

**Yum China (Q4 2024 Earnings) transcript  
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**Corporate Speakers**

- Florence Lip; Yum China; Senior Director, Investor Relations
- Joey Wat; Yum China; Chief Executive Officer
- Adrian Ding; Yum China; Chief Financial Officer

**Participants**

- Michelle Cheng; Goldman Sachs; Managing Director
- Chen Luo; Bank of America; Securities Analyst
- Kin Shun Ling; Jefferies; Analyst
- Lillian Lou; Morgan Stanley; Equity Research Analyst
- Christine Peng; UBS; Head of Greater China Consumer Sector
- Yushen Wang; CLSA; Research Analyst
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**PRESENTATION**

Operator^ Good day. And thank you for standing by. Welcome to the Yum China Fourth Quarter and Fiscal Year 2024 Earnings Conference Call. (Operator Instructions) Please note that today's call is being recorded. I would now like to turn the conference over to your speaker Florence. Please go ahead.

Florence Lip^ Thank you, Operator. Hello, everyone. Thank you for joining Yum China's fourth quarter 2024 earnings conference call. On today's call are our CEO, Ms. Joey Wat; and our Acting CFO, Mr. Adrian Ding.

I'd like to remind everyone that our earnings call and investor materials contain forward-looking statements, which are subject to future events and uncertainties. Actual results may differ materially from these forward-looking statements.

All forward-looking statements should be considered in conjunction with the cautionary statement in our earnings release and the risk factors included in our filings with the SEC. This call also includes certain non-GAAP financial measures. You should carefully consider the comparable GAAP measures.

Reconciliation of non-GAAP and GAAP measures is included in our earnings release, which is available to the public through our Investor Relations website located at [ir.yumchina.com](http://ir.yumchina.com). You can also find the webcast of this call and a PowerPoint presentation on our IR website.

Please note that during today's call all year-over-year growth results exclude the impact of foreign currency, unless otherwise noted. Now I would like to turn the call over to Joey Wat, CEO of Yum China. Joey?

Joey Wat^ Hello, everyone. And thank you for joining us. We just celebrated Chinese New Year last week. I want to wish everyone a happy and healthy Year of the Snake. I'm excited to share that we achieved another quarter of strong results in quarter four, capping a record-breaking year. In the fourth quarter, system sales grew 4% year-over-year, outperforming the industry.

Same-store sales index sequentially improved to 99% of prior year levels. Restaurant margin and OP margin expanded significantly year-over-year. Core operating profit grew 35%. For the full year, we set multiple new records.

We opened a record 1,751 net new stores, ending the year with 16,395 stores. Adjusted operating profit reached \$1.2 billion. Core OP increased 12% and diluted EPS grew 22%. Our dual focus on operational efficiency and innovation led to improvements in both the top and bottom lines. Despite a challenging environment and value-minded consumers, our efforts have led to eight consecutive quarters of positive transaction growth.

We have sequentially improved the same-store sales index and expanded margins since quarter two. KFC has shown considerable resilience and growth momentum. KFC accelerated store openings and reached 2,200 plus cities in China. Delivery sales grew 16%, continuing our decade-long double-digit annual growth momentum.

2024 feels to me like an inflection point for Pizza Hut. It has made significant progress in transforming itself by enhancing its mass market appeal and operational efficiency. Core OP more than tripled in quarter four and grew 19% for the full year. Both brands have tapped into underserved markets and expanded into adjacent categories to drive incremental traffic, sales and profit.

Our breakthrough models KCOFFEE Cafe and Pizza Hut WOW showed promising results and have significant potential for further growth. I want to thank our incredible team for delivering these strong results. Embracing our people-first culture, we celebrated our achievements with over 11,000 restaurant managers at our RGM convention in Hong Kong.

We continue to delight our customers with great food and excellent value for money, and we are grateful to our shareholders for your continued support. With that, let me turn the call over to Adrian to discuss our results in detail. Afterward, I will share additional highlights on our CNY activities and our strategy. Adrian?

Adrian Ding^ Thank you, Joey, and Happy Chinese New Year, everyone. In 2024, all of our brands made notable progress. Let me share some color by brand. I'll start with KFC, which consistently delivered strong performance.

In 2024, KFC grew system sales by 6%, exceeding industry levels. We have developed innovative products for our flagship categories of Original Recipe Chicken and Juicy Whole Chicken, resulting in double-digit sales growth.

We have also expanded our delivery market share on aggregator platforms by capturing more smaller orders. At the same time, we improved rider efficiency and further enhanced customer

experience. KFC opened a record 1,352 net new stores in 2024, bringing our total store count to 11,648. Our flexible models enable us to broaden our reach with a mix of company-owned and franchise stores.

