is, given it is the first time of a multi-provincial school break in quarter four last year, the impact was actually a little positive surprise to us, right, back in quarter four. And that is why when we reported our February earnings, we also mentioned kind of the same comment. And then hopefully the 3% positive comp sales was a little surprise to the market. I did not give the exact breakdown, because it is hard to break down that way.

This year is the second time with the ad hoc school break in November. It is slightly more broad-based compared to last year, and we look forward to seeing how the trading goes in November. And I would encourage people to also focus equally importantly October, November and December. December is important as well. We have lots of campaigns lining up in the coming two months. So at this point in time, what we can say is we are working very hard to try to achieve sequential improvement comp sales in quarter four.

And your second part of the question is, if I remember correctly, whether we are taking shares from competitors.

Anne Ling - Jefferies - Analyst

Right.

Adrian Ding - Yum China - Chief Financial Officer

I would say the market is large enough. I think in our previous earnings as well as earlier in the Q&A, Joey did comment on the fact that the chainification rate here in China is still quite low. For restaurant, it is 20% to 30%. For beverage, it is much higher. If I remember correctly, it is around 60% for beverage chainification rate. So that is why you will see lots of new players and existing players are actually in the catering space and opening stores in a very fast fashion.

And the market is large enough to accommodate lots of successful players. And if anything, if you are thinking about the consumer sentiment, as we mentioned earlier on the call, we think overall speaking, the overall consumer is more open-minded about the rational discounting, more rational discounting, as well as a little bit of pricing that we all observed throughout the year.

Although arguably, week-over-week, month-over-month, there is some volatilities in the overall promotional environment. But if you were to compare this year over next year, sorry, this year over past year, I think arguably most people would believe that the whole consumption sentiment is more rational.

All I'm trying to say is that the market is still quite favorable for a chain restaurant like us, and also it is not only favorable to us, it can accommodate and support multiple successful players in the

space. And we look forward to growing our market share, continue building our brand in China. And we give quite a bit of color in terms of how we think about our store opening strategy in our prepared remark as well as earlier on the Q&A as well. That is, I guess, the response to your question, Anne.

Joey Wat - Yum China - Chief Executive Officer, Director

Just one more comment for your question, Anne. Last year, with the platform subsidies, Yum China, in general, we are quite disciplined with our trading, particularly in food, because the cost of sales in food is quite high. So we are very disciplined.

We do take some subsidy and invest in the emerging business, like the Lavazza and the smaller emerging business, and drinks. Drinks for us, for KFC, is about mid-teens in terms of mix, and it is about low teens for Pizza Hut in our mix. And both drink business actually for quarter three grow quite nicely, actually have positive growth because we have quite a few new drinks launch, which were proven popular among customers. I think that is the context I can share with you, Anne. Thank you.

Anne Ling - Jefferies - Analyst

Thank you, Joey.

Operator

Our next question comes from the line of Christine Peng from UBS. Please ask your question, Christine. Your line is open.

Christine Peng - UBS AG - Head of Greater China Consumer Sector

Hi. Thanks for the comments given by the management so far. So I have a question specifically for Adrian in terms of your earlier comment about labor cost. So basically, your comments point to a steady cost of labor as percentage revenue in 2027. So having said that, we do notice that the Chinese government is putting into place a stricter enforcement of social insurance collection, especially in recent months. So I just want to understand what are the assumptions behind this cost of labor stable kind of trend you are foreseeing in 2027? Are there any specific measures you can share with investors?

And one thing I also want to clarify with you is that you are mentioning the Pizza Hut China acquisition is bringing 30 bps of margin expansion in the third quarter alone. But when I look at the details, the cost of occupancy and others as a percentage of revenue for Pizza Hut actually, its percentage dropped more than 200 bps on a year-on-year basis. And so I just want to understand the 30 bps margin expansion, how that compare with the more than 200 basis points of margin savings in the cost of occupancy for Pizza Hut in the third quarter alone. Thank you.

Adrian Ding - Yum China - Chief Financial Officer

Thank you, Christine. The final part of your question, I think the 30 basis points margin expansion is for the Group. And if you were to calculate the impact on Pizza Hut, I believe it will be around 170 or 160, 170 basis points for Pizza Hut. So that kind of is the difference there.

And the second part of the question, I guess I'm responding in reverse order. Please bear with me. The second part of the question is on the assumptions on COL. So the recent stricter compliance or requirements by the government on social benefit and social security has no impact on us because as you and hopefully everyone else on the call know that we are super compliant in terms of the different regulations. Specifically on social security, right?

Our social security base for our full-time employee is calculated on the actual wage, which include the base pay, the bonus, the overtime, et cetera, et cetera. It's not calculated on the minimum wage, right? So hopefully that's kind of the core part of your second part of the question.

The first part of your question is on the COL outlook for next year. You mentioned broadly stable. I think, yeah, that's kind of what we meant. But more specifically, what we meant here is the pressure on COL and the pressure on rider cost will be much more moderate next year compared to this year, right? Because this year, we're having mid-50s delivery mix for the full year, lapping last year, especially in the first half of last year, it's around 40% in the mix, right? That's a significant pressure on the rider cost.

