

**EXHIBIT 9**

**FINANCIAL STATEMENTS**



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

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934 for the fiscal year ended December 31, 2005

OR

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

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

Commission file number 1-13163

**YUM! BRANDS, INC.**

(Exact name of registrant as specified in its charter)

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

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

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

40213  
(Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of Each Class</u>	<u>Name of Each Exchange on Which Registered</u>
Common Stock, no par value	New York Stock Exchange
Rights to purchase Series A Participating Preferred Stock, no par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in the Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

The aggregate market value of the voting stock (which consists solely of shares of Common Stock) held by non-affiliates of the registrant as of June 11, 2005 computed by reference to the closing price of the registrant's Common Stock on the New York Stock Exchange Composite Tape on such date was \$15,137,243,884. All executive officers and directors of the registrant have been deemed, solely for the purpose of the foregoing calculation, to be "affiliates" of the registrant.

The number of shares outstanding of the registrant's Common Stock as of February 24, 2006 was 275,830,856 shares.

**Documents Incorporated by Reference**

Portions of the definitive proxy statement furnished to shareholders of the registrant in connection with the annual meeting of shareholders to be held on May 18, 2006 are incorporated by reference into Part III.

---

## PART I

### Item 1. Business.

YUM! Brands, Inc. (referred to herein as “YUM” or the “Company”), was incorporated under the laws of the state of North Carolina in 1997. The principal executive offices of YUM are located at 1441 Gardiner Lane, Louisville, Kentucky 40213, and the telephone number at that location is (502) 874-8300.

YUM, the registrant, together with its subsidiaries, is referred to in this Form 10-K annual report (“Form 10-K”) as the Company. The terms “we,” “us” and “our” are also used in the Form 10-K to refer to the Company.

This Form 10-K should be read in conjunction with the Cautionary Statements on page 52.

#### (a) General Development of Business

In January 1997, PepsiCo announced its decision to spin-off its restaurant businesses to shareholders as an independent public company (the “Spin-off”). Effective October 6, 1997, PepsiCo disposed of its restaurant businesses by distributing all of the outstanding shares of common stock of YUM to its shareholders.

On May 7, 2002, YUM completed the acquisition of Yorkshire Global Restaurants, Inc. (“YGR”), the parent company and operator of Long John Silver’s (“LJS”) and A&W All-American Food Restaurants (“A&W”). Additionally, on May 16, 2002, following receipt of shareholder approval, the Company changed its name from TRICON Global Restaurants, Inc. to YUM! Brands, Inc.

Throughout this Form 10-K, the terms “restaurants,” “stores” and “units” are used interchangeably.

#### (b) Financial Information about Operating Segments

YUM consists of six operating segments: KFC, Pizza Hut, Taco Bell, LJS/A&W, YUM Restaurants International (“YRI” or “International Division”) and YUM Restaurants China (“China Division”). For financial reporting purposes, management considers the four U.S. operating segments to be similar and, therefore, has aggregated them into a single reportable operating segment. In 2005, we began reporting information for our international business in two separate operating segments as a result of changes to our management reporting structure. The China Division includes mainland China (“China”), Thailand and KFC Taiwan, and the International Division includes the remainder of our international operations.

Operating segment information for the years ended December 31, 2005, December 25, 2004 and December 27, 2003 for the Company is included in Management’s Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”) in Part II, Item 7, pages 25 through 52 and in the related Consolidated Financial Statements and footnotes in Part II, Item 8, pages 53 through 96.

#### (c) Narrative Description of Business

##### General

YUM is the world’s largest quick service restaurant (“QSR”) company based on number of system units, with over 34,000 units in more than 100 countries and territories. Through the five concepts of KFC, Pizza Hut, Taco Bell, LJS, and A&W (the “Concepts”), the Company develops, operates, franchises and licenses a worldwide system of restaurants which prepare, package and sell a menu of competitively priced food items. In all five of its Concepts, the Company either operates units or they are operated by independent franchisees or licensees under the terms of franchise or license agreements. Franchisees can range in size from individuals owning just one unit to large publicly traded companies. In

addition, the Company owns non-controlling interests in Unconsolidated Affiliates who operate similar to franchisees. As of year-end 2005, approximately 22 percent of YUM's worldwide units were operated by the Company, approximately 66 percent by franchisees, approximately 7 percent by licensees and approximately 5 percent by Unconsolidated Affiliates.

At year-end 2005, we had over 20,000 system units, including over 3,000 multi-branded units, in the U.S. which generated revenues of \$5.9 billion and operating profit of \$760 million during 2005. As of year-end 2005, approximately 23 percent of U.S. units were operated by the Company, approximately 66 percent by franchisees and approximately 11 percent by licensees.

The International Division, based in Dallas, Texas, comprises over 11,000 restaurants, primarily KFCs and Pizza Huts, operating in over 100 countries outside the U.S. In 2005, YRI achieved revenues of \$2.1 billion and operating profit of \$372 million. As of year-end 2005, approximately 12 percent of International Division units were operated by the Company, approximately 77 percent by franchisees, approximately 2 percent by licensees and approximately 9 percent by Unconsolidated Affiliates. In 2005, YRI opened more than 700 new restaurants for the sixth straight year.

The China Division, based in Shanghai, China, has been reported separately since the beginning of 2005. The China Division has more than 2,200 system restaurants, predominately KFCs. In 2005, the China Division achieved revenues of nearly \$1.3 billion and operating profit of \$211 million. As of year-end 2005, approximately 67 percent of China Division units were operated by the Company, approximately 9 percent by franchisees and approximately 24 percent by Unconsolidated Affiliates.

## **Restaurant Concepts**

In each Concept, consumers can dine in and/or carry out food. In addition, Taco Bell, KFC, LJS and A&W offer a drive-thru option in many stores. Pizza Hut offers a drive-thru option on a much more limited basis. Pizza Hut and, on a much more limited basis, KFC offer delivery service.

Each Concept has proprietary menu items and emphasizes the preparation of food with high quality ingredients as well as unique recipes and special seasonings to provide appealing, tasty and attractive food at competitive prices.

The franchise program of the Company is designed to assure consistency and quality, and the Company is selective in granting franchises. Under the standard franchise agreement, franchisees supply capital – initially by paying a franchise fee to YUM, purchasing or leasing the land, building and equipment and purchasing signs, seating, inventories and supplies and, over the longer term, by reinvesting in the business. Franchisees then contribute to the Company's revenues through the payment of royalties based on a percentage of sales.

The Company believes that it is important to maintain strong and open relationships with its franchisees and their representatives. To this end, the Company invests a significant amount of time working with the franchisee community and their representative organizations on all aspects of the business, including new products, equipment and management techniques.

The Company is actively pursuing the strategy of multibranding, primarily in the U.S., where two or more of its Concepts are operated in a single unit. By combining two or more restaurant concepts, particularly those that have complementary daypart strengths in one location, the Company believes it can generate higher sales volumes from such units, significantly improve returns on per unit investment, and enhance its ability to penetrate a greater number of trade areas throughout the U.S. Through market planning initiatives encompassing all of its Concepts, the Company has established, and annually updates, multi-year development plans by trade area to optimize franchise and company penetration of its Concepts and to improve returns on its existing asset base. The development of multibranded units may be limited, in some instances, by prior development and/or territory rights granted to franchisees.

At year-end 2005, there were 3,289 multibranded units in the worldwide system. These units were comprised of 2,548 units offering food products from two of the Concepts (a "2n1"), 48 units offering food products from three of the Concepts (a "3n1"), and 669 units offering food products from Pizza Hut and WingStreet, a flavored chicken wings concept. YUM has developed 24 units offering food products from KFC and Wing Works, another flavored chicken wings concept developed by YUM.

Following is a brief description of each concept:

### KFC

- KFC was founded in Corbin, Kentucky by Colonel Harland D. Sanders, an early developer of the quick service food business and a pioneer of the restaurant franchise concept. The Colonel perfected his secret blend of 11 herbs and spices for Kentucky Fried Chicken in 1939 and signed up his first franchisee in 1952. KFC is based in Louisville, Kentucky.
- As of year-end 2005, KFC was the leader in the U.S. chicken QSR segment among companies featuring chicken-on-the-bone as their primary product offering, with a 47 percent market share (Source: The NPD Group, Inc.; NPD Foodworld; CREST) in that segment which is nearly four times that of its closest national competitor.
- KFC operates in 96 countries and territories throughout the world. As of year-end 2005, KFC had 5,443 units in the U.S., and 8,288 units outside the U.S. Approximately 21 percent of the U.S. units and 24 percent of the non-U.S. units are operated by the Company.
- Traditional KFC restaurants in the U.S. offer fried chicken-on-the-bone products, primarily marketed under the names Original Recipe and Extra Tasty Crispy. Other principal entree items include chicken sandwiches (including the Snacker and the Twister), Colonel's Crispy Strips, Wings, Popcorn Chicken and, seasonally, Chunky Chicken Pot Pies. KFC restaurants in the U.S. also offer a variety of side items, such as biscuits, mashed potatoes and gravy, coleslaw, corn, and potato wedges, as well as desserts. While many of these products are offered outside of the U.S., international menus are more focused on chicken sandwiches and Colonel's Crispy Strips, and include side items that are suited to local preferences and tastes. Restaurant decor throughout the world is characterized by the image of the Colonel.