We added nearly 1,000 company-owned net new stores in 2024. The payback period for our new stores remained healthy at two years. 30% of KFC's net new stores were franchise stores. They help us unlock incremental opportunities in lower-tier cities, remote areas, and strategic locations such as highways, campuses, and tourist areas. KFC's growth potential in China is huge.

Coffee is a key growth driver for KFC. In 2024, KFC sold 250 million cups of KCOFFEE, marking a 30% growth. Our breakthrough KCOFFEE Cafe model expanded from around 50 cafes in 2023 to 700 cafes in 2024. We plan to expand the model to 1,300 locations by the end of 2025. KFC and KCOFFEE Cafe generated synergies, driving incremental sales and profit.

In terms of product innovation, aside from our signature fruity sparkling coffee, this winter, we launched the handshaken Americano with frozen pear. The drink features a real frozen pear(手摇冻梨美式), a traditional Northern Chinese delicacy, and has generated significant social buzz. Pizza Hut has made substantial progress in becoming more affordable for customers, and profitable for our company.

In 2024, Pizza Hut achieved the highest level of OP in RMB since our spin-off. Same-store transactions grew 5%. Restaurant margin expanded by 60 basis points on a comparable basis. Pizza Hut also opened a record of 412 net new stores, bringing the total to 3,724 stores. Pizza Hut's payback period for new stores improved from three years in 2023 to two to three years in 2024.

We're transforming Pizza Hut into a more mass-market brand by widening price range and enriching the menu. Sales of pizza priced under RMB 50 increased 50% year-over-year. Pizza Dough Burgers, a new category we launched in April, has already reached a low single-digit percentage of our sales mix, showing good potential.

As Pizza Hut expanded its addressable market, we also streamlined operations to improve efficiency. We managed to reduce our cost of labor by 110 basis points in 2024. Our breakthrough WOW model is gradually maturing, exceeding 200 stores in 2024. Dine-in sales saw solid growth, while delivery sales also improved. WOW stores attract younger customers and meet functional needs, expanding Pizza Hut's addressable market.

Although the ticket average is lower by design due to smaller party sizes and lower per person spending, we successfully drove transaction growth. Margins have improved since launch. We'll continue to refine the WOW model and expand to more locations in 2025.

Lavazza continued to grow through its dual growth engines of coffee shops and retail businesses. Store economics have meaningfully improved due to better operational efficiency and reduced new store capital expenditure. The retail segment saw sales grow of over 30% and became profitable in 2024.

We've made good progress in building appreciation for Lavazza's coffee expertise and enriching food choices, such as Lavazza's signature KAFA beans, considered the first coffee on earth, and our Michelin Star chef-themed food offerings.

For Little Sheep and Huang Ji Huang, our focus has been on improving their menus, refining store models, and strengthening their supply chain. Little Sheep's new conveyor belt hotpot model is designed to appeal to solo diners and younger consumers. Huang Ji Huang has demonstrated resilience, delivering profits for five consecutive years ever since our acquisition.

For Taco Bell in 2024, we pruned our store portfolio to focus on our key markets, Beijing and Shanghai. These efforts led to improved operating results.

Let me now go through our quarter four P&L. As a reminder, restaurant margin on a comparable basis excludes additional VAT deductions as well as temporary relief from landlords and government agencies received in the prior year. Core OP further excludes foreign exchange impact and special items.

For quarter four, system sales grew 4% year-over-year, and same-store sales index sequentially improved to 99% of prior year levels. KFC system sales increased 5% year-over-year. Same-store sales index improved sequentially, reaching 99% of prior year levels, with a 3% same-store transaction growth year-over-year.

Our widened price range, reduced delivery fees, and smaller ticket items, like coffee and breakfast, successfully attracted consumers. Quarter four ticket average was RMB 38, 4% lower than prior year levels, yet stable with quarter three.

Pizza Hut system sales increased 3% year-over-year. Same-store sales index achieved 98% of prior year levels, improving by 4 percentage points sequentially. Same-store transactions grew 9% year-over-year, the highest growth quarter in 2024. The ticket average was 10% lower year-over-year, which is in line with our strategy to transform Pizza Hut into a more mass-market brand.

More importantly, Pizza Hut's profitability continued to grow. Core OP in quarter four more than tripled year-over-year. Our restaurant margin was 12.3%, 160 basis points higher year-over-year. On a comparable basis, restaurant margin was 180 basis points higher year-over-year.