But coming into quarter three, if you look at the rider cost, it's only 30 basis points of cost increase. So the pressure already meaningfully moderated compared to more than 150 basis points in the first half of the year. So hopefully that moderation on rider pressure will last into quarter four and next year, because next year, as we mentioned in the earlier part of the Q&A, the delivery sales mix will be broadly stable compared to where we are right now.

And if you use the broadly stable figure, the mid-50s percentage of delivery sales mix lapping this year, which is, let's say 53%, 54%, I believe, for full year, it will be only slightly increased or broadly stable, right? And then if you take into account the wage inflation and all that, the COL, hopefully the pressure will be much more moderate.

And the key levers in driving COL efficiency to mitigate wage inflation is really the digitalization, the process optimization, and centralize of many of the tasks, including recruitment, training, interviewing, inventory replenishment, labor scheduling, even some of the preparation work of the raw materials, we centralize some of those. So these are the measures, as we mentioned in this earning and previously, to drive our COL efficiency. But overall, COL, that will not decrease, just to be clear. It is just the pressure will be much more moderate compared to previously.

Joey Wat - Yum China - Chief Executive Officer, Director

Just one comment on the other side of the cost. While we'll maintain the stable COL with all the factors Adrian talked about, I just want to highlight that our store managers really are the hero to help us manage the COL. Because right now, between KFC and Pizza Hut, somewhere between

70% to 80% of the stores are run by what we call Mega RGM, mega store manager, who run two to four stores with the help of the centralization, digitization, automation.

The other side of the equation I want to emphasize is, one, these Mega RGM, their take-home pay has been increasing by mid-teens in the last two to three years, despite we keep the overall labor cost stable. And the turnover rate is somewhere between mid-single digit for the Mega RGM. So not only we kept the COL stable, but we are retaining the best store manager, and we continue to give them a very nice salary increase. So that we have the best people to run our stores, which is the best way to protect the business in the short term and long term. Thank you.

Operator

Thank you. In the interest of time, we will take our last question from the line of Siyang Wang from CICC. Go ahead Siyang, your line is open.

Siyang Wang - CICC - Analyst

Thanks for taking my question. I am Siyang Wang from CICC. Still congratulations on delivering resilient growth. My question is on new store openings. You have raised the year's net opening target to 2,400. What new market opportunities have led you to increase the target, and how do the sales and the profit of new stores compare with those of mature stores? That is all.

Adrian Ding - Yum China - Chief Financial Officer

Thank you, Siyang. So indeed, we raised our target from 1,900 to over 2,400 for the year, which represents roughly 13% of the store base end of last year. And we do see vast opportunity, ample opportunity, and white space here in China.

And as we mentioned in our prepared remarks, over half of our new store openings have been in lower-tier cities, strategic channels, and areas or trade zones with no existing dine-in or delivery coverage. Those we call the (双空白), double white space. That is actually incremental opportunity for us, and it is important for us to open store there quickly to better service our consumers there and build our brand equity, because we firmly believe the strong brand equity and one of the leading brand equity here we enjoy at the Western QSR space here in China is with the past four decades hard work, building a lot of our stores in high-tier city, followed by mid-tier city. And now, we are actually quite expanding into lower-tier city in a fast fashion, leveraging on our new store model like KFC Small Town, Pizza Hut WOW, and KFC and Pizza Hut Gemini model.

And we are conscious of achieving a balance of comp sales, i.e. limiting the sales transfer, at the same time grow our top line as a whole and profitability as a whole. And that's why we give the color on over half of our new store open were in locations with limited or no sales transfer. So that is kind of how we look at it.

It is exactly because of the ample white space that we see here in China that we believe this step-up pace of store opening is something that we will continue to do over the next few years as well.

And hopefully with that, coupled with the solid comp sales, we will be able to deliver our three-year guidance as shared on Investor Day for both the top line, bottom line last year in November.

Joey Wat - Yum China - Chief Executive Officer, Director

And for both KFC and Pizza Hut, we still have 1,500 cities that does not have our stores. Particularly for Pizza Hut, there is still 1,500 city plus that has KFC, but not Pizza Hut. Just very, very simple math there.

And one last comment of our new store opening is, above all the new store target or new store opening, we are very disciplined, very, very disciplined that we want our new store to deliver two to three years payback. And that is the quality requirement before we talk about the numbers. Therefore, buying back the Pizza Hut brand helps Pizza Hut new store opening because we do not have to pay 2.8% royalty anymore, and expand the margin, allow more store to meet our requirements, and we can up the target. Now we also have the modules that is very suitable for entering the lower-tier city. It really helps. Thank you.

Florence Lip - Yum China - Senior Director of Investor Relations

Thank you, Joey, and thank you, Adrian, as well. This concludes our Q&A session. Thank you for joining the call today.

Operator

Thank you for your participation in today's conference. This does conclude the program. You may now disconnect your line.

D I S C L A I M E R

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