### Pizza Hut

- The first Pizza Hut restaurant was opened in Wichita, Kansas, and within a year, the first franchise unit was opened. Today, Pizza Hut is the largest restaurant chain in the world specializing in the sale of ready-to-eat pizza products. Pizza Hut is based in Dallas, Texas.
- As of year-end 2005, Pizza Hut was the leader in the U.S. pizza QSR segment, with a 15 percent market share (Source: The NPD Group, Inc.; NPD Foodworld; CREST) in that segment.
- Pizza Hut operates in 91 countries and territories throughout the world. As of year-end 2005, Pizza Hut had 7,566 units in the U.S., and 5,006 units outside of the U.S. Approximately 22 percent of the U.S. units and 18 percent of the non-U.S. units are operated by the Company.
- Pizza Hut features a variety of pizzas, which may include Pan Pizza, Thin 'n Crispy, Hand Tossed, Sicilian, Stuffed Crust, Twisted Crust, The Big New Yorker, The Insider, The Chicago Dish and 4forALL. Each of these pizzas is offered with a variety of different toppings. In some restaurants, Pizza Hut also offers breadsticks, pasta, salads and sandwiches. Menu items outside of the U.S. are generally similar to those offered in the U.S., though pizza toppings are often suited to local preferences and tastes.

### Taco Bell

- The first Taco Bell restaurant was opened in 1962 by Glen Bell in Downey, California, and in 1964, the first Taco Bell franchise was sold. Taco Bell is based in Irvine, California.
- As of year-end 2005, Taco Bell was the leader in the U.S. Mexican QSR segment, with a 60 percent market share (Source: The NPD Group, Inc.; NPD Foodworld; CREST) in that segment.
- Taco Bell operates in 14 countries and territories throughout the world. As of year-end 2005, there were 5,845 Taco Bell units in the U.S., and 245 units outside of the U.S. Approximately 21 percent of the U.S. units and 1 percent of the non-U.S. units are operated by the Company.
- Taco Bell specializes in Mexican-style food products, including various types of tacos, burritos, gorditas, chalupas, quesadillas, salads, nachos and other related items. Additionally, proprietary entrée items include Grilled Stuff Burritos and Border Bowls. Taco Bell units feature a distinctive bell logo on their signage.

### LJS

- The first LJS restaurant opened in 1969 and the first LJS franchise unit opened later the same year. LJS is based in Louisville, Kentucky.
- As of year-end 2005, LJS was the leader in the U.S. seafood QSR segment, with a 33 percent market share (Source: The NPD Group, Inc.; NPD Foodworld; CREST) in that segment.
- LJS operates in 6 countries and territories throughout the world. As of year-end 2005, there were 1,169 LJS units in the U.S., and 34 units outside the U.S. Approximately 52 percent of the U.S. units are operated by the Company. All non-U.S. units are operated by franchisees or licensees.
- LJS features a variety of seafood items, including meals featuring batter-dipped fish, chicken, shrimp, hushpuppies and portable snack items. LJS units typically feature a distinctive seaside/nautical theme.

### A&W

- A&W was founded in Lodi, California by Roy Allen in 1919 and the first A&W franchise unit opened in 1925. A&W is based in Louisville, Kentucky.
- A&W operates in 11 countries and territories throughout the world. As of year-end 2005, there were 449 A&W units in the U.S., and 229 units outside the U.S. Approximately 3 percent of the U.S. units are operated by the Company. All non-U.S. units are operated by franchisees or licensees.
- A&W serves A&W draft Root Beer and a signature A&W Root Beer float, as well as hot dogs and all-American pure-beef hamburgers.

### **Restaurant Operations**

Through its Concepts, YUM develops, operates, franchises and licenses a worldwide system of both traditional and non-traditional QSR restaurants. Traditional units feature dine-in, carryout and, in some instances, drive-thru or delivery services. Non-traditional units, which are typically licensed outlets, include express units and kiosks which have a more limited menu and operate in non-traditional locations like malls, airports, gasoline service stations, convenience stores, stadiums, amusement parks and colleges, where a full-scale traditional outlet would not be practical or efficient.



The Company's restaurant management structure varies by concept and unit size. Generally, each Company restaurant is led by a restaurant general manager ("RGM"), together with one or more assistant managers, depending on the operating complexity and sales volume of the restaurant. In the U.S., the average restaurant has 25 to 30 employees, while internationally this figure can be significantly higher depending on the location and sales volume of the restaurant. Most of the employees work on a part-time basis. We issue detailed manuals, which may then be customized to meet local regulations and customs, covering all aspects of restaurant operations, including food handling and product preparation procedures, safety and quality issues, equipment maintenance, facility standards and accounting control procedures. The restaurant management teams are responsible for the day-to-day operation of each unit and for ensuring compliance with operating standards. CHAMPS – which stands for Cleanliness, Hospitality, Accuracy, Maintenance, Product Quality and Speed of Service – is our core systemwide program for training, measuring and rewarding employee performance against key customer measures. CHAMPS is intended to align the operating processes of our entire system around one set of standards. RGMs' efforts, including CHAMPS performance measures, are monitored by Area Coaches. Area Coaches typically work with approximately six to twelve restaurants. The Company's restaurants are visited from time to time by various senior operators who help ensure adherence to system standards and mentor restaurant team members.

RGMs attend and complete their respective Concepts' required training programs. These programs consist of initial training, as well as additional continuing development and training programs that may be offered or required from time to time. Initial manager training programs generally last at least six weeks and emphasize leadership, business management, supervisory skills (including training, coaching, and recruiting), product preparation and production, safety, quality control, customer service, labor management, and equipment maintenance.

## **Supply and Distribution**

The Company is a substantial purchaser of a number of food and paper products, equipment and other restaurant supplies. The principal items purchased include chicken products, cheese, beef and pork products, paper and packaging materials, flour, produce, certain beverages, seafood, cooking oils, pinto beans, seasonings and tomato-based products.

The Company, along with the representatives of the Company's KFC, Pizza Hut, Taco Bell, LJS and A&W franchisee groups, are members in the Unified FoodService Purchasing Co-op, LLC (the "Unified Co-op") which was created for the purpose of purchasing certain restaurant products and equipment in the U.S. The core mission of the Unified Co-op is to provide the lowest possible sustainable store-delivered prices for restaurant products and equipment. This arrangement combines the purchasing power of the Company and franchisee restaurants in the U.S. which the Company believes will further leverage the system's scale to drive cost savings and effectiveness in the purchasing function. The Company also believes that the Unified Co-op has resulted, and should continue to result, in closer alignment of interests and a stronger relationship with its franchisee community.

The Company is committed to conducting its business in an ethical, legal and socially responsible manner. To encourage compliance with all legal requirements and ethical business practices, YUM has a supplier code of conduct for all U.S. suppliers to our business. To ensure the wholesomeness of food products, suppliers are required to meet or exceed strict quality control standards. Long-term contracts and long-term vendor relationships are used to ensure availability of products. The Company has not experienced any significant continuous shortages of supplies, and alternative sources for most of these products are generally available. Prices paid for these supplies are subject to fluctuation. When prices increase, the Company may be able to pass on such increases to its customers, although there is no assurance this can be done in the future.

Most food products, paper and packaging supplies, and equipment used in the operation of the Company's restaurants are distributed to individual restaurant units by third party distribution companies. Since November 30, 2000, McLane Company, Inc. ("McLane") has been the exclusive distributor for Company-operated KFCs, Pizza Huts and Taco Bells in the U.S. and for a substantial number of franchisee and licensee stores. McLane became the distributor when it assumed all supply and distribution responsibilities under an existing agreement between AmeriServe Food Distribution, Inc. ("AmeriServe") and the Company (the "AmeriServe Agreement"). McLane acquired AmeriServe after AmeriServe emerged from Chapter 11 bankruptcy on November 28, 2000. A discussion of the impact of the AmeriServe bankruptcy reorganization process on the Company is contained in Note 4 to the Consolidated Financial Statements. The terms of the AmeriServe agreement with the Company extend through October 31, 2010 and generally prohibit KFC, Pizza Hut and Taco Bell restaurants from using alternative distributors in the U.S. The Company stores within the LJS system are covered under a separate agreement with McLane.

The International and China Divisions and their franchisees use decentralized sourcing and distribution systems involving many different global, regional, and local suppliers and distributors. In certain countries, the International Division owns all or a portion of the distribution system. The China Division also owns all of the distribution system in mainland China, while the distribution systems for KFC Taiwan and Thailand are dependent on third-parties.

## **Trademarks and Patents**

The Company and its Concepts own numerous registered trademarks and service marks. The Company believes that many of these marks, including its Kentucky Fried Chicken®, KFC®, Pizza Hut®, Taco Bell® and Long John Silver's® marks, have significant value and are materially important to its business. The Company's policy is to pursue registration of its important marks whenever feasible and to oppose vigorously any infringement of its marks. The Company also licenses certain A&W trademarks and service marks (the "A&W Marks"), which are owned by A&W Concentrate Company (formerly A&W Brands, Inc.). A&W Concentrate Company, which is not affiliated with the Company, has granted the Company an exclusive, worldwide (excluding Canada), perpetual, royalty-free license (with the right to sublicense) to use the A&W Marks for restaurant services.

The use of these marks by franchisees and licensees has been authorized in KFC, Pizza Hut, Taco Bell, LJS and A&W franchise and license agreements. Under current law and with proper use, the Company's rights in its marks can generally last indefinitely. The Company also has certain patents on restaurant equipment which, while valuable, are not material to its business.

### **Working Capital**

Information about the Company's working capital is included in MD&A in Part II, Item 7, pages 25 through 52 and the Consolidated Statements of Cash Flows in Part II, Item 8, page 57.

### **Customers**

The Company's business is not dependent upon a single customer or small group of customers.

### **Seasonal Operations**

The Company does not consider its operations to be seasonal to any material degree.

### **Backlog Orders**

Company restaurants have no backlog orders.

### **Government Contracts**

No material portion of the Company's business is subject to renegotiation of profits or termination of contracts or subcontracts at the election of the U.S. government.