We achieved savings across all cost lines. Cost of sales was 31.9%, 50 basis points lower year-over-year. Cost of sales improved through favorable commodity prices and our spending better and buying better initiatives under Project Red Eye.

We continued to pass savings from these initiatives to our consumers, offering excellent value for money. Cost of labor was 28.2%, 80 basis points lower year-over-year, or 90 basis points lower on a comparable basis. Improved operational efficiency more than offset wage increases for our frontline staff.

Occupancy and other was 27.6%, 30 basis points lower year-over-year, or 40 basis points lower on a comparable basis. This came from cost optimizations such as utility savings and simplified operations.

Our OP margin was 5.8%, 140 basis points higher year-over-year, driven by improved restaurant margin. Operating profit was USD 151 million, growing 35% year-over-year. Core OP also increased 35% year-over-year. Net income was USD 115 million, growing 17% year-over-year.

As a reminder, our mark-to-market equity investment had a negative impact of \$9 million in quarter four, compared to a negative impact of \$14 million in the same period last year. We recognized \$16 million lower interest income this year from a lower cash balance. Diluted EPS was \$0.30, growing 27% year-over-year, or 20% excluding mark-to-market equity investment impact.

For the full year, system sales grew 5%, and same-store sales index reached 97% of prior year levels. Restaurant margin was 15.7%, steady year-over-year on a comparable basis. G&A expenses were 5.0% of revenue, in line with our target, and 80 basis points lower compared to 5.8% in the prior year. This was due to operational efficiency gains and lower performance-based compensation in the year, among other factors.

Operating profit grew 8% to \$1.2 billion. Core operating profit increased 12%. Effective tax rate was 26.7%, in line with our guidance and prior year. Net income was \$911 million, up 13% year-over-year.

Diluted EPS was \$2.33, growing 22% year-over-year, or 12% excluding mark-to-market equity investment impact. Now let's turn to capital returns to shareholders. We are on track to return \$4.5 billion to shareholders from 2024 through 2026, with a total of \$3 billion allocated for 2025 and 2026. The average annual amount is equivalent to around 9% of our market cap.

In 2024, we returned \$1.5 billion including USD 248 million in quarterly cash dividends and \$1.24 billion in share repurchases. Total repurchases exceeded 31 million shares, representing 8% of our total shares outstanding.

We generated \$714 million in free cash flow in 2024 and ended the year with \$2.8 billion in net cash. With our healthy cash position and robust cash-generating capabilities, we're stepping up our quarterly dividend significantly by 50% from \$0.16 to \$0.24.

Assuming \$0.24 per quarter, our payout ratio would be equivalent to over 40% of our diluted EPS in 2024. Additionally, our \$360 million of share repurchase plan for the first half of 2025 has been executed daily. We're committed to providing attractive capital returns to shareholders.

Finally, moving on to our 2025 outlook. We continue to maintain our dual focus on system sales and same-store sales growth. In terms of our footprint expansion, we are on track to reach 20,000 stores by 2026.

In 2025, we expect to open between 1,600 and 1,800 net new stores. Capital expenditure in 2024 totaled USD 705 million. In 2025, we expect capital expenditure to be in the range of USD 700 million to USD 800 million.

Turning to margins, while commodity prices remain largely favorable, we continue to expect wage inflation in 2025. With our ongoing efforts in operational efficiency, we expect G&A expenses as a percentage of revenue to slightly decrease for the year. For 2025, we expect to hold core OP margin relatively stable or even slightly improve it year-over-year.

By brand, we're committed to maintaining healthy restaurant margins for KFC and improving Pizza Hut in the mid- to long run.

As consumers celebrate the Chinese New Year, we're offering them delicious food, great value, and an enjoyable experience. While trading so far has met our expectations, we need to closely monitor post-holiday trading.

The external environment remains dynamic. Consumers are willing to spend more during holidays, but may become more cautious afterwards. We remain hopeful that stimulus policies may positively impact consumption in the mid- to long run.

For quarter one, we're confident that same-store transaction index will continue to be positive for the ninth consecutive quarter, and our goal is to outperform the industry. Let me pass it back to Joey for her comments on CNY and our strategy.

Joey Wat^ Thank you, Adrian. Building on Adrian's observations on Chinese New Year trading, I was delighted to see our stores bustling with customers. We offered them great food at an incredible value and exciting campaigns featuring Olympic champion and popular IPs.

At KFC, we brought crayfish back for the eighth consecutive year. We even combined it with our iconic Beef Wrap (香辣拌小龙虾嫩牛五方) to create a new customer favorite. Our Chinese New Year tradition is the Golden Bucket. This year, for the first time, it included a whole chicken, making it a great choice for sharing with family and friends.

At Pizza Hut, we introduced festive trade-up options for our pizzas such as Pistachio Stuffed Crust and Fortune Cat (招财猫饼底), a crust in the shape of Fortune Cat. In China, the pistachio symbolizes happiness and the Fortune cat represents luck and prosperity. Customers love these good wishes for starting the new year.

As I reflect on our industry-leading results over the past few years, I come back to our dual focus on operational efficiency and innovation. I think it's fair to say that most view these two as trade-offs, to get one you must compromise on the other.

At Yum China, we reject that as a false trade-off. We need both, and both is the only outcome we will accept. Operational efficiency has been a hallmark of Yum China from the beginning, but we have dialed up our efforts significantly in the last couple of years.

Our Project Fresh Eye and Red Eye initiatives have given us new perspectives on our operations and transformed our organization. They have made us more efficient, agile, and competitive, from our restaurants and shared service centers to our supply chain.

At the same time, we have doubled down on digitization, leveraging technology and Gen-AI to enhance customer experience and efficiency. The gains we have realized from these initiatives are not merely incremental. They represent structural improvements in our business capabilities that set us up for profitable growth far into the future.

Innovation colors everything we do in every aspect of our business. We introduced around 600 new or upgraded menu items in 2024. Exciting new food and excellent value for money drive traffic to our stores.

We innovated new store models such as KFC Small Town Mini and Pizza Hut WOW to tap into underserved customer segments. We have found that operational efficiency and innovation fit all and reinforce one another. We have employed innovation to attack the problem of operational complexity.

At KFC, our menu innovation focuses on infusing fresh energy into our flagship categories to unleash their huge potential. Our original Recipe Chicken burger (原味鸡汉堡), Gigantic Egg Tart (巨大的蛋挞) and Crispy Whole Chicken (薄脆炸全鸡), generated a lot of excitement. At the same time, we are simplifying operations to support these menu innovations.

The same strategy applies to Pizza Hut. In December, we launched a brand-new menu with delicious new products while streamlining operations. For example, the Golden Salty Egg Chicken Pizza (鎏金咸蛋黄嫩鸡披萨), crafted with our existing ingredients instantly became a popular choice. We also lowered prices on several of our iconic products while protecting margins.

Our value for money communication is now more straightforward and compelling. Customers love our new menu, and in quarter four, Pizza Hut achieved the best same-store transaction growth in 2024.

Before we turn to Q&A, I would like just to recap the three key takeaways from today. First, we achieved record-breaking results in 2024 from top line to bottom line. KFC remains our key growth engine and profit contributor. Pizza Hut has made significant progress, transforming in every aspect and feels to me as though it has reached an inflection point.

Second, our dual focus on operational efficiency and continuous innovation has made our business more resilient and competitive, positioning us for long-term sustainable growth. Lastly, we remain committed to both sustainable growth and capital returns to shareholders.

We are on track to return \$4.5 billion to shareholders from 2024 through 2026. The average annual amount represents around 9% of our market cap. This quarter, we are stepping up dividends by 50%. With that, I will pass it back to Florence.

Florence Lip^ Thanks, Joey. (Operator Instructions) Operator, please start the Q&A.

## QUESTIONS AND ANSWERS

Operator^ (Operator Instructions) We are now going to proceed with our first question. The first questions come from the line of Michelle Cheng from Goldman Sachs.

Michelle Cheng^ Hi Joey, Adrian. Congrats again for the very solid results. And we understand the consumption environment is still quite fluid. So I would like to take a chance to hear your observation on the competitive landscape.

So we indeed hear some companies who are slowing down the expansion and even they are starting to withdraw some of the promotion activities. And we noticed that KFC actually started to raise the price early of the year.

So are we seeing the competitive landscape improving? And also, we see more opportunities to further accelerate, penetrate expanding our market share. So it will be great to hear your insights.

Joey Wat^ Thank you, Michelle. We do see some rationalization of marketing promotion and also a little bit of a price increase including ourselves. So I think that is healthy because very modest price increase and the rationalization of the promotion, they do help to manage the cost pressure. So that is sort of the overall what we are observing.

However most importantly, I think, for us, we know what our focus and maybe I'll take this time to just really highlight the few things that Adrian and I will both make in our opening remarks earlier. Obviously our hard work in Pizza Hut for change, let me start with Pizza Hut.