### **Competition**

The retail food industry, in which the Company competes, is made up of supermarkets, supercenters, warehouse stores, convenience stores, coffee shops, snack bars, delicatessens and restaurants (including the QSR segment), and is intensely competitive with respect to food quality, price, service, convenience, location and concept. The industry is often affected by changes in consumer tastes; national, regional or local economic conditions; currency fluctuations; demographic trends; traffic patterns; the type, number and location of competing food retailers and products; and disposable purchasing power. Each of the Concepts compete with international, national and regional restaurant chains as well as locally-owned restaurants, not only for customers, but also for management and hourly personnel, suitable real estate sites and qualified franchisees. In 2005, the restaurant business in the U.S. consisted of about 900,000 restaurants representing approximately \$476 billion in annual sales. The Company's Concepts accounted for about 2% of those restaurants and about 4% of those sales. There is currently no way to reasonably estimate the size of the competitive market outside the U.S.

### **Research and Development ("R&D")**

The Company operates R&D facilities in Louisville, Kentucky; Dallas, Texas; and Irvine, California and in several locations outside the U.S. The Company expensed \$33 million in 2005 and \$26 million in both 2004 and 2003, for R&D activities. From time to time, independent suppliers also conduct research and development activities for the benefit of the YUM system.

## **Environmental Matters**

The Company is not aware of any federal, state or local environmental laws or regulations that will materially affect its earnings or competitive position, or result in material capital expenditures. However, the Company cannot predict the effect on its operations of possible future environmental legislation or regulations. During 2005, there were no material capital expenditures for environmental control facilities and no such material expenditures are anticipated.

## **Government Regulation**

U.S. The Company is subject to various federal, state and local laws affecting its business. Each of the Company's restaurants must comply with licensing and regulation by a number of governmental authorities, which include health, sanitation, safety and fire agencies in the state or municipality in which the restaurant is located. In addition, the Company must comply with various state laws that regulate the franchisor/franchisee relationship. To date, the Company has not been significantly affected by any difficulty, delay or failure to obtain required licenses or approvals.

A small portion of Pizza Hut's and LJS's sales are attributable to the sale of beer and wine. A license is required in most cases for each site that sells alcoholic beverages (in most cases, on an annual basis) and licenses may be revoked or suspended for cause at any time. Regulations governing the sale of alcoholic beverages relate to many aspects of restaurant operations, including the minimum age of patrons and employees, hours of operation, advertising, wholesale purchasing, inventory control and handling, storage and dispensing of alcoholic beverages.

The Company is also subject to federal and state laws governing such matters as employment and pay practices, overtime, tip credits and working conditions. The bulk of the Company's employees are paid on an hourly basis at rates related to the federal and state minimum wages.

The Company is also subject to federal and state child labor laws which, among other things, prohibit the use of certain "hazardous equipment" by employees 18 years of age or younger. The Company has not to date been materially adversely affected by such laws.

The Company continues to monitor its facilities for compliance with the Americans with Disabilities Act ("ADA") in order to conform to its requirements. Under the ADA, the Company could be required to expend funds to modify its restaurants to better provide service to, or make reasonable accommodation for the employment of, disabled persons. We believe that expenditures, if required, would not have a material adverse effect on the Company's operations.

International and China Divisions. The Company's restaurants outside the U.S. are subject to national and local laws and regulations which are similar to those affecting the Company's U.S. restaurants, including laws and regulations concerning labor, health, sanitation and safety. The international restaurants are also subject to tariffs and regulations on imported commodities and equipment and laws regulating foreign investment. International compliance with environmental requirements has not had a material adverse effect on the Company's results of operations, capital expenditures or competitive position.

## **Employees**

As of year-end 2005, the Company employed over 272,000 persons, approximately 78 percent of whom were part-time. Approximately 46 percent of the Company's employees are employed in the U.S. The Company believes that it provides working conditions and compensation that compare favorably with those of its principal competitors. Most Company employees are paid on an hourly basis. Some of the Company's non-U.S. employees are subject to labor council relationships that vary due to the diverse cultures in which the Company operates. The Company considers its employee relations to be good.

**(d) Financial Information about Geographic Areas**

Financial information about our significant geographic areas (U.S., International Division and China Division) is incorporated herein by reference from Selected Financial Data in Part II, Item 6, page 23; Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") in Part II, Item 7, pages 25 through 52; and in the related Consolidated Financial Statements and footnotes in Part II, Item 8, pages 53 through 96.

**(e) Available Information**

The Company makes available through the Investor Relations section of its internet website at [www.yum.com](http://www.yum.com) its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, as soon as reasonably practicable after electronically filing such material with the Securities and Exchange Commission. Our Corporate Governance Principles and our Code of Conduct are also located within this section of the website. The reference to the Company's website address does not constitute incorporation by reference of the information contained on the website and should not be considered part of this document. These documents, as well as our SEC filings, are available in print to any shareholder who requests a copy from our Investor Relations Department.

**Item 1A. Risk Factors.**

We face a variety of risks that are inherent in our business and our industry, including operational, legal, regulatory and product risks. The following are some of the more significant factors that could affect our business and our results of operations. Other factors may exist that the Company cannot anticipate or that the Company does not consider to be significant based on information that is currently available.

*Health concerns arising from outbreaks of Avian Flu may have an adverse effect on our business.*

In 2004 and 2005, Asian and European countries experienced outbreaks of Avian Flu, and some commentators have hypothesized that further outbreaks could occur and reach pandemic levels. While fully-cooked chicken has been determined to be safe for consumption, and while the Company has taken and continues to take measures to anticipate and minimize the effect of these outbreaks on our business, any further outbreaks could adversely affect the price and availability of poultry and cause customers to shift their preferences. In addition, outbreaks on a widespread basis could also affect our ability to attract and retain employees.

*Food safety and food-borne illness concerns may have an adverse effect on our business.*

The Company considers food safety a top priority and dedicates substantial resources to ensure that our customers enjoy safe, quality food products. However, food-borne illnesses (such as E. coli, hepatitis A, trichinosis or salmonella) and food safety issues have occurred in the past, and could occur in the future. If such instances of food-borne illness or other food safety issues were to occur, whether at our restaurants or those of our competitors, negative publicity could result which could adversely affect sales and profitability. If our customers become ill from food-borne illnesses, we could also be forced to temporarily close some restaurants. Additionally, the occurrence of food-borne illnesses or food safety issues could adversely affect the price and availability of affected ingredients. Finally, like other companies in the restaurant industry, some of our products may contain genetically engineered food products; increased regulation of and opposition to genetically engineered food products have on occasion and may in the future force us to use alternative sources at increased costs.

*Our foreign operations subject us to risks that could negatively affect our business.*

Our restaurants are operated in numerous countries and territories and our foreign business is significant. We intend to further expand our international operations over the next several years. As a result, our business and operations are

subject to the risk of changes in economic conditions, tax systems, consumer preferences, social conditions and political conditions inherent in foreign operations, including changes in the laws and policies that govern foreign investment in countries where our restaurants are operated, as well as changes in United States laws and regulations relating to foreign trade and investment. In addition, our results of operations and the value of our foreign assets are affected by fluctuations in foreign currency exchange rates, which may favorably or adversely affect reported earnings. There can be no assurance as to the future effect of any such changes on our results of operations, financial condition or cash flows.

Mainland China is one of our fastest developing markets. Any significant or prolonged deterioration in U.S.-China relations could adversely affect our China business. Our growing investments in our China operations will increase our exposure in this market. Many of the risks and uncertainties of doing business in China are solely within the control of the Chinese government. China's government regulates the scope of our foreign investments and business conducted within China. Although management believes it has structured our China operations to comply with local laws, there are uncertainties regarding the interpretation and application of laws and regulations and the enforceability of intellectual property and contract rights in China. If we were unable to enforce our intellectual property and contract rights in China, our business would be adversely impacted.

*Changes in commodity and other operating costs or supply chain and business disruptions could adversely affect our results of operations.*

While the Company takes measures to anticipate and react to changes in food and supply costs, any increase in the prices of the ingredients most critical to our menu, such as beef, chicken, cheese and produce, among others, could adversely affect our operating results. Although we try to manage the impact that these fluctuations have on our operating results, we remain susceptible to increases in food costs as a result of factors beyond our control, such as general economic conditions, seasonal fluctuations, weather conditions, demand, food safety concerns, product recalls, labor disputes and government regulations. In addition to food, we purchase electricity, oil and natural gas needed to operate our restaurants, and suppliers purchase gasoline needed to transport food and supplies to us. Any significant increase in energy costs could adversely affect our business through higher rates and the imposition of fuel surcharges by our suppliers. Because we provide moderately priced food, we may choose not to, or be unable to, pass along commodity price increases to our customers. Additionally, significant increases in gasoline prices could result in a decrease of customer traffic at our restaurants. We rely on third party distribution companies to deliver food and supplies to our stores. Interruption of distribution services due to financial distress or other issues could impact our operations. Our operating costs also include premiums that we pay for our insurance (including workers' compensation, general liability, property and health) which may increase over time, thereby further increasing our costs. Finally, our industry is susceptible to natural disasters which could result in restaurant closures and business disruptions.

*Our operating results are closely tied to the success of our Concepts' franchisees.*

As a result of our franchising programs, our operating results are dependent upon the sales volumes and viability of our franchisees. Any significant inability of our franchisees to operate successfully could adversely affect our operating results. Franchisees may not have access to the financial or management resources that they need to open or continue operating the restaurants contemplated by their franchise agreements with us, or be able to find suitable sites on which to develop them. In addition, franchisees may not be able to negotiate acceptable lease or purchase terms for the sites, obtain the necessary permits and government approvals or meet construction schedules. Our franchisees generally depend upon financing from banks and other financial institutions in order to construct and open new restaurants. In some instances, financing has been difficult to obtain for some operators. Any of these problems could slow our planned growth.

*We could be party to litigation that could adversely affect us by increasing our expenses or subjecting us to material money damages and other remedies.*

As a restaurant industry participant, we are susceptible to claims filed by customers alleging that we are responsible for an illness or injury they suffered at or after a visit to our restaurants. Regardless of whether any claims against us are valid, or

whether we are ultimately held liable, such litigation may be expensive to defend and may divert time and money away from our operations and hurt our performance. A judgment for significant monetary damages in excess of any insurance coverage could adversely affect our financial condition or results of operations. Any adverse publicity resulting from these allegations may also adversely affect our reputation, which in turn could adversely affect our results.