We have done something right because we actually use the word inflection point for this quarter because we really have seen every aspect of the business has been transformed in a very positive way. The results speak for itself. Very nice improvement of the same-store sales, 4%, and then the OP improvement is solid. And then the net new store opening is 412 this year, 2024.

It's the best net new store in the last 10 years really, and still, the breakeven is two to three years. And the breakthrough of the two business -- of the business model, one is just to become even more mass market, which has been our goal in the last many years with the introduction of additional product and lowering the price. And then the second breakthrough is the WOW.

So a very nice result with very clear growth drivers. So we are at the inflection point for Pizza Hut. For KFC, it's a very big business already, but yet we still see quarter four and ongoing strong momentum and performance in three ways.

One is we continue to widen the offering in terms of price point, increasing the entry price point, but also higher ticket average, such as whole chicken. And then also, secondly, is the KCOFFEE improvement.

It's 30% growth for KCOFFEE alone, and that's very, very nice. And then the delivery, so delivery is not only one quarter, it's 10 years of double-digit increase. And net-net, for both

business, just to do another health check is -- the same-store transaction growth is -- it's nice and healthy on the eighth quarter of such.

So with all this happening, we are capturing incremental business and hopefully, a little bit of market share. But with that said, Michelle, it's still a very big market. And our market share, relatively speaking, is still very small, even though we are the biggest player in the market.

And there's still a lot of the opportunity for us to expand the business, have more market share by going to lower-tier city and going for the incremental franchisees store, et cetera, et cetera. I'll pause here. Thank you, Michelle.

Operator^ We are now going to proceed with our next question. The question come from the line of Chen Luo from Bank of America.

Chen Luo^ Hi Joey and Adrian. Congrats again on the results. So my question is focused on the new store expansion. We also noticed that; A) we have opened more and more smaller stores; and B) we are also expanding to more and more to the lower tier cities. And number three, we are now shifting from equity store-focused model to a hybrid model with more and more franchise stores to be opened in the next few years. And what's the implication from these changes?

For example, if you look at the second half numbers of last year, so our net store opening growth was around low teens. But then if you look at the revenue contribution from new stores, it should be around 5% for Q4 and about 6% for second half. And meanwhile, our franchise stores as a percentage of total net new stores increased to about 33% versus only teens in the first half.

So with all these things in mind, is it fair to say that the near-term algo in terms of the revenue contribution from new store opening in the coming few quarters could be just around 5% or 6%, similar to second half of last year due to smaller stores and more and more expansion into lower-tier cities as well as the franchise stores? I hope my answer is -- my question is clear.

Joey Wat^ Thank you, Luo Chen. I'll address your question of the new store and franchise store and then Adrian probably can help elaborate a bit in terms of relationship of the store number versus the revenue contribution.

So I mean Luo Chen, we are pursuing a dual focus on both returning a lot of capital to the shareholder and, at the same time pursuing high growth. So we have addressed the capital allocation already in our opening remarks.

So on the new store opening area, you can see that we just continue to be very aggressive with that because as I answered my question to Michelle earlier, there's still a lot of opportunity for us to open store, both in the top-tier city and lower-tier city.

And the strategy needs to be slightly different, but we see that opportunity. And then the lower-tier city right now is a big focus because even we observed the trading in the last year or even last quarter, lower-tier city is still doing better. So we'll continue to do that.

But it does require a different model, for example, lower investment, smaller menu, simpler operation, but net-net, the criteria is we still want a two-year payback for the stores across all city tiers and for KFC and two to three years for Pizza Hut. As long as we can achieve that, we'll continue our journey to open more store in top-tier city and lower-tier cities.

When it comes to the relationship between company-owned stores and franchisee stores, despite our accelerated franchisee store opening in the last year and particularly last quarter, the company-owned store still contribute to vast majority actually specifically 85% of our entire portfolio.

So it's going to take a while for the franchise store to catch up even though we are catching up. So for the company-owned stores, it does have very nice store economics. However why we're accelerating the franchisee store because they're incremental. They are incremental in two areas.

One is strategic location such as highway service center, college campus, hospitals, et cetera, et cetera. And secondly, they are in the lower tier city and remote areas as well. So both are incremental. And operationally, we can do it. Our team can do it.

And operationally, we have the appropriate store models such as KFC Small Town Mini for KFC. And then right now the Pizza Hut WOW is very promising for the lower-tier city as well. So therefore, we are doing more. So it's a natural development of our company's capabilities. And then I'll pause I'll let Adrian answer the relationship between the revenue and the stores.