In addition, the restaurant industry has been subject to claims that relate to the nutritional content of food products, as well as claims that the menus and practices of restaurant chains have led to the obesity of some guests. We may also be subject to this type of claim in the future and, even if we are not, publicity about these matters (particularly directed at the quick service and fast-casual segments of the industry) may harm our reputation and adversely affect our results.

*Changes in governmental regulations may adversely affect our business operations.*

We and our franchisees are subject to various federal, state and local regulations. Each of our restaurants is subject to state and local licensing and regulation by health, sanitation, food and workplace safety and other agencies. Requirements of local authorities with respect to zoning, land use, licensing, permitting and environmental factors could delay or prevent development of new restaurants in particular locations.

We are subject to the U.S. Americans with Disabilities Act and similar state laws that give civil rights protections to individuals with disabilities in the context of employment, public accommodations and other areas. The expenses associated with any facilities modifications required by these laws could be material. Our operations are also subject to the U.S. Fair Labor Standards Act, which governs such matters as minimum wages, overtime and other working conditions, family leave mandates and a variety of similar state laws that govern these and other employment law matters. The compliance costs associated with these laws and evolving regulations could be substantial.

*We may not attain our target development goals.*

We are pursuing a disciplined growth strategy, which, to be successful, will depend in large part on our ability and the ability of our franchisees to upgrade existing restaurants and open new restaurants, and to operate these restaurants on a profitable basis. We cannot guarantee that we, or our franchisees, will be able to achieve our expansion goals or that new, upgraded or converted restaurants will be operated profitably. Further, there is no assurance that any restaurant we open or convert will obtain operating results similar to those of our existing restaurants. The success of our planned expansion, including our multibranding initiatives, will depend upon numerous factors, many of which are beyond our control.

*The restaurant industry in which we operate is highly competitive.*

The restaurant industry in which we operate is highly competitive with respect to price and quality of food products, new product development, advertising levels and promotional initiatives, customer service, reputation, restaurant location, and attractiveness and maintenance of properties. If our restaurants and franchised restaurants are unable to compete successfully with other restaurants in new and existing markets, our business could be adversely affected. In the restaurant industry, labor is a primary operating cost component. Competition for qualified employees could also require us to pay higher wages to attract a sufficient number of employees. In addition, our success depends to a significant extent on numerous factors affecting discretionary consumer spending, including economic conditions, disposable consumer income and consumer confidence. Adverse changes in these factors could reduce guest traffic or impose practical limits on pricing, either of which could harm our results of operations.

#### **Item 1B. Unresolved Staff Comments.**

The Company has received no written comments regarding its periodic or current reports from the staff of the Securities and Exchange Commission that were issued 180 days or more preceding the end of its 2005 fiscal year and that remain unresolved.

## **Item 2. Properties.**

As of year-end 2005, the Company owned over 2,000 units and leased land, building or both in over 5,500 units worldwide. These units are further detailed as follows:

- The U.S. owned over 1,700 units and leased land, building or both in over 2,900 units,
- The International Division owned over 200 units and leased land, building or both in over 1,000 units, and
- The China Division leased land, building or both in over 1,500 units.

Company restaurants in the U.S. which are not owned are generally leased for initial terms of 15 or 20 years and generally have renewal options; however, Pizza Hut delivery/carryout units in the U.S. generally are leased for significantly shorter initial terms with short renewal options. Company restaurants in the International Division which are not owned have initial lease terms and renewal options that vary by country. Company restaurants in the China Division which are not owned are generally leased for initial terms of 10 to 15 years and generally do not have renewal options. The Company generally does not lease or sub-lease units that it owns or leases to franchisees.

Pizza Hut and YRI lease their corporate headquarters and a research facility in Dallas, Texas. Taco Bell leases its corporate headquarters and research facility in Irvine, California. KFC owns its and LJS's, A&W's and YUM's corporate headquarters and a research facility in Louisville, Kentucky. In addition, YUM leases office facilities for certain support groups in Louisville, Kentucky. The China Division leases their corporate headquarters in Shanghai, China. Additional information about the Company's properties is included in the Consolidated Financial Statements and footnotes in Part II, Item 8, pages 53 through 96.

The Company believes that its properties are generally in good operating condition and are suitable for the purposes for which they are being used.



### **Item 3. Legal Proceedings.**

The Company is subject to various claims and contingencies related to lawsuits, taxes, real estate, environmental and other matters arising in the normal course of business. The following is a brief description of the more significant of these categories of lawsuits and other matters. Except as stated below, the Company believes that the ultimate liability, if any, in excess of amounts already provided for these matters in the Consolidated Financial Statements, is not likely to have a material adverse effect on the Company's annual results of operations, financial condition or cash flows.

#### **Franchising**

A substantial number of the restaurants of each of the Concepts are franchised to independent businesses operating under arrangements with the Concepts. In the course of the franchise relationship, occasional disputes arise between the Company and its Concepts' franchisees relating to a broad range of subjects, including, without limitation, quality, service, and cleanliness issues, contentions regarding grants, transfers or terminations of franchises, territorial disputes and delinquent payments.

#### **Suppliers**

The Company, through approved distributors, purchases food, paper, equipment and other restaurant supplies from numerous independent suppliers throughout the world. These suppliers are required to meet and maintain compliance with the Company's standards and specifications. On occasion, disputes arise between the Company and its suppliers on a number of issues, including, but not limited to, compliance with product specifications and terms of procurement and service requirements.

#### **Employees**

At any given time, the Company or its affiliates employ hundreds of thousands of persons, primarily in its restaurants. In addition, each year thousands of persons seek employment with the Company and its restaurants. From time to time, disputes arise regarding employee hiring, compensation, termination and promotion practices.

Like other retail employers, the Company has been faced in a few states with allegations of purported class-wide wage and hour violations.

On August 13, 2003, a class action lawsuit against Pizza Hut, Inc., entitled Coldiron v. Pizza Hut, Inc., was filed in the United States District Court, Central District of California. Plaintiff alleges that she and other current and former Pizza Hut Restaurant General Managers ("RGMs") were improperly classified as exempt employees under the U.S. Fair Labor Standards Act ("FLSA"). There is also a pendent state law claim, alleging that current and former RGMs in California were misclassified under that state's law. Plaintiff seeks unpaid overtime wages and penalties. On May 5, 2004, the District Court granted conditional certification of a nationwide class of RGMs under the FLSA claim, providing notice to prospective class members and an opportunity to join the class. Approximately 12 percent of the eligible class members have elected to join the litigation. However, on June 30, 2005, the District Court granted Pizza Hut's motion to strike all FLSA class members who joined the litigation after July 15, 2004. The effect of this order is to reduce the number of FLSA class members to only approximately 88 (or approximately 2.5% of the eligible class members).

In November 2005, the parties agreed to a settlement. Pizza Hut believes that definitive settlement documents will be preliminarily and finally approved by the Court within sixty to ninety days following submission of the documents to the Court. We have provided for this settlement amount in our Consolidated Financial Statements.

On November 26, 2001, a lawsuit against Long John Silver's, Inc. ("LJS") entitled Kevin Johnson, on behalf of himself and all others similarly situated v. Long John Silver's, Inc. ("Johnson") was filed in the United States District Court for the Middle District of Tennessee, Nashville Division. Johnson's suit alleged that LJS's former "Security/Restitution for

Losses" policy (the "Policy") provided for deductions from RGMs and Assistant Restaurant General Managers ("ARGMs") salaries that violate the salary basis test for exempt personnel under regulations issued pursuant to the FLSA. Johnson alleged that all RGMs and ARGMs who were employed by LJS for the three year period prior to the lawsuit – i.e., since November 26, 1998 – should be treated as the equivalent of hourly employees and thus were eligible under the FLSA for overtime for any hours worked over 40 during all weeks in the recovery period. In addition, Johnson claimed that the potential members of the class are entitled to certain liquidated damages and attorney's fees under the FLSA.

LJS believed that Johnson's claims, as well as the claims of all other similarly situated parties, should be resolved in individual arbitrations pursuant to LJS's Dispute Resolution Program ("DRP"), and that a collective action to resolve these claims in court was clearly inappropriate under the current state of the law. Accordingly, LJS moved to compel arbitration in the Johnson case. LJS and Johnson also agreed to stay the action effective December 17, 2001, pending mediation and entered into a tolling agreement for that purpose. After mediation did not resolve the case, and after limited discovery and a hearing, the Court determined on June 7, 2004, that Johnson's individual claims should be referred to arbitration. Johnson appealed, and the decision of the District Court was affirmed in all respects by the United States Court of Appeals for the Sixth Circuit on July 5, 2005.

On December 19, 2003, counsel for plaintiff in the above referenced Johnson lawsuit, filed a separate demand for arbitration with the American Arbitration Association ("AAA") on behalf of former LJS managers Erin Cole and Nick Kaufman, who reside in South Carolina (the "Cole Arbitration"). Claimants in the Cole Arbitration demand a class arbitration on behalf of the same putative class - and the same underlying FLSA claims - as were alleged in the Johnson lawsuit. The complaint in the Cole Arbitration subsequently was amended to allege a practice of deductions (distinct from the allegations as to the Policy) in violation of the FLSA salary basis test, and to add Victoria McWhorter, another LJS former manager, as an additional claimant. LJS has denied the claims and the putative class alleged in the Cole Arbitration, and it is LJS's position that the claims of Cole, Kaufman, and McWhorter should be individually arbitrated.

Arbitrations under LJS's DRP, including the Cole Arbitration, are governed by the rules of the AAA. In October 2003, the AAA adopted its Supplementary Rules for Class Arbitrations ("AAA Class Rules"). The AAA appointed an arbitrator for the Cole Arbitration. On June 15, 2004, the arbitrator issued a clause construction award, ruling that the DRP does not preclude class arbitration. LJS moved to vacate the clause construction award in the United States District Court for the District of South Carolina. On September 15, 2005, the federal court in South Carolina ruled that it did not have jurisdiction to hear LJS's motion to vacate. LJS has appealed the U.S. District Court's ruling to the United States Court of Appeals for the Fourth Circuit. While judicial review of the clause construction award was pending, the arbitrator permitted claimants to move for a class determination award, which was opposed by LJS. On September 19, 2005, the arbitrator issued a class determination award, certifying a class of LJS's RGMs and ARGMs employed between December 17, 1998, and August 22, 2004, on FLSA claims, to proceed on an opt-out basis under the AAA Class Rules. That class determination award was upheld on appeal by the United States District Court for the District of South Carolina on January 20, 2006. LJS has appealed the ruling of the U.S. District Court to the United States Court of Appeals for the Fourth Circuit.

LJS believes that the DRP provides for individual arbitrations. LJS also believes that if the Cole Arbitration must proceed on a class basis, (i) the proceedings should be governed by the opt-in collective action structure of the FLSA, (ii) a class should not be certified under the applicable provisions of the FLSA, and (iii) each individual should not be able to recover for more than two years (and a maximum three years) prior to the date they file a consent to join the arbitration. We have provided for the estimated costs of the Cole Arbitration, based on a projection of eligible claims, the amount of each eligible claim, the estimated legal fees incurred by the claimants and the results of settlement negotiations in this and other wage and hour litigation matters. But in view of the novelties of proceeding under the AAA Class Rules and the inherent uncertainties of litigation, there can be no assurance that the outcome of the arbitration will not result in losses in excess of those currently provided for.

On September 21, 2005, a collective action lawsuit against the Company and KFC Corporation, originally entitled Parler v. Yum Brands, Inc., d/b/a KFC, and KFC Corporation, was filed in the United States District Court for the District of

Minnesota. Plaintiff alleges that he and other current and former KFC Assistant Unit Managers (“AUM’s”) were improperly classified as exempt employees under the FLSA. Plaintiff seeks overtime wages and liquidated damages. On January 17, 2006, the District Court dismissed the claims against the Company with prejudice, leaving KFC Corporation as the sole defendant. Notice will be mailed to current and former KFC AUM’s advising them of the litigation and providing an opportunity to join the case if they choose to do so.

We believe that KFC has properly classified its AUM’s as exempt under the FLSA and accordingly intend to vigorously defend against all claims in this lawsuit. However, in view of the inherent uncertainties of litigation, the outcome of this case cannot be predicted at this time. Likewise, the amount of any potential loss cannot be reasonably estimated.

## Customers

The Company’s restaurants serve a large and diverse cross-section of the public and in the course of serving so many people, disputes arise regarding products, service, accidents and other matters typical of large restaurant systems such as those of the Company.

On December 17, 2002, Taco Bell was named as the defendant in a class action lawsuit filed in the United States District Court for the Northern District of California entitled Moeller, et al. v. Taco Bell Corp. On August 4, 2003, plaintiffs filed an amended complaint that alleges, among other things, that Taco Bell has discriminated against the class of people who use wheelchairs or scooters for mobility by failing to make its approximately 220 company-owned restaurants in California (the “California Restaurants”) accessible to the class. Plaintiffs contend that queue rails and other architectural and structural elements of the Taco Bell restaurants relating to the path of travel and use of the facilities by persons with mobility-related disabilities (including parking spaces, ramps, counters, restroom facilities and seating) do not comply with the U.S. Americans with Disabilities Act (the “ADA”), the Unruh Civil Rights Act (the “Unruh Act”), and the California Disabled Persons Act (the “CDPA”). Plaintiffs have requested: (a) an injunction from the District Court ordering Taco Bell to comply with the ADA and its implementing regulations; (b) that the District Court declare Taco Bell in violation of the ADA, the Unruh Act, and the CDPA; and (c) monetary relief under the Unruh Act or CDPA. Plaintiffs, on behalf of the class, are seeking the minimum statutory damages per offense of either \$4,000 under the Unruh Act or \$1,000 under the CDPA for each aggrieved member of the class. Plaintiffs contend that there may be in excess of 100,000 individuals in the class. For themselves, the four named plaintiffs have claimed aggregate minimum statutory damages of no less than \$16,000, but are expected to claim greater amounts based on the number of Taco Bell outlets they visited at which they claim to have suffered discrimination.

On February 23, 2004, the District Court granted Plaintiffs’ motion for class certification. The District Court certified a Rule 23(b)(2) mandatory injunctive relief class of all individuals with disabilities who use wheelchairs or electric scooters for mobility who, at any time on or after December 17, 2001, were denied, or are currently being denied, on the basis of disability, the full and equal enjoyment of the California Restaurants. The class includes claims for injunctive relief and minimum statutory damages.

Pursuant to the parties’ agreement, on or about August 31, 2004, the District Court ordered that the trial of this action be bifurcated so that stage one will resolve Plaintiffs’ claims for equitable relief and stage two will resolve Plaintiffs’ claims for damages. The parties are currently proceeding with the equitable relief stage of this action. During this stage, Taco Bell filed a motion to partially decertify the class to exclude from the Rule 23(b)(2) class claims for monetary damages. The District Court denied the motion. Plaintiffs filed their own motion for partial summary judgment as to liability relating to a subset of the California Restaurants. The District Court denied that motion as well. Discovery is ongoing as of the date of this report.

Taco Bell has denied liability and intends to vigorously defend against all claims in this lawsuit. Although this lawsuit is at a relatively early stage in the proceedings, it is likely that certain of the California Restaurants will be determined to be not fully compliant with accessibility laws and that Taco Bell will be required to take certain steps to make those restaurants fully compliant. However, at this time, it is not possible to estimate with reasonable certainty the potential

costs to bring any non compliant California Restaurants into compliance with applicable state and federal disability access laws. Nor is it possible at this time to reasonably estimate the probability or amount of liability for monetary damages on a class wide basis to Taco Bell.

### **Intellectual Property**

The Company has registered trademarks and service marks, many of which are of material importance to the Company's business. From time to time, the Company may become involved in litigation to defend and protect its use of its registered marks.

### **Other Litigation**

On January 16, 1998, a lawsuit against Taco Bell Corp., entitled Wrench LLC, Joseph Shields and Thomas Rinks v. Taco Bell Corp. ("Wrench") was filed in the United States District Court for the Western District of Michigan. The lawsuit alleged that Taco Bell Corp. misappropriated certain ideas and concepts used in its advertising featuring a Chihuahua. The plaintiffs sought to recover monetary damages under several theories, including breach of implied-in-fact contract, idea misappropriation, conversion and unfair competition. On June 10, 1999, the District Court granted summary judgment in favor of Taco Bell Corp. Plaintiffs filed an appeal with the U.S. Court of Appeals for the Sixth Circuit and oral arguments were held on September 20, 2000. On July 6, 2001, the Sixth Circuit Court of Appeals reversed the District Court's judgment in favor of Taco Bell Corp. and remanded the case to the District Court. Taco Bell Corp. unsuccessfully petitioned the Sixth Circuit Court of Appeals for rehearing en banc, and its petition for writ of certiorari to the United States Supreme Court was denied on January 21, 2002. The case was returned to District Court for trial which began on May 14, 2003 and on June 4, 2003 the jury awarded \$30 million to the plaintiffs. Subsequently, the plaintiffs moved to amend the judgment to include pre-judgment interest and post-judgment interest and Taco Bell filed its post-trial motion for judgment as a matter of law or a new trial. On September 9, 2003, the District Court denied Taco Bell's motion and granted the plaintiffs' motion to amend the judgment.

In view of the jury verdict and subsequent District Court ruling, we recorded a charge of \$42 million in 2003. We appealed the verdict to the Sixth Circuit Court of Appeals and interest continued to accrue during the appeal process. Prior to a ruling from the Sixth Circuit Court of Appeals, we settled this matter with the Wrench plaintiffs on January 15, 2005. Concurrent with the settlement with the plaintiffs, we also settled the matter with certain of our insurance carriers. As a result of these settlements, reversals of previously recorded expense of \$14 million were recorded in the year ended December 25, 2004. We paid the settlement amount to the plaintiffs and received the insurance recovery during the first quarter of 2005. During the third quarter of 2005, we entered into a settlement agreement with another insurance carrier and as a result income of \$2 million was recorded in the quarter.

We intend to seek additional recoveries from our other insurance carriers during the periods in question. We have also filed suit against Taco Bell's former advertising agency in the United States District Court for the Central District of California seeking reimbursement for the settlement amount as well as any costs that we have incurred in defending this matter. The District Court has issued a minute order granting defendant's motion for summary judgment but has requested submissions from the defendant for its review before issuing a final order. We believe that a grant by the District Court of this summary judgment motion would be erroneous under the law. We will evaluate our options once a final order has been issued. Any additional recoveries will be recorded as they are realized.

#### Item 4. Submission of Matters to a Vote of Security Holders.

No matters were submitted to a vote of shareholders during the fourth quarter of 2005.