Adrian Ding^ Thank you. Thank you, Joey. So Luo Chen, you are exactly right that the size of the stores become smaller and smaller. And it's worth noting that even for the larger stores, in the first year of their opening, the revenue tends to be smaller.

Overall, our new store that opened this year enjoyed a 50% to 60% of revenue compared to the mature stores. So that's the first point. The second point is the store week also play a role here. So if keeping all else equal, and net new store growth rate is the same, the time at which we open the stores within the quarter will play a role in the system sales growth.

So that -- I think these two points combined will address your question on the mathematical relationship there. And lastly, I think you asked the question over the next few quarters, what is our system sales growth guidance.

I think if overall macro situation is stable, as it is right now, we would, as you pointed out, enjoy a mid-single-digit growth of system sales this year in 2025. Obviously new store only play a portion of the role here.

It's important to note that SSSG is also important in deciding what is the ultimate system sales growth. So these two combined will contribute to the final figure of system sales growth. But at this point in time we do expect mid-single digit growth for this year, 2025. Thank you, Luo Chen.

Operator^ We are now going to proceed with our next question. The question come from the line of Anne Ling from Jefferies.

Anne Ling^ Thank you very much for taking my question. Just one question regarding the TA. So I understand that the same-store sales growth, the decline actually narrowed then like if we take a look at the breakdown, TA is still negative, but however, we have a very strong TC to offset this. So my question is, when do you think that this TA will start to turn positive, or yes. So I think that's the key question that I have, especially for KFC.

Joey Wat^ Thank you, Anne.

So our TA trend is basically consistent with our intended strategy to drive traffic. And as you point out, we continue to drive same-store transaction growth, it's the eighth consecutive quarter, and that allow us to grow our business in underserved market segment, which is working.

And at the same time it's important to note that while we are doing that, we are able, at the same time protect the margin as it show in the quarter four margin, restaurant margin or OP margin both actually improved because our TA strategy is also aligned with our dual focus on operational efficiency and innovation. And then answering your question about our plan going forward.

Well in the long term -- longer term, we take a balanced approach to maintain a steady TA. For example, our quarter four TA, which is KFC, would be RMB 38 is still higher than the TA pre-pandemic.

In the short term, our goal of the TA is to remain relatively stable. Our quarter four TA RMB 38 again is stable versus quarter three. And our focus is on value and then also widening the price range and also to drive the traffic and it's working.

And we don't have any material plan to change our approach even after the modest price increase back to December 2024. And for Pizza Hut, our strategy is to continue to drive the TA down to make it more mass market while improving the sales and the profit. Thank you, Anne.

Operator^ We are now going to proceed with our next question. The questions come from the line of Lillian Lou from Morgan Stanley.

Lillian Lou^ Hi Joey and Adrian, congrats again. My question is more on margin. Obviously I think the fourth quarter is another evidence of a very strong execution, efficiency and all around the operation management. And in particular, I think the payroll and the labor cost savings was quite significant.

So trying to understand going forward in 2025 with all the cost project initiatives continuing, what are line items in particular are we seeing more chance or savings further? And what kind of overall margin improvement trend we can expect for 2025?

Adrian Ding^ Thank you, Lillian. So let me try to address this question. Firstly, sales is an important factor to determine the margin for 2025. And I'll actually first state the conclusion first on the overall margin trend and then break it down for the different drivers.

As to the conclusion, as I mentioned in the prepared remark, we look to keep the core OP margin for the full year relatively stable or even slightly improve it year-over-year. And by brand, we're

committed to maintain a healthy restaurant margin for KFC and improving Pizza Hut restaurant margin in the mid- to long run. And then now I'll break it down into different drivers.

Firstly, I'll discuss about COS. So we continue to invest in value for money to drive incremental traffic and commodity price remained favorable, as I mentioned in the prepared remarks, in the near term, and we continued improvement -- continue to seek improvements through Project Red Eye initiatives, redesigning our product approach to optimize ingredient use.

In terms of our long-term guidance, we still aim to keep our COS at 31%, plus or minus 1%. But for the year of 2025, this ratio is likely to fall in the upper half of our guided range with some slight improvement year-over-year from 2024. So COS as a percentage of sales will slightly improve year-over-year, but it will fall in the upper half of our guided range. So that's on COS.

In terms of COL, we will face some headwinds. So we are facing ongoing cost pressure from wage inflation, which over the years tend to be low single digit to mid-single digit. And then increase in our rider cost is also a challenge because the delivery mix will increase. But to clarify, the rider cost per ticket will go down, as we previously discussed about, but the increasing delivery mix will make the rider cost as a percentage of our sales increase. We continue to make every effort to drive operational efficiency to partially offset those cost pressures on COL, but overall, we do expect to face some headwind on COL as a percentage of sales.