#### Executive Officers of the Registrant

The executive officers of the Company as of February 24, 2006, and their ages and current positions as of that date are as follows:

<u>Name</u>	<u>Age</u>	<u>Position</u>
David C. Novak	53	Chairman of the Board, Chief Executive Officer and President
Richard T. Carucci	48	Chief Financial Officer
Greg Creed	48	Chief Operating Officer
Christian L. Campbell	55	Senior Vice President, General Counsel, Secretary and Chief Franchise Policy Officer
Jonathan D. Blum	47	Senior Vice President – Public Affairs
Charles E. Rawley, III	55	Chief Development Officer
Anne P. Byerlein	47	Chief People Officer
Ted F. Knopf	54	Senior Vice President Finance and Corporate Controller
Gregg R. Dedrick	46	President and Chief Concept Officer, KFC
Peter R. Hearl	54	President and Chief Concept Officer, Pizza Hut
Emil J. Brolick	58	President and Chief Concept Officer, Taco Bell
Graham D. Allan	50	President, YUM! Restaurants International
Samuel Su	53	President, YUM! Restaurants China

**David C. Novak** is Chairman of the Board, Chief Executive Officer and President of YUM. He has served in this position since January 2001. From December 1999 to January 2001, Mr. Novak served as Vice Chairman of the Board, Chief Executive Officer and President of YUM. From October 1997 to December 1999, he served as Vice Chairman and President of YUM. Mr. Novak previously served as Group President and Chief Executive Officer, KFC and Pizza Hut from August 1996 to July 1997. Mr. Novak joined Pizza Hut in 1986 as Senior Vice President, Marketing. In 1990, he became Executive Vice President, Marketing and National Sales, for Pepsi-Cola Company. In 1992, he became Chief Operating Officer, Pepsi-Cola North America, and in 1994 he became President and Chief Executive Officer of KFC North America. Mr. Novak is also a director of J.P. Morgan Chase.

**Richard T. Carucci** is Chief Financial Officer of YUM. He has served in this position since March 2005. From October 2004 to February 2005, he served as Senior Vice President, Finance and Chief Financial Officer – Designate of YUM. From May 2003 to October 2004, he served as Executive Vice President and Chief Development Officer of YRI. From November 2002 to May 2003, he served as Senior Vice President for YRI and also assisted Pizza Hut in asset strategy development. From November 1999 to July 2002, he was Chief Financial Officer of YRI.

**Greg Creed** is Chief Operating Officer of YUM. He has served in this position since December 2005. Mr. Creed served as Chief Marketing Officer of Taco Bell since 2001. From 1997 to 2001, Mr. Creed served as Chief Marketing Officer and Interim General Manager of the KFC and Pizza Hut businesses in Australia.

**Christian L. Campbell** is Senior Vice President, General Counsel, Secretary and Chief Franchise Policy Officer of YUM. He has served as Senior Vice President, General Counsel and Secretary since September 1997. In January 2003, his title and job responsibilities were expanded to include Chief Franchise Policy Officer. From 1995 to September 1997, Mr. Campbell served as Senior Vice President, General Counsel and Secretary of Owens Corning, a building products company. Before joining Owens Corning, Mr. Campbell served as Vice President, General Counsel and Secretary of Nalco Chemical Company in Naperville, Illinois, from 1990 through 1994.

**Jonathan D. Blum** is Senior Vice President – Public Affairs for YUM. He has served in this position since July 1997. Mr. Blum previously served as Vice President of Public Affairs for Taco Bell, a position that he held since joining Taco Bell in 1993.

**Charles E. Rawley, III** is Chief Development Officer of YUM. He has served in this position since January of 2001. Prior to that, he served as President and Chief Operating Officer of KFC. Mr. Rawley assumed his position of Chief Operating Officer in 1995 and President in 1998. Mr. Rawley joined KFC in 1985 as a Director of Operations. He served as Vice President of Operations for the Southwest, West, Northeast, and Mid-Atlantic Divisions from 1988 to 1994, when he became Senior Vice President, Concept Development for KFC.

**Anne P. Byerlein** is Chief People Officer of YUM. She has served in this position since December 2002. From October 1997 to December 2002, she was Vice President of Human Resources of YUM. From October 2000 to December 2002, she also served as KFC's Chief People Officer. Ms. Byerlein has also served as Vice President of Corporate Human Resources of PepsiCo. From 1988 to 1996, Ms. Byerlein served in a variety of human resources positions within the restaurant divisions of PepsiCo.

**Ted F. Knopf** is Senior Vice President Finance and Corporate Controller of YUM. He has served in this position since April 2005. From September 2001 to April 2005, Mr. Knopf served as Vice President of Corporate Planning and Strategy. From July 2000 until August 2001, he served as Chief Financial Officer for Yum Restaurant Services, Group, Inc. ("YRSG"), a subsidiary of the Company. From October 1997 until June 2000, Mr. Knopf served as Controller of YRSG.

**Gregg R. Dedrick** is President and Chief Concept Officer of KFC. He has served in this position since September 2003. From January 2002 to September 2003, Mr. Dedrick acted as a Strategic Advisor to YUM while serving as Chief Administrative Officer of his church, which is one of the ten largest churches in the United States. From July 1997 to January 2002, he served as Chief People Officer of YUM. Mr. Dedrick also served as Senior Vice President, Human Resources for Pizza Hut and KFC, a position he assumed in 1996. He served as Senior Vice President, Human Resources of KFC in 1995 and Vice President, Human Resources of Pizza Hut in 1994. Mr. Dedrick joined the Pepsi-Cola Company in 1981 and held various positions from 1981 to 1994.

**Peter R. Hearl** is President and Chief Concept Officer of Pizza Hut. He has served in this position since November 2002. Prior to this position, he was Chief People Officer and Executive Vice President of YUM, a position he held from January 2002 until November 2002. From December 1998 to January 2002, he served as Executive Vice President of YRI. Prior to that, he was Regional Vice President for YRI in Asia Pacific, a position he assumed in October 1997. From March 1996 to September 1997, Mr. Hearl was Regional Vice President for YRI with responsibility for Australia, New Zealand and South Africa. Prior to that, he was Regional Vice President for KFC with responsibility for the United Kingdom, Ireland and South Africa, a position he assumed in January 1995. From September 1993 to December 1994, Mr. Hearl was Regional Vice President for KFC Europe.

**Emil J. Brolick** is President and Chief Concept Officer of Taco Bell. He has served in this position since July 2000. Prior to joining Taco Bell, Mr. Brolick served as Senior Vice President of New Product Marketing, Research & Strategic Planning for Wendy's International, Inc. from August 1995 to July 2000. From March 1988 to August 1995, he held various positions at Wendy's including Manager, Planning and Evaluation and Vice President, Strategic Planning and Research.

**Graham D. Allan** is the President of YRI. He has served in this position since November 2003. Immediately prior to this position he served as Executive Vice President of YRI. From December 2000 to January 2003, Mr. Allan was the Managing Director of YRI. Prior to that, he was Managing Director of KFC in the United Kingdom from 1996 until November 2000.

**Samuel Su** is the President of YUM! Restaurants China. He has served in this position since 1997. Prior to this, he was the Vice President of North Asia for both KFC and Pizza Hut. Mr. Su started his career with YUM in 1989 as KFC International's Director of Marketing for the North Pacific area.

Executive officers are elected by and serve at the discretion of the Board of Directors.

**PART II**

**Item 5. Market for the Registrant's Common Stock, Related Stockholder Matters and Issuer Purchases of Equity Securities.**

The Company's common stock trades under the symbol YUM and is listed on the New York Stock Exchange ("NYSE"). The following sets forth the high and low NYSE composite closing sale prices by quarter for the Company's common stock and dividends per common share.

2005				
Quarter	High	Low	Dividends Declared	Dividends Paid
First	\$ 51.65	\$ 45.12	\$ 0.10	\$ 0.10
Second	53.09	46.96	0.115	0.10
Third	53.29	46.86	—	0.115
Fourth	52.17	46.70	0.23	0.115

2004				
Quarter	High	Low	Dividends Declared	Dividends Paid
First	\$ 38.28	\$ 32.56	\$ —	\$ —
Second	39.50	35.72	0.10	—
Third	40.13	35.88	—	0.10
Fourth	46.95	39.33	0.20	0.10

The Company initiated quarterly dividends payments to its stockholders in 2004. In 2004, the Company declared three cash dividends of \$0.10 per share of common stock. In 2005, the Company declared one cash dividend of \$0.10 per share of common stock and three cash dividends of \$0.115 per share of common stock. The last dividend declared in 2005 had a distribution date of February 3, 2006. Going forward, the Company is targeting dividend payments equating to a payout ratio of 15% to 20% of net income.

As of February 24, 2006, there were approximately 94,798 registered holders of record of the Company's common stock.

The Company had no sales of unregistered securities during 2005, 2004 or 2003.



### Issuer Purchases of Equity Securities

The following table provides information as of December 31, 2005 with respect to shares of Common Stock repurchased by the Company during the quarter then ended:

Fiscal Periods	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Approximate dollar value of shares that may yet be purchased under the plans or programs
Period 10 9/4/05 – 10/1/05	917,900	\$ 49.38	917,900	\$ 302,272,280
Period 11 10/2/05 – 10/29/05	2,187,300	\$ 49.92	2,187,300	\$ 193,077,104
Period 12 10/30/05 – 11/26/05	1,867,000	\$ 48.44	1,867,000	\$ 602,642,024
Period 13 11/27/05 – 12/31/05	2,755,900	\$ 48.47	2,755,900	\$ 469,075,032
Total	7,728,100	\$ 48.98	7,728,100	\$ 469,075,032

In May 2005, our Board of Directors authorized a share repurchase program to repurchase, through May 2006, up to \$500 million (excluding applicable transaction fees) of our outstanding Common Stock. For the quarter ended December 31, 2005, approximately 7.1 million shares were repurchased under this program. This program was completed during the quarter.

In November 2005, our Board of Directors authorized a share repurchase program to repurchase, through November 2006, up to \$500 million (excluding applicable transaction fees) of our outstanding Common Stock. For the quarter ended December 31, 2005, approximately 644,000 shares were repurchased under this program.

**Item 6. Selected Financial Data.**  
**Selected Financial Data**  
**YUM! Brands, Inc. and Subsidiaries**  
(in millions, except per share and unit amounts)

	Fiscal Year				
	2005	2004	2003	2002	2001
<b>Summary of Operations</b>					
Revenues					
Company sales	\$ 8,225	\$ 7,992	\$ 7,441	\$ 6,891	\$ 6,138
Franchise and license fees	1,124	1,019	939	866	815
Total	9,349	9,011	8,380	7,757	6,953
Facility actions <sup>(a)</sup>	(19)	(26)	(36)	(32)	(1)
Wrench litigation income (expense) <sup>(b)</sup>	2	14	(42)	—	—
AmeriServe and other (charges) credits <sup>(c)</sup>	2	16	26	27	3
Operating profit	1,153	1,155	1,059	1,030	891
Interest expense, net	127	129	173	172	158
Income before income taxes and cumulative effect of accounting change	1,026	1,026	886	858	733
Income before cumulative effect of accounting change	762	740	618	583	492
Cumulative effect of accounting change, net of tax <sup>(d)</sup>	—	—	(1)	—	—
Net income	762	740	617	583	492
Basic earnings per common share <sup>(e)</sup>	2.66	2.54	2.10	1.97	1.68
Diluted earnings per common share <sup>(e)</sup>	2.55	2.42	2.02	1.88	1.62
<b>Cash Flow Data</b>					
Provided by operating activities <sup>(f)</sup>	\$ 1,238	\$ 1,186	\$ 1,099	\$ 1,112	\$ 851
Capital spending, excluding acquisitions	609	645	663	760	636
Proceeds from refranchising of restaurants	145	140	92	81	111
Repurchase shares of common stock	1,056	569	278	228	100
Dividends paid on common shares	123	58	—	—	—
<b>Balance Sheet</b>					
Total assets	\$ 5,698	\$ 5,696	\$ 5,620	\$ 5,400	\$ 4,425
Long-term debt	1,649	1,731	2,056	2,299	1,552
Total debt	1,860	1,742	2,066	2,445	2,248
<b>Other Data</b>					
Number of stores at year end					
Company	7,587	7,743	7,854	7,526	6,435
Unconsolidated Affiliates	1,648	1,662	1,512	2,148	2,000
Franchisees	22,666	21,858	21,471	20,724	19,263
Licensees	2,376	2,345	2,362	2,526	2,791
System	34,277	33,608	33,199	32,924	30,489
U.S. Company blended same store sales growth <sup>(g)</sup>					
	4%	3%	—	2%	1%
International Division system sales growth <sup>(h)</sup>					
Reported	9%	14%	13%	6%	—
Local currency <sup>(i)</sup>	6%	6%	5%	7%	7%
China Division system sales growth <sup>(h)</sup>					
Reported	13%	23%	23%	25%	14%
Local currency <sup>(i)</sup>	11%	23%	23%	25%	17%
Shares outstanding at year end <sup>(e)</sup>	278	290	292	294	293
Cash dividends declared per common share	\$ 0.445	\$ 0.30	—	—	—
Market price per share at year end <sup>(e)</sup>	\$ 46.88	\$ 46.27	\$ 33.64	\$ 24.12	\$ 24.62

Fiscal year 2005 includes 53 weeks and fiscal years 2004, 2003, 2002 and 2001 include 52 weeks.

Fiscal year 2005 includes the impact of the adoption of Statement of Financial Accounting Standards ("SFAS") No. 123R (Revised 2004), "Share Based Payment," ("SFAS 123R"). This resulted in a \$38 million decrease in net income, or a decrease of \$0.13 to basic and diluted earnings per share for 2005. If SFAS 123R had been effective for prior years presented, reported basic and diluted earnings per share would have decreased \$0.12 and \$0.12, \$0.12 and \$0.12, \$0.14 and \$0.13, and \$0.13 and \$0.13 per share for 2004, 2003, 2002, and 2001, respectively, consistent with previously disclosed pro-forma information. See Note 2 to the Consolidated Financial Statements.

From May 7, 2002, results include Long John Silver's ("LJS") and A&W All-American Food Restaurants ("A&W"), which were added when we acquired Yorkshire Global Restaurants, Inc.

Fiscal year 2002 includes the impact of the adoption of SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"). As a result we ceased amortization of goodwill and indefinite-lived assets beginning December 30, 2001. If SFAS 142 had been effective for 2001, reported net income would have increased \$26 million and both basic and diluted earnings per share would have increased \$0.09.

The selected financial data should be read in conjunction with the Consolidated Financial Statements and the Notes thereto.

- (a) See Note 4 to the Consolidated Financial Statements for a description of Facility actions in 2005, 2004, and 2003.
- (b) See Note 4 and Note 21 to the Consolidated Financial Statements for a description of Wrench litigation in 2005, 2004, and 2003.
- (c) See Note 4 to the Consolidated Financial Statements for a description of AmeriServe and other charges (credits) in 2005, 2004, and 2003.
- (d) Fiscal year 2003 includes the impact of the adoption of SFAS No. 143, "Accounting for Asset Retirement Obligations". See Note 2 to the Consolidated Financial Statements for further discussion.
- (e) Per share and share amounts have been adjusted to reflect the two-for-one stock split distributed on June 17, 2002.
- (f) All prior years presented have been adjusted for the reclassification of distributions from unconsolidated affiliates from investing activities to operating activities in accordance with SFAS No. 95, "Statement of Cash Flows." These reclassifications increased net cash provided by operating activities by \$55 million, \$46 million, \$24 million and \$19 million for 2004, 2003, 2002, and 2001, respectively.
- (g) U.S. Company blended same-store sales growth includes the results of Company owned KFC, Pizza Hut and Taco Bell restaurants that have been open one year or more. LJS and A&W are not included.
- (h) International Division and China Division system sales growth includes the results of all restaurants regardless of ownership, including Company owned, franchise, unconsolidated affiliate and license restaurants. Sales of franchise, unconsolidated affiliate and license restaurants generate franchise and license fees for the Company (typically at a rate of 4% to 6% of sales). Franchise, unconsolidated affiliate and license restaurant sales are not included in Company sales we present on the Consolidated Statements of Income; however, the fees are included in the Company's revenues. We believe system sales growth is useful to investors as a significant indicator of the overall strength of our business as it incorporates all our revenue drivers, Company and franchise same store sales as well as net unit development. Additionally, as previously noted, we began reporting information for our international business in two separate operating segments (the International Division and the China Division) in 2005 as a result of changes in our management structure. Segment information for periods prior to 2005 has been restated to reflect this reporting.
- (i) Local currency represents the percentage change excluding the impact of foreign currency translation. These amounts are derived by translating current year results at prior year average exchange rates. We believe the elimination of the foreign currency translation impact provides better year-to-year comparability without the distortion of foreign currency fluctuations.

## Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

### Introduction and Overview

YUM! Brands, Inc. and Subsidiaries (collectively referred to as "YUM" or the "Company") comprises the worldwide operations of KFC, Pizza Hut, Taco Bell, Long John Silver's ("LJS") and A&W All-American Food Restaurants ("A&W") (collectively "the Concepts") and is the world's largest quick service restaurant ("QSR") company based on the number of system units. LJS and A&W were added when YUM acquired Yorkshire Global Restaurants, Inc. ("YGR") on May 7, 2002. YUM is the second largest QSR company outside the U.S. with over 13,800 units. YUM became an independent, publicly-owned company on October 6, 1997 (the "Spin-off Date") via a tax-free distribution of our Common Stock (the "Distribution" or "Spin-off") to the shareholders of our former parent, PepsiCo, Inc. ("PepsiCo").

Through its Concepts, YUM develops, operates, franchises and licenses a system of both traditional and non-traditional QSR restaurants. Traditional units feature dine-in, carryout and, in some instances, drive-thru or delivery services. Non-traditional units, which are typically licensed outlets, include express units and kiosks which have a more limited menu and operate in non-traditional locations like malls, airports, gasoline service stations, convenience stores, stadiums, amusement parks and colleges, where a full-scale traditional outlet would not be practical or efficient.

The retail food industry, in which the Company competes, is made up of supermarkets, supercenters, warehouse stores, convenience stores, coffee shops, snack bars, delicatessens and restaurants (including the QSR segment), and is intensely competitive with respect to food quality, price, service, convenience, location and concept. The industry is often affected by changes in consumer tastes; national, regional or local economic conditions; currency fluctuations; demographic trends; traffic patterns; the type, number and location of competing food retailers and products; and disposable purchasing power. Each of the Concepts compete with international, national and regional restaurant chains as well as locally-owned restaurants, not only for customers, but also for management and hourly personnel, suitable real estate sites and qualified franchisees.

Our business consists of three reporting segments: United States, the International Division and the China Division. The China Division includes mainland China ("China"), Thailand and KFC Taiwan and the International Division includes the remainder of our international operations.

The Company's key strategies are:

- Building dominant restaurant brands in China
- Driving profitable international expansion
- Improving restaurant operations
- Multibranding category-leading brands

The Company is focused on five long-term measures identified as essential to our growth and progress. These five measures and related key performance indicators are as follows:

- China Division and International Division expansion
  - China Division and International Division system-sales growth (local currency)
  - Number of new China Division and International Division restaurant openings
  - Net China Division and International Division unit growth
- Multibrand innovation and expansion
  - Number of multibrand restaurant locations
  - Number of multibrand units added
  - Number of franchise multibrand units added

- Portfolio of category-leading U.S. brands
  - U.S. blended same store sales growth
  - U.S. system sales growth
- Global franchise fees
  - New restaurant openings by franchisees
  - Franchise fee growth
- Strong cash generation and returns
  - Cash generated from all sources
  - Cash generated from all sources after capital spending
  - Restaurant margins

Our progress against these measures is discussed throughout the Management's Discussion and Analysis ("MD&A").

Throughout the MD&A, the Company provides the percentage change excluding the impact of foreign currency translation. These amounts are derived by translating current year results at prior year average exchange rates. We believe the elimination of the foreign currency translation impact provides better year-to-year comparability without the distortion of foreign currency fluctuations.

This MD&A should be read in conjunction with our Consolidated Financial Statements on pages 56 through 59 and the Cautionary Statements on page 52. All Note references herein refer to the Notes to the Consolidated Financial Statements on pages 60 through 96. Tabular amounts are displayed in millions except per share and unit count amounts, or as otherwise specifically identified.