And then thirdly, coming to O&O. We do see much improvement from O&O from the past few years. If you compare 2024 from 2019 before the COVID times, there is a significant improvement in rental. Back then, the rental was around 10% of sales. Now as you know it's below 9%, although we don't disclose the exact figures. Depreciations also meaningfully improved as a result of capital expenditure improvement. And also, we see a higher return on investment on advertising expenses.

So advertising A&P expense have been improving over the past five years. And then speaking of 2025, we will continue to look for opportunities to generate some savings in O&O, but the O&O cost as a percentage of revenue is likely to be stable year-over-year from 2024 to 2025.

The opportunities that I mentioned include the AMP opportunities, particularly for Pizza Hut because the AMP as a percentage of sales for Pizza Hut is still slightly higher than KFC. So we do see some opportunities there. But for some other lines within the O&O, we also feel some pressure. So overall, for occupancy other costs is likely to be stable.

And lastly, coming to G&A as I mentioned in the prepared remarks, we target a full year G&A expense as percentage of sales to slightly decrease, but we do expect some quarterly fluctuations. So that hope gives you some more color on our margin. And in a nutshell the conclusion is the core OP margin will remain relatively stable or slightly improved year-over-year.

Adrian Ding^ Thank you, Lillian.

Joey Wat^ Thank you, Adrian. (inaudible) one short comment regarding the cost of labor. In terms of approach, specifically, what exactly have we been doing mainly focusing on a few things: simplification, automation, centralization, digitization. So all these activities in the stores

are going through these few approach to improve the efficiency of COL. So exactly what are we doing?

Well for example, generative AI, we'll be using generative AI to screen millions of resume and then also forecasting, et cetera, and that certainly helped save the labor cost. And we're also outsourcing some activities in the stores to the Central Kitchen and not only save the COL, also change the profile of the staff number in the store, which we're going to share more in annual report later on.

So specifically, that's what we have been doing, and it's been ongoing and particularly a focus since Project Fresh Eye last year as well. But it will be ongoing. Thank you, Lillian.

Operator^ We are now going to proceed with our next question, the questions come from the line of Christine Peng from UBS.

Christine Peng^ Thank you management for the opportunity to raise the question. So I have a very quick question regarding Pizza Hut WOW. I think Adrian probably mentioned earlier that Pizza Hut WOW, the capital return is actually pretty good compared with the traditional Pizza Hut store.

But I just want to get more clarity in terms of the store economics such as unit revenue, margin? So that we can better understand the potential of this business new format going forward?

Adrian Ding^ So thank you, Christine. Indeed, as I mentioned in the prepared remarks, Pizza Hut WOW, we do observe some pretty encouraging progress, but I need to caution that it's a new model that's only like a seven months old. It takes time for any new model to become mature. And the right word we are using -- we were using in the prepared remarks was the modest maturing as in the process of maturing.

So we do observe some early signs of significant outperformance on the dine-in part of the sales and the delivery part of sales, it's improving since the first Pizza Hut WOW model opened in May. But still, there is a slight gap versus the regular Pizza Hut model in terms of delivery sales. And in terms of margin, it's always our philosophy, the transaction comes first and then sales and the margin.

So margin, we're still in the process of fixing the margin. Currently, in terms of the 200 WOW stores, the COS and COL for many of those stores become broadly on par versus the regular Pizza Hut model as percent of sales. But the overall margin, there is still a slight gap versus the main model. So we are still in the process of fixing those.

So for the year, for 2025, the focus here on WOW model is really to, firstly, further improve the delivery sales; and secondly, to fix the margins. Obviously over the past seven months, over the 200 WOW stores, a vast majority or almost all of those stores are flipping from the regular Pizza Hut models.

We only opened the first new Pizza Hut Wow store in December. This year, we'll test opening new Pizza Hut WOW stores, especially we do see some good potential in lower-tier cities and in a highly competitive trade zones where the consumers do seek value for money.

So it's a new model again, and then it takes time for the model to mature, but we do have high hopes and excitement on this model. Thank you, Christine.

Operator^ We are now going to proceed with our next question, the questions come from Ethan Wang from CLSA.

Ethan Wang^ (inaudible) Just a follow-up question on Adrian's previous comment on the headwind on labor cost.

So Adrian you mentioned, labor cost ticket delivery has been down, but because delivery as a percentage of the sales is going up, so that may be due to some headwinds. Just wanted to understand more on that point, because actual delivery sales as percentage of total revenue has been going up last year, but you are able to achieve lower labor cost per store, that's quite impressive.