#### **Factors Affecting Comparability of 2005 Results to 2004 Results and 2004 Results to 2003 Results**

##### International Reporting Changes

In 2005, we began reporting information for our international business in two separate operating segments as a result of changes to our management reporting structure. The China Division includes mainland China ("China"), Thailand and KFC Taiwan, and the International Division includes the remainder of our international operations. While this reporting change did not impact our consolidated results, segment information for previous periods has been restated to be consistent with the current period presentation.

Beginning in 2005, we also changed the China business reporting calendar to more closely align the timing of the reporting of its results of operations with our U.S. business. Previously our China business, like the rest of our international businesses, closed one month (or one period for certain of our international businesses) earlier than YUM's period end date to facilitate consolidated reporting. To maintain comparability of our consolidated results of operations, amounts related to our China business for December 2004 have not been reflected in our Consolidated Statements of Income and net income of the China business of \$6 million for the one month period ending December 31, 2004 was recognized as an adjustment directly to consolidated retained earnings in the year to date ended December 31, 2005. Our consolidated results of operations for the year to date ended December 31, 2005 include the results of operations of the China business for the months of January, 2005 through December, 2005. Our consolidated results of operations for the years to date ended December 25, 2004 and December 27, 2003 continue to include the results of operations of the China business for the months December, 2003 through November, 2004 and December, 2002 through November, 2003, respectively, as previously reported.

Adoption of Statement of Financial Accounting Standards No. 123R, "Share-Based Payment"

In the fourth quarter 2005, the Company adopted SFAS No. 123 (Revised 2004), "Share-Based Payment" ("SFAS 123R"), which replaces SFAS No. 123 "Accounting for Stock-Based Compensation" ("SFAS 123"), supersedes APB 25, "Accounting for Stock Issued to Employees" and related interpretations and amends SFAS No. 95, "Statement of Cash Flows." The provisions of SFAS 123R are similar to those of SFAS 123, however, SFAS 123R requires all new, modified and unvested share-based payments to employees, including grants of employee stock options and restricted stock, be recognized in the financial statements as compensation cost over the service period based on their fair value on the date of grant. Compensation cost is recognized over the service period on a straight-line basis for the fair value of awards that actually vest.

We adopted SFAS 123R using the modified retrospective application transition method effective September 4, 2005, the beginning of our fourth quarter. As permitted by SFAS 123R, we applied the modified retrospective application transition method to the beginning of the fiscal year of adoption (our fiscal year 2005). As such, the first three fiscal quarters of 2005 are required to be adjusted to recognize the compensation cost previously reported in the pro forma footnote disclosures under the provisions of SFAS 123. However, years prior to 2005 have not been restated.

The adoption of SFAS 123R in 2005 resulted in the reduction of operating profit of \$58 million (\$10 million in payroll and employee benefits and \$48 million in general and administrative expense), a reduction of net income of \$38 million (net of tax benefits of \$20 million), a reduction of both basic and diluted earnings per share of \$0.13 per share, a reduction of \$87 million in cash flows from operating activities and an increase of \$87 million in cash flows from financing activities.

The following table shows the 2005 quarterly after-tax effect of adoption of SFAS 123R on the previously reported first three quarters of 2005.

	First Quarter		Second Quarter		Third Quarter	
	Net Income	Diluted EPS	Net Income	Diluted EPS	Net Income	Diluted EPS
Reported results prior to SFAS 123R adoption	\$ 161	\$ 0.53	\$ 187	\$ 0.62	\$ 214	\$ 0.72
Impact of SFAS 123R adoption	(8)	(0.03)	(9)	(0.03)	(9)	(0.03)
Results subsequent to SFAS 123R adoption	<u>\$ 153</u>	<u>\$ 0.50</u>	<u>\$ 178</u>	<u>\$ 0.59</u>	<u>\$ 205</u>	<u>\$ 0.69</u>

We also have included the following tables detailing the additional expense by quarter, by segment and by financial statement line item of the impact of adoption of SFAS 123R as well as the related decrease in operating profit, income tax benefit and decrease in net income. The numbers as presented have been rounded to accommodate our financial statement presentation conventions. However, unrounded expense by segment is relatively consistent throughout all quarters relative to actual number of days in the quarter.

	Quarter ended March 19, 2005				
	U.S.	International	China	Unallocated	Total
Payroll and employee benefits	\$ 2	\$ 1	\$ —	\$ —	\$ 3
General and administrative	3	2	1	4	10
Operating profit	<u>\$ 5</u>	<u>\$ 3</u>	<u>\$ 1</u>	<u>\$ 4</u>	13
Income tax benefit					(5)
Net income impact					<u>\$ 8</u>

Quarter ended June 11, 2005

	U.S.	International	China	Unallocated	Total
Payroll and employee benefits	\$ 2	\$ —	\$ —	\$ —	\$ 2
General and administrative	3	2	1	5	11
Operating profit	<u>\$ 5</u>	<u>\$ 2</u>	<u>\$ 1</u>	<u>\$ 5</u>	13
Income tax benefit					(4)
Net income impact					<u>\$ 9</u>

Quarter ended September 4, 2005

	U.S.	International	China	Unallocated	Total
Payroll and employee benefits	\$ 2	\$ —	\$ —	\$ —	\$ 2
General and administrative	4	3	1	4	12
Operating profit	<u>\$ 6</u>	<u>\$ 3</u>	<u>\$ 1</u>	<u>\$ 4</u>	14
Income tax benefit					(5)
Net income impact					<u>\$ 9</u>

Quarter ended December 31, 2005

	U.S.	International	China	Unallocated	Total
Payroll and employee benefits	\$ 2	\$ 1	\$ —	\$ —	\$ 3
General and administrative	4	4	1	6	15
Operating profit	<u>\$ 6</u>	<u>\$ 5</u>	<u>\$ 1</u>	<u>\$ 6</u>	18
Income tax benefit					(6)
Net income impact					<u>\$ 12</u>

Year ended December 31, 2005

	U.S.	International	China	Unallocated	Total
Payroll and employee benefits	\$ 8	\$ 2	\$ —	\$ —	\$ 10
General and administrative	14	11	4	19	48
Operating profit	<u>\$ 22</u>	<u>\$ 13</u>	<u>\$ 4</u>	<u>\$ 19</u>	58
Income tax benefit					(20)
Net income impact					<u>\$ 38</u>

Prior to 2005, all stock options granted were accounted for under the recognition and measurement principles of APB 25 and its related Interpretations. Accordingly, no stock-based employee compensation expense was reflected in the Consolidated Statements of Income for stock options, as all stock options granted had an exercise price equal to the market value of the underlying common stock on the date of grant. Had the Company applied the fair value provisions of SFAS 123 to stock options in 2004 and 2003, net income of \$740 million and \$617 million, respectively, would have been reduced by \$37 million and \$38 million, respectively, to \$703 million and \$579 million, respectively. Additionally, both basic and diluted earnings per common share would have decreased \$0.12 per share for both 2004 and 2003.

### Extra Week in 2005

Our fiscal calendar results in a 53<sup>rd</sup> week every five or six years. Fiscal year 2005 includes a 53<sup>rd</sup> week in the fourth quarter for the majority of our U.S. businesses as well as our international businesses that report on a period, as opposed to a monthly, basis. In the U.S., we permanently accelerated the timing of the KFC business closing by one week in December 2005, and thus, there was no 53<sup>rd</sup> week benefit for this business. Additionally, all China Division businesses report on a monthly basis and thus did not have a 53<sup>rd</sup> week.

The following table summarizes the estimated increase (decrease) of the 53<sup>rd</sup> week on revenues and operating profit:

	U.S.	International Division	Unallocated	Total
Revenues				
Company sales	\$ 58	\$ 27	\$ —	\$ 85
Franchise and license fees	8	3	—	11
Total Revenues	\$ 66	\$ 30	\$ —	\$ 96
Operating profit				
Franchise and license fees	\$ 8	\$ 3	\$ —	\$ 11
Restaurant profit	14	5	—	19
General and administrative expenses	(2)	(3)	(3)	(8)
Equity income from investments in unconsolidated affiliates	—	1	—	1
Operating profit	\$ 20	\$ 6	\$ (3)	\$ 23

### Mainland China Issues

Our KFC business in mainland China was negatively impacted by the interruption of product offerings and negative publicity associated with a supplier ingredient issue experienced in late March, 2005 as well as consumer concerns related to Avian Flu in the fourth quarter of 2005. As a result of the aforementioned issues, the China Division experienced system sales growth in 2005 of 11% excluding foreign currency translation which is below our ongoing target of at least 22%. During the year to date ended December 31, 2005, we entered into an agreement for a partial recovery of our losses related to the supplier ingredient issue with the supplier. As a result of the agreement, we recognized approximately \$24 million in Other income (expense) in our Consolidated Statement of Income for the year ended December 31, 2005.

### Sale of an Investment in Unconsolidated Affiliate

During the second quarter of 2005, we sold our fifty percent interest in the entity that operated almost all KFCs and Pizza Huts in Poland and the Czech Republic to our then partner in the entity, principally for cash. Concurrent with the sale, our former partner completed an initial public offering ("IPO") of the majority of the stock it then owned in the entity. Prior to the sale, we accounted for our investment in this entity using the equity method. Subsequent to the IPO, the new publicly held entity, in which YUM has no ownership interest, is a franchisee as was the entity in which we previously held a fifty percent interest.

This transaction generated a one-time gain of approximately \$11 million for YUM as cash proceeds (net of expenses) of approximately \$25 million from the sale of our interest in the entity exceeded our recorded investment in this unconsolidated affiliate. As with our equity income from investments in unconsolidated affiliates, the approximate \$11 million gain was recorded in Other income (expense) in our Consolidated Statements of Income.

The sale did not have a significant impact on our subsequently reported results of operations in 2005 nor is it expected to have a significant impact on the Company's results of operations going forward.