So why is that not the case going into 2025, I just want to understand it?

Adrian Ding^ Thank you, Ethan. So just to offer some more color here. you are right in pointing out that the 2024, we successfully managed to improve our operational efficiency significantly to offset the impact of delivery sales mix increase on the COL.

So as a natural consequence, that will be a high base for us. That will be a tough lapping for us. As you know the Project Fresh Eye actually kicked off in late 2023. So the full year, there is an impact on 2024. And the COL is one of the key areas of Project Fresh Eye in terms of efficiency enhancement and productivity improvement.

So with this tough lapping and tough base, for 2025, I just gave some pretty transparent guidance on how the COL as percent of sales may evolve. First, I'll break down into two parts, just offer some more color.

The first part is the non-rider part, right? The non-rider part, obviously we do face a low to mid-single-digit wage inflation, but we will make every effort to try to further enhance our operational efficiency to hopefully offset that wage inflation.

So we do look at the non-rider part of COL to be broadly stable as a percentage of sales for the full year 2025. And then the second part is obviously the delivery part. In terms of the delivery cost per ticket, it will be lower year-over-year from 2024 to 2025.

There are a lot of efficiency measures there. Notably, the platform riders, which is one of the key initiatives, improve the cost and, at the same time the quality of service still improving.

As we mentioned in one of our previous earnings release, KFC currently already enjoy around half of the stores with the platform riders doing the delivery. And Pizza Hut is having a lower

percentage. And obviously there is room to improve on both this penetration for platform riders in our stores.

So that's some of the drivers to drive down the per ticket cost on delivery. But the increase in delivery mix as a percentage of sales is probably more than the savings we can generate from there.

So all in all, the delivery part of the COL as a percent of sales may likely slightly increase year-over-year. So overall, if you add these two together, one is probably stable, the other one is slightly increased, we do face some headwinds there on COL.

But as I mentioned, we do have some other margin initiatives, for instance, COS. Hopefully, it will be slightly better year-over-year for both the brands and for Yum China and O&O will be broadly stable.

All in all, as a result, the restaurant margin for KFC, we hope to maintain the healthy level of restaurant margin year-over-year. For Pizza Hut, we look to improve it over the mid- to long run, and hopefully slightly improve it for this year as well. And for Yum China as a whole, for 2025, the core OP margin, we expect that to be stable or slightly increase year-over-year.

Operator^ We are now going to proceed with the last question, and the questions come from Sijie Lin from CICC.

Sijie Lin^ And I have one question. So our pricing strategy is very clear, both for KFC and Pizza Hut. So I just want to further evaluate our actions. So for Pizza Hut, it has been going through promotion activities from December last year to February this year.

So how does this affect same-store sales and margin? And also, we see that the TA for Pizza Hut has already reached 78 in Q4. So do you think this level has already reached our expectation? Or you still have some room to trade down in the future?

Joey Wat^ Thank you, Sijie. For Pizza Hut, our goal actually will continue to drive down the TA for the pizza model. It's very impressive the brand team has done to move it to 78, but we see room to go that slightly further, but above KFC, obviously and also above Pizza Hut WOW, then I think we'll be happy.

In terms of the pizza pricing and promotion, let's take the new menu that we just launched. We launched 40 new products in the December 2024 new menu, and then we lowered the list price of about 30 iconic products for the Pizza Hut model, starting from RMB 9.9 for the drinks and desert, So it's very attractive.

And then in the price reduction, some item, very iconic, for example, escargot, we halved the price. However here's the little, very important point. We kept the margin neutral through the innovation.

So we are very happy that we found ways to deliver our iconic product, which -- with much better value for money for the customer and also protect the margin. And the communication becomes very straightforward as well.

No need to go through the very sophisticated promotional pricing, we just go straight to the very attractive menu price, and we still protect the margin. So that's what we have been doing, and customers resonate very well with that. And thus, we have observed a very nice transaction growth. So we'll continue to do that.

So I'm glad that we -- our team took a very bold move with that 30 iconic product price reduction and still protect the margins. So we'll continue to find new ways to serve our customers even better going forward. Thank you.

Florence Lip^ Thanks, Joey. Thanks, Adrian. Thank you, everyone, for joining the call today. For further questions, please reach out through the contact information in our earnings release and on our website.

Joey Wat^ Thank you.

Adrian Ding^ Thank you, all. Thank you.

Operator^ This concludes today's conference call. Thank you all for participating. You may now disconnect your lines. Thank